From Base Erosion and Profit Shifting to Base Expansion and Profit Sharing

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International Tax Policy Standards

1. **States are sovereign and are free to design their tax system under domestic tax law. This being said, States exercise tax jurisdiction on cross border income based on the residence and source principles**

   – Concurrent application of residence vs source rules leads to double taxation

2. **States enter into Tax Treaties (TT) on a bilateral basis**

   – The operative provisions primarily allocate taxing rights and eliminate double taxation

   – Agreements based on the OECD Model favor residence State taxation. For example the provision on business income and royalties

3. **States enact Transfer Pricing (TP) rules to ensure an appropriate amount of profit allocation among various members of a Multinational Enterprise**

   – At the core, TP rules are based on the principle that higher the risks, the higher the return (positive or negative)

The misuse of International Tax Policy Standards and the BEPS response

Domestic law

Action 2
Neutralise the effects of hybrid mismatch arrangements

Action 3
Strengthen CFC rules

Action 4
limit interest deductibility

Action 5
harmful tax practices
(minimum standard)

Action 12
Mandatory disclosure rules

Tax Treaties

Action 6
Prevent treaty abuse
(minimum standard)

Action 14
Dispute resolution
(minimum standard)

Action 2
Treaty provisions
(recommendations)

Action 7
Prevent the artificial avoidance of PE status
(recommendations)

Action 15
MLI

Transfer Pricing

Actions 8 - 10
Aligning transfer pricing outcomes with value creation

Action 13
Re-examine transfer pricing documentation
(minimum standard)

Digital Economy

Impact of the BEPS economic activity related recommendations on the International Tax Legal Order

Entity

Income

Core Economic activities vis-à-vis income generation

- Performs key core functions, controls key risks, employs key assets and has financial capacity to carry out its activities

Arguable impact on the International Tax Legal Order

•Income allocation from Transfer Pricing Perspective

•Access to Tax Treaty Benefits

•Access to EU Secondary Law (PSD or IRD) and non application of EU CFC rules and EU ATAD GAAR

•Access to preferential regimes in domestic law (patent boxes vs other regimes)

Key Concerns

•Being «subjective», the concepts create opportunities for tax disputes, especially once the structures become transparent through CBC reporting or exchange of tax rulings

•States will compete with each other for attracting economic activities through corporate tax rate reductions or tax incentives

•The new concepts do not change allocation of taxing rights and neither do they significantly change the arm's length standard

The rise of Digital Business Models: Pressure on changing Tax Treaty and Transfer Pricing Policy

Ireland

facebook

Data Processing

Advertising Revenue

Data from users

United Kingdom

Key issue: Where is value created?

European Commission

OECD
BETTER POLICIES FOR BETTER LIVES

Disagreement among States on the value creation principle

Outcome: Although the value creation principle is a "*fuzzy*" concept there is pressure on changing allocation of taxing rights and profit allocation rules

International Corporate Tax Policy Standards: Future outlook in light of Digitalization of the Economy

1. **Arguments will also be made for radical corporate tax policy reforms such as:**
   - Destination Based Cash Flow taxes for corporates
   - Formulary apportionment (multi factor or single factor)

   The residence vs source principle will continue. Unilateral measures will be on the rise and their compatibility with tax treaties/EU law will be a core area of discussion

2. **Tax Treaty Policy: Allocation of taxing rights**

   - The State of source will receive enhanced taxing rights either through a new PE definition or a shared taxing rights mechanism (fees for digital services provision). The open questions: Will the change be made only for digitalized businesses or all businesses in general ? Will these changes be implemented through the MLI? Will they be a minimum standard or not?

3. **Transfer Pricing Policy: Profit allocation within a Multinational**

   - Transactions between separate entities: Further clarification on the application of the PSM in the context of digitalized business models

   - Transactions between head office and PE: If a digital PE or a SEP test for all businesses is put forward, how will profits be allocated to such a threshold? Possible solution – From FAR to a FARM analysis