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The OECD released seven of the 15 action deliverables in its base erosion and profit-shifting project in final or semi-final form on September 16, 2014, 14 months after initially unveiling its action plan. This article critically examines from a macro standpoint this phase of the BEPS initiative.

What unites the dates February 12, 2013, July 19, 2013, and September 16, 2014? They are the key dates to this point in the OECD's crusade against base erosion and profit shifting, which will be remembered either as a well-coordinated campaign against abusive tax avoidance by large multinational enterprises, or a waste of vast amounts of time, resources, and energy for businesses, tax communities, and governments.[1]

The initiative was announced on February 12, 2013;[2] the 15-step action plan was unveiled on July 19, 2013;[3] and the first set of final and semifinal deliverables was released on September 16, 2014.[4] In between the latter two dates, several discussion drafts of the action items were released for comment.[5]

We expressed doubt in this magazine,[6] after the July 19 release, whether the BEPS project was rolling out anything concerning tax planning that developed countries (for example, Canada, the U.S., and so forth) hadn't already considered or whether it would change how international tax law is formulated and administered, at least in countries such as Canada.

Nothing in the interim report on hybrids of March 14, 2014, changed (as we wrote previously[7]) those views, though we did acknowledge the tremendous amount of passion and work that the OECD was investing in the project.

What now, with this third phase? This article sets out our current views and prognoses at a macro level, and we leave it to others to grapple with the fine points in the hundreds of pages that were published on September 16.

The explanatory statement on the deliverables seeks to set the tone and ambit of this crusade:

> Beyond securing revenues by realigning taxation with economic activities and value creation, the OECD/G20 BEPS Project aims to create a single set of consensus-based international tax rules to address BEPS, and hence to protect tax bases while offering increased certainty and predictability to taxpayers.

With friends like these, one doesn't need enemies: Taxpayers are being offered certainty that they will pay

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[1]To say nothing of those of the OECD, which, after all, was supposed to dissolve after completing the singular purpose for which it (actually its predecessor) was created, namely to administer the Marshall Plan after World War II.

[2]OECD, *Addressing Base Erosion and Profit Shifting* (Paris: OECD Publishing, 2013).

[3]OECD, *Action Plan on Base Erosion and Profit Shifting* (Paris: OECD Publishing, 2013).

[4]OECD, *BEPS 2014 Deliverables: First Recommendations for International Approach to Combat Tax Avoidance by Multinational Enterprises.*

[5]*See, for example*, OECD public discussion drafts on action 2 (hybrids) and action 6 (on treaty shopping), released March 2014.

[6]Nathan Boidman and Michael Kandev, ''BEPS: The OECD Discovers America?'' *Tax Notes Int'l*, Dec. 16, 2013, p. 1017.

[7]Boidman and Kandev, ''BEPS on Hybrids: A Canadian Perspective,'' *Tax Notes Int'l*, June 30, 2014, p. 1233.

tax without the flexibility of intelligently protecting their interests through tax management. But of more immediate concern is that the European Union is not content to wait for the BEPS project to kick in for the future. Instead, it is seeking to penalize past arrangements under the guise that those that involved advance tax rulings from Ireland (in the case of Apple) and Luxembourg (in the case of Amazon and Fiat) constituted illegal state aid. The EU is considering whether to order those companies to pay over their tax savings stemming from those rulings.[8] And from a macro standpoint, isn't it ironic that one of the main beneficiaries of BEPS, the Netherlands, is now a cheerleader for the project?[9]

I. The Core of the Seven Deliverables

At their core, the seven deliverables issued September 16 fall into four categories:

- those that seek to fix allegedly broken international tax rules (for example, transfer pricing, particularly where intangibles are involved, and in the context of e-commerce);
- those that seek to impose new rules (for example, for hybrid instruments or entities or other asymmetrical arrangements);
- those that seek enhanced transfer pricing documentation (for example, country-by-country reporting); and
- those that seek new procedures to render legally applicable BEPS proposals (for example, the proposed multilateral instrument).

Note that the proposals to adopt anti-treaty-shopping rules were not categorized above because, depending on the point of view, they could be allocated to either or both of the first two categories above; and the proposals on harmful tax competition are beyond the scope of this commentary.

The essential questions and issues related to these four categories are as follows.

1. Are the Rules Broken?

Is transfer pricing broken, and does it need fixing, particularly in the highly charged environment of the BEPS project? Action 8 takes that position.[10]

Given that action 8 does *not* recommend a departure from the hegemony of the arm's-length principle, we suggest that the words of Canadian Tax Court Judge Robert Hogan, in the high-profile guarantee fee case of *General Electric Capital Canada Inc.*,[11] are still apt and govern (paragraph 273): ''transfer pricing is largely a question of facts and circumstances coupled with a high dose of common sense.''

That approach effectively says that mechanical rules cannot be written for the arm's-length principle and that guidelines for applying the arm's-length principle (whether those written by OECD or otherwise) can only suggest what a *reasoned* facts and circumstances inquiry will show.[12] If that is correct, it suggests that as a matter of substantive law in the transfer pricing sphere, the most the OECD should be doing is a continuation of its work since 1979 and it should not be tying it to a BEPS crusade.[13]

Action 1 on the digital economy correctly limits the debate to questions of permanent establishment-related changes and these are matters that have been thoroughly aired before by the OECD.

In summary, there seems to be no particular reason to wrap matters in terms of a current or impending international tax crisis. After all, this is not a matter of life and death. These matters are better handled under established procedures and not the hype and hysteria of the BEPS project.

2. Are New Rules Needed?

Here we see BEPS at its missionary zenith — in particular, action 2 calls for new domestic and treaty rules to counter hybrid-based tax planning and action 6 for new domestic and treaty rules to counter treaty shopping (and other abusive treaty-related tax planning).

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[8]In the cases of Apple and Fiat, see Stephanie Soong Johnston and Kristen A. Parillo, ''European Commission Addresses Apple and Fiat Rulings Probe,'' *Tax Notes Int'l*, Oct. 6, 2014, p. 7. In the case of Amazon, the latest to be raised, see Johnston and Parillo, ''European Commission Reviewing Amazon Tax Ruling,'' *Tax Notes Int'l*, Oct. 13, 2014, p. 111.

[9]The Netherlands, press release, ''Netherlands Welcomes OECD Progress on BEPS'' (Sept. 19, 2014):

> The Dutch government applauded the OECD's first reports on base erosion and profit-shifting deliverables in a September 19 release that described the Netherlands' contributions to BEPS initiatives and its continued support for the action plan.

[10]Without more, two recent Canadian government victories in transfer pricing cases would indicate the answer is negative. *McKesson Canada Corporation v. The Queen*, 2013 TCC 404; and *Marzen Artistic Aluminium Ltd. v. The Queen*, Docket 2010-860 (IT) 9, June 10, 2014.

[11]*General Electric Capital Canada Inc. v. The Queen,* 2010 DTC 1007.

[12]For a not inconsistent view, see Ajay Gupta, ''BEPS Action 8 (Intangibles): Arm's Length Is Still the Mantra,'' *Tax Notes Int'l*, Sept. 22, 2014, p. 987.

[13]Interestingly, the September 25 Daily Tax Report under the heading ''Officials See Battle to Reach Consensus on BEPS Transfer Pricing Items'' notes comments by Robert Stack, U.S. Treasury deputy assistant secretary (international tax affairs), (see *infra* note 20) that there is likely to be difficulty in reaching consensus next year on the outstanding transfer pricing issues (actions 9 and 10).

But are these initiatives warranted and justified? What's the problem? The OECD believes it is inappropriate for an MNE to arrange its affairs to trigger a deduction rule in Country C for, say, an intercompany interest payment on a straight loan from a group company in Country B and avoid a tax in Country B by making a matching outgoing payment on a hybrid instrument issued by the group company in Country B and treated as debt in Country B to the parent company in Country A that treats the hybrid as equity. The OECD says that in such circumstances unless Country A and/or B change their rules to block the deduction/no inclusion result, Country C should change its law to disallow the interest deduction.

Is the latter appropriate? Country C presumably has carefully evaluated the economic merits — *for* Country C — of allowing the interest payment deduction. That assessment does not change because of the manner in which one or more other countries (here A and B) treat the related flows. Why should Country C risk possible adverse effects of changing its rules to accommodate and feed the missionary zeal of the OECD actors to stamp out tax planning?

The short answer is that it shouldn't.[14] This approach — which questions the merits of change — can properly be raised for every hybrid recommendation.

The proposed new anti-treaty-shopping rules raise similar questions of propriety and merit, but with an added and complicating dimension. That is, ostensibly treaty shopping does hurt the country that is counseled by BEPS to adopt a U.S.-style limitation on benefits or a ''one of the main purpose'' test or both. Or does it?

In a country like Canada, resource asset/activities aside, which unlike the U.S. is *not* the center of, or at the center of, the world economic engine, how does one know that the result of adopting anti-treaty-shopping measures will raise tax revenue? Maybe instead the frustrated foreign investor will walk and take its investment elsewhere.

Or perhaps the reason to treaty-shop into a country like Canada, with its labyrinth of complex substantive and procedural tax rules (including the infamous section 116 compliance rules on sales of Canadian property[15]), is not because a treaty benefit is not available for a direct investment but instead because treaty shopping would reduce administrative and compliance hassles.[16]

So perhaps those of the seven deliverables that aim to fix or to add new law should be dropped and countries should be encouraged to pursue their own tax policy objectives, in the context of their own particular facts and requirements and without the possibly distorting and prejudicial effects of a one-size-fits-all anti-avoidance approach.

3. Information Reporting and Sharing

The rush toward massive transfer pricing-related information reporting and sharing will undoubtedly be successful in that it will culminate in widespread adoption of action 13 because here everybody is a winner except taxpayers who will be burdened in a way that is impossible to comprehend in advance and difficult to measure.

We suggest that the irony will be that information overload will ensue and tax administrations will not be able to make effective use of the vast additional data at its disposal. In that case, there will be no winners, only losers.

4. A Multilateral Instrument

As far as the fourth factor — the use of a multilateral instrument as a means to jump-start widespread adoption of rules to fix or expand obstacles to international tax planning — several points may be made.[17]

First, that would have limited scope if countries decide (whether for the reasons suggested above or otherwise) against adopting the BEPS fixes or added law.

Second, it is difficult to see how countries like Canada or the U.S., with complex legal and political requirements and challenges for adoption of tax law changes (including tax treaties), would or could ever sign on to such a tool for adopting law that affects tax revenues. In the U.S., the tax legislation gridlock would most likely scupper such an approach. In Canada, prerogatives of Parliament in dealing with revenue law could obstruct the approach.

Third, in both countries the traditional dynamic that sees bilateral treaty negotiation as an opportunity for

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[14]And does the OECD acknowledge this in the explanatory statement with the following:

> Finally, some policy issues have emerged which will require careful consideration to make sure that no collateral damage emerges from the exercise. Namely, the scope of the report on hybrid mismatch arrangements may need further consideration *so that there is no conflict with policy considerations* or undue impact on ordinary capital market transactions while tax treaty anti-abuse provisions need to ensure that they do not hamper legitimate transactions, in particular in the case of the fund industry. Other policy issues might also arise when developing the deliverables. [Emphasis added.]

[15]*See* Boidman and Kandev, ''Reducing Barriers to Foreign Investment in Canada?'' *Tax Notes Int'l*, Mar. 10, 2008, p. 885. *Also see* Kandev and Fred Purkey, ''Practical Troubles With the Disposition of Canadian-Situs Property by Nonresidents of Canada,'' *Tax Notes Int'l*, Sept. 12, 2011, p. 807.

[16]For a complete discussion, see Kandev, ''Canada Intent on Stoppin' the Shoppin' and More,'' *Tax Notes Int'l*, Mar. 31, 2014, p. 1201.

[17]*See* action 15.

using bargaining chips to advance the bottom-line interests of the respective parties clearly militates against the acceptance and adoption of a multilateral instrument.

II. Fantasy vs. Reality

The G-20 and OECD leaders express the view that the recommendations are holy grail and will be uniformly adopted, at least in substantial part.

Each of the seven deliverables has an introductory statement that countries have made ''international legal commitments'' to adopt the deliverables.[18] Hardly a day goes by without reports of this type. We argue that this is pure fantasy.

The reality is that nothing can bind, in advance, the Canadian or U.K. parliaments or the U.S. Congress to enact any particular tax law or tax treaty (which in Canada requires enactment and in the U.S. approval by the Senate). Furthermore, for many in the U.S., the OECD is a symbol of European bureaucracy and as such is persona non grata.

It is true that the latter factor will positively influence countries in continental Europe, Asia, and South America, and that there may well be a rote-like acceptance. (See Section III of this article.)

To this point no public comments have been made by senior Canadian tax legislators,[19] while several comments by senior U.S. Treasury officials indicate varying degrees of support for the deliverables.[20]

It is clearly relevant to note that Canada's Supreme Court stated in its first decision on transfer pricing[21] that although the work of the OECD on transfer pricing may be of interest, it is not law, per se, in Canada. That belief should hold for any other work of the OECD in the field of taxation, including the BEPS deliverables. And Canada is not alone here — an Australian court similarly rejected the hegemony of the OECD in a transfer pricing decision.[22]

Finally, Pascal Saint-Amans, who heads the BEPS project, reportedly has acknowledged — during a briefing before the release of the seven deliverables — the reality:

> Saint-Amans said 44 countries participating in the joint project have agreed on the first seven BEPS installments. Countries must implement the BEPS measures for them to take effect, he noted, adding, *''these are morally binding instruments, not legally binding instruments because that's not what we provide.''* [Emphasis added.][23]

III. The Countries That Frame the Debate

In the September 26 issue of Worldwide Tax Daily there were reports of responses by several countries to a U.N. questionnaire about the BEPS project.

Chile's[24] response that the U.N., OECD, and others assist developing countries to design appropriate anti-BEPS law typifies the current state of affairs. It is also consistent with an earlier report that advocated that developed countries develop ''tool kits'' to assist emerging countries in that endeavor.[25]

That helps frame the dynamic. At one pole are the countries that feel victimized by BEPS and require assistance in combating it. At the other are the countries that at once are being asked to assist the less-developed countries and that harbor the multinationals that allegedly perpetrate the BEPS (and in some case provide the tax rules that are used for BEPS).

IV. General Reactions and Conclusion

The business and tax communities seem to be in a daze, mesmerized by the OECD blitz and fearing the

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[18]The full language is as follows:

> By its nature, BEPS requires co-ordinated responses. This is why countries are investing time and resources in developing shared solutions to common problems. At the same time, countries retain their sovereignty over tax matters and measures may be implemented in different countries in different ways, as long as they do not conflict with countries' international legal commitments.

[19]Members of the Department of Finance — similar to the U.S. Treasury Department.

[20]*See*, *for example*, Parillo, ''Stack Provides Insights on BEPS Reports,'' *Tax Notes Int'l*, Sept. 22, 2014, p. 993; and Margaret Burow, David D. Stewart, and Parillo, ''Stack Provides Insights on BEPS Reports, Outlines Next Steps,'' *Tax Notes Int'l,* Sept. 29, 2014, p. 1087; and Parillo, ''More Work Remains on BEPS Deliverables, U.S. Treasury Officials Say,'' Worldwide Tax Daily (Sept. 25, 2014):

> The OECD's release of seven progress and final reports under the base erosion and profit-shifting initiative represents a major step forward, but more work remains on refining the recommendations and considering how to implement them, U.S. Treasury Department officials said September 24.

[21]*Canada v. GlaxoSmithKline Inc.*, [2012] 3 SCR 3.

[22]*SNF (Australia) PTY Ltd v. Commissioner of Taxation,* [2011] FCAFC 74.

[23]Rick Mitchell and Kevin A. Bell, ''OECD Issues Work on Seven BEPS Actions, Tax Chief Saint-Amans Predicts Immediate Impact on Tax Planning,'' *Tax Management Transfer Pricing Report*, Sept. 18, 2014, p. 643 at 644.

[24]There were also responses reported in that edition of Worldwide Tax Daily from Brazil, China, Ghana, India, Malaysia, Mexico, Singapore, Tonga, Zambia, groups from South Africa, and two charities.

[25]''G-20 Orders OECD to Help Developing Countries Counter Base Erosion,'' Worldwide Tax Daily (Sept. 25, 2014):

> The OECD announced September 22 that the G-20 mandated it and the Global Forum on Transparency and Exchange of Information to develop toolkits to help developing countries address base erosion and profit shifting and to launch pilot projects that would assist them in implementing automatic exchanges of information.

worst. And that seems to have induced a state of not only passive acquiescence but active participation in the proposed execution. Many leading advisory firms, in particular, seem to simply accept as legitimate the BEPS barrage and then ask what they can do to make the execution as efficient (certainly not as painless) as possible.[26]

We hope that the comments in this article might stimulate discussion on the appropriate relevance of the BEPS project and help to put matters into perspective. ◆

[26]*See* various comments of that sort in Mitchell and Bell, *supra* note 23, and in Mitchell and Bell, ''U.S. Official Welcomes Seven BEPS Actions, Practitioners Give More Muted Response,'' *Tax Management Transfer Pricing Report*, Sept. 18, 2014, p. 667; and newsletters from several leading advisory firms. But not all observers take that approach. *See*, *for example*, both the latter *TMTPR* report and, separately, Angelo Contrino, ''BEPS: Is International Tax Planning Over?'' *Tax Notes Int'l*, Sept. 8, 2014, p. 841.

(Footnote continued in next column.)