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Coordinating the Action of Regional and Global Players during the Shift from Bilateralism to Multilateralism in International Tax Law

The editor introduces this issue of the *World Tax Journal* with a contribution that welcomes the BEPS project as a significant step in the transition from bilateralism to multilateralism in international taxation. The broad-based consensus and participation in setting the BEPS standards make such project an enhanced form of multilateralism if compared with that which allowed the Global Forum on Fiscal Transparency to implement the standards developed by a more limited number of countries. The contribution of the editor also addresses how global multilateralism relates with regional multilateralism in some areas of the world, such as the European Union, calling for a stronger cooperation among the institutional players within a coordinated framework for the exercise of taxing powers in cross-border situations that could give rise to global international tax law.

Introductions often point out highlights or the policy of a journal but should do more than that, in particular at special occasions, since the editor bears the responsibility of the actual content of a journal. A fast-paced development – lead by the OECD and backed up by G20 – is reshaping the very core legal structure of international taxation into a globally coordinated complex legal system. The challenge for the *World Tax Journal* is to examine problems and implications of this phenomenon from a legal and economic perspective, in order to provide quality independent analysis in time for global players to still take the input into account in their decision making.

This introduction links the past and the present of our journal, showing a continued focus on the study of how international taxation is shifting from legal bilateralism to multilateralism. The current issue of the World Tax Journal starts right where the previous one ended.

The articles published in the last issue of the *World Tax Journal* proved that multilateralism has already blossomed in international taxation through global fiscal transparency. Almost a century after the failed attempt to establish it as the legal standard framework for regulating international taxation, it is now turning into the driving force of mutual assistance in tax matters across the borders.

From a legal perspective, formal bilateralism on mutual assistance in tax matters as preserved by articles 26 and 27 of tax treaties is gradually becoming obsolete. Since 2009, any inconsistency with the internationally agreed standards for fiscal transparency exposes a State to face the opposition of a significantly large portion of the global community in the framework of the forum for fiscal transparency. States have therefore, and in fact, lost their power to negotiate the content of this part of their bilateral agreements. In such circumstances it no longer makes sense to keep mutual assistance regulated at the bilateral level

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through a bunch of treaties whose clauses are becoming homogeneous as to their wording and scope. This explains why a growing number of States accede to multilateral legal instruments on mutual assistance and is one of the reasons for the success of the joint Council of Europe and OECD multilateral convention.[1] The future will further boost such development and it is all a matter of deciding in what near future mutual assistance in tax matters will be completely carved out of its formal bilateral dimension.

The growth of legal multilateralism at worldwide level has also revamped the function and scope of mutual assistance within the European Union. The outcome of this process is clear if one looks at how the directives on mutual assistance in tax matters have been updated and upgraded to some new and more challenging forms of cooperation among tax authorities, which now cater for simultaneous and joint audits and mechanisms that have expanded the use of automatic exchange of information. The enhanced mechanisms for assistance, now already in force, makes it almost resemble the strong assistance existing within the area of harmonized taxation, as it was already common practice in the field of VAT.

Oligopolism and even unilateralism have been, in many instances, the driving forces of legal multilateralism in the field of mutual assistance. Narrow-based decision making set the internationally agreed standards for fiscal transparency upon political mandate of the G20 and tolerated the United States to push forward FATCA-styled rules throughout the world. This had questionable legitimacy, considering that international standards for fiscal transparency were in fact the outcome of the will of a limited group of countries which imposed their decisions on all others. That original flaw (from a legal perspective) was in substance never questioned. The sound policy on which the internationally agreed standards for fiscal transparency are based has gradually released the initial tension. A particularly important role in such process was played by the broad-based implementation of such standards in the framework of the Global Forum for Fiscal Transparency.[2]

The challenge for the future is to supplement the existence of multilateral legal instruments on mutual assistance with a true multilateralism also in the decision-making phase. Although the end of formal bilateralism in this field is somehow near, the path to achieve true multilateralism can prove longer. And it is certainly not favoured by the attitude of some countries, which are more often formally than substantively compliant with the international standards for fiscal transparency and lack sufficient consensus around the world to develop some more systematic exceptions to such standards.[3]

Within this shift from bilateralism to multilateralism in the field of mutual assistance in international taxation, two additional critical issues arise.

First, stronger powers for tax authorities to cooperate in cross-border scenarios worldwide should march hand-in-hand with a stronger protection of taxpayers' basic rights. The plea for an effective and timely protection of human rights across borders in this field is even

1. Kazakhstan was the 64th country to sign this Convention, in December 2013.
2. The Global Forum on Fiscal Transparency currently consists of 121 countries.
3. An example of this type of situations is given by the so-called Rubik agreements. Despite not formally hindering the scope of exchange of information provisions, they keep in fact the bulk of tax relevant information with the State of the paying agent, thus increasing the likelihood of fishing expedition for tax authorities and in fact frustrating the function of mutual assistance in a framework of enhanced opacity that clashes with the transparency that all countries are genuinely pursuing in line with the internationally accepted standards.

more obvious insofar as one considers that taxpayers are, after all, human beings! Besides, the need to sharpen the fight against fraudsters should not turn into a disproportionate bonfire of all basic values that constitute the bulk of customary international law and the legal background of civilized nations across the world in the protection of persons. The expected increased relevance of automatic exchange of information in cross-border tax matters should lead the scientific community to increase efforts to identify minimal standards and best practices for the protection of taxpayers' rights.

Second, the international tax (economic and legal) community should start considering whether the two basic components of customary international law (namely its *diuturnitas* and *opinio juris ac necessitatis*)[4] are gradually being met in tax matters as a consequence of the (very broad and almost) general acceptance of the standards for fiscal transparency worldwide. If that were the case, together with a new form of hardening of soft international tax law, the shift to true multilateralism would become much easier and so would also the broadening of the base in the decision making in this field. The technical expertise of the Global Forum for Fiscal Transparency and its seamless functioning over the past few years could induce to conclude that its role could develop into a kind of decision-making forum, making multilateralism in the decision making more transparent and democratic.

If we move from international mutual assistance in tax matters to the exercise of taxing powers in cross-border situations, the establishment of multilateralism as the rule for decision making is the basic assumption and the ultimate goal of the OECD's BEPS project. I concur with Yariv Brauner, author of one contribution in this very issue of our journal, in welcoming and supporting the BEPS project. I believe that the entire tax community should do so.

BEPS is the driving force of the most ambitious reform plan ever undertaken in the field of international taxation.

If successful, it will lead to a better coordinated exercise of taxing powers across borders and will be extremely positive for us all, legal and economic tax experts around the world. In other words, BEPS will lead each State, when exercising its taxing prerogatives, to look across the borders and make sure that no undesirable advantage in terms of the overall tax burden can arise for business as a consequence of inconsistencies between two or more legal tax systems. Since business turned global, a holistic approach across borders is indispensable with a view to removing economic distortions and global legal unfairness due to the fragmentation of legal positivism and the differently shaped boundaries of each legal tax system. Insofar BEPS succeeds to give global problems of international taxation a global (or globally coordinated) answer, BEPS can become an unprecedented form of long-sighted reform that aligns the exercise of national taxing sovereignties in the desirable direction.

The interim evaluation by Brauner of the entire BEPS project, just like all other contributions that are being published by other journals on specific points of such project, should be read constructively with a view to singling out the issues that could potentially harm the achievement of this ambitious result. We felt that having one single independent review of the project would best serve the function of representing the true value of academic research

4. From the legal perspective *diuturnitas* is in essence the persistent duration (or durability) of a given legal behaviour. If combined with the *opinio juris sive necessitatis* such behaviour is observed upon the assumption that it corresponds to that which would be necessary in order to comply with the law.

at this very delicate moment of the history of international tax law and also supplement the work that other specialized journals are doing.

The interaction of such article with the contribution drafted by Chloe Burnett provides our readers with an insight on one highly technical and critical area of BEPS, such as that of debt deductions, which is framed within BEPS Action Item 4. Both authors and the editor believe that base erosion and profit shifting are best countered through a worldwide approach. This is one more reason for supporting, even if with some constructive technical criticism in respect of specific points, the BEPS project. In particular, Burnett surveys various systems from a comparative tax law perspective and pleads in favour of worldwide ratio rules, which in her view best combine the desirable features of an effective and manageable handling of debt deductions.

Analysing the legal implications of BEPS is not just a matter for our legal readers, but of paramount importance also for those with an economic background, since legal differences in international taxation often prevent the achievement of closer consistency in terms of policy between the desirable goals and the external interferences.

BEPS is the leading force that moves the substantive side of international tax law, namely the one that concerns the boundaries of connecting factors to a taxing jurisdiction and the way in which it is exercised, towards convergence but without depriving States of the essence of their tax sovereignty. Well beyond the strong political support of G20, the action within this project – unlike the oligopoly that set the core of the internationally agreed standards for fiscal transparency and left its sole implementation to a broader group of countries within the framework of the Global Forum for Fiscal Transparency – allows OECD and non-OECD G20 countries (leaving the door for participation also open to other non-OECD member countries) to set a consistent legal framework within which each State can then exercise its taxing sovereignty in a view that prevents and counters base erosion and profit shifting by multinationals.

Various contingencies have contributed to establish a positive international framework for the OECD to set this specific initiative in motion. The global financial crisis certainly made it more urgent for a large number of OECD member countries to enhance the effectiveness of tax systems on internationally mobile factors and to address more seriously the definition of the boundaries for legitimate international tax planning of multinational enterprises. The unlimited use of tax minimization arrangements by some enterprises through international planning and structures with a doubtful function or multiple deductions in the globalized scenario gave rise to major scandals.

This contributed to making public opinion aware of this phenomenon and led politicians and decision makers to conclude that it had gone well beyond any acceptable boundaries. The originally legitimate right to minimize the tax burden turned into a major and worrying source of global tax unfairness. Further regional or local issues, such as for instance the hard dialogue between the US President and the legislature, or the almost unproductive dialogue of positive integration of direct taxes within the European Union, enhanced the coordinating role of the OECD and its potential to aggregate a broad-based consensus in the world. The impression and hope is that BEPS will be much more than the source of mere soft international tax law. Nevertheless, even if its output were eventually (in some cases) the issuing of non-binding rules left to the implementation at national level, the experience with fiscal

transparency gives sufficient evidence that effective results can anyway be achieved through this type of action.

What can the world gain from the establishment of a consistent set of rules in respect of taxation of multinational enterprises? Much, in our opinion. Some aspects can be better perceived insofar as one considers that the era of artificial segregation between taxable income and the activities that generate it will be over. Possibly, this will set the world free from all superstructures that have long turned international tax planning into an area in which it was lucrative for businesses to invest and all other taxpayers ended up paying a correspondingly higher or lower share of taxes than that borne by other taxpayers.

From the perspective of fairness, BEPS is expected to steer the shift from coordinated bilateralism, currently operating through tax treaties that are mostly patterned along the clauses of the OECD Model, towards a complex international tax legal order, where multilateralism sets the boundaries of the legal framework for taxation of multinational enterprises. In this new order, States otherwise preserve at the national level the substance of their decision making in international tax policy, thus setting their respective priorities as to how they should exercise their tax sovereignty. Also, it would ensure coordination among different forms of regional multilateralism, even when operated in connection with the issuing of supranational law binding various groups of countries in different areas of the world.

From the perspective of fairness this will imply a significant development at the worldwide and national level, realigning the tax burden on income with the level how taxpayers generate the corresponding income within a given national community. This also prevents States to artificially reduce the burden of such taxpayers by asking multinational enterprises to assume it in part, unless when the latter in fact accept to generate income through other entities genuinely established in that country.

Besides the obvious phasing out of double and multiple deductions and the new boundaries for consistent transfer pricing across borders in line with the value-production chain, BEPS should (and hopefully will) generate significant turmoil in areas of international tax planning where hidden complicities of numerous States with multinational enterprises persist. This is, in my view, clearly the case where multinational enterprises are allowed to operate at preferential tax conditions for the official, and desirable, ground of fostering research and development (R&D), even if such regime in fact applies to a much larger number of cases, which do not necessarily have an actual direct connection between R&D and the actual income-generating activity.[5] Action Item 5 should therefore affirm that, even if the use of tax incentives for R&D is in principle legitimate, it should not lead to simply attract mobile capital and be rather limited to promote genuine R&D strategies. Academic research is being carried out by a group of universities, with a view to presenting some relevant results in the framework of the 2015 Congress of the International Fiscal Association.

This journal promotes also an intense technical dialogue on such[6] and other related issues, also with a view to drawing a fair dividing line between the right to remain in control of

5. This is in particular the case of several IP box regimes. The debate on the legitimacy of including them and on their boundaries is particularly intense in various OECD member countries within the framework of what should be the features of a modern and competitive international tax system.
6. An occasion is given by the 7th Frans Vanistendael Conference, to be held in Leuven (Belgium) on 7 March 2014, which exclusively focuses on base erosion and profit shifting and aims at providing a technical independent forum for global BEPS players with the academic community.

international tax policy decision making and the need to eradicate regimes that artificially segregate taxable income and its income-generating activities. In my view, critical issues may arise as to the right of developing countries to make use of tax incentives for purposes of reducing external obstacles for multinational enterprises to generate income on their own territory, flowing from, for instance, geographical remoteness, lack of infrastructures and the like.

The presence of non-OECD member countries within the different BEPS' working groups can be particularly relevant in this specific area. One may wonder whether and to what extent also BRICS[7] could possibly influence the OECD's BEPS work development in a way that the desirable goal of aligning taxable income with income generating activities does not deprive developing countries of their right to use taxation also for non-fiscal purposes without external interferences. Although economic literature has found little evidence and is thus generally sceptical as to the impact of taxation on foreign direct investment, legal and interdisciplinary research questions, in fact, whether this is due to the disturbance caused by international tax planning, which routed investment in and out of tax havens, to a clear analysis of the output of quantitative analysis.[8]

One more important factor should be recorded in the framework of these developments. This is not merely symbolically represented also in the composition of this issue of the *World Tax Journal*. For the first time in the history of international taxation, BEPS in fact raises the need for liaising with supranational law of the European Union with a view to finding a solution that is sustainable and enforceable also by EU Member States. This is perhaps due to the fact that the BEPS project digs deeper into areas of domestic tax law, which have been the object of various judgments of the European Court of Justice as to how the supremacy of EU law restricts the exercise of taxing powers by its Member States. This is particularly evident in the case of Action Item 3 and the strengthening of CFC legislation,[9] but also as to harmful tax practices (including the current boundaries of R&D tax incentives) and the shift from countering tax avoidance to countering aggressive tax planning.

A more thorough knowledge of how supranational law of the European Union affects the exercise of taxing sovereignty (in the framework of what is soon to become the standard for taxing income of multinational enterprises) is therefore turning into an indispensable component for all our readers. The contribution by Marcel Schaper is very original for being the first ever to apply computational legal analysis in the field of direct taxation. This was done with the specific aim of determining the *status quo* of how supranational law of the European

7. As Brauner indicated in his contribution in this issue, the current and upcoming role of BRICS in international taxation is the object of a focused research group, whose results will soon be published in a book published by IBFD.
8. *See* further on this F. Barthel et al., *The Relationship between Double Taxation Treaties and Foreign Direct Investment*, in M. Lang et al. (eds.), *Tax Treaties: Building Bridges between Law and Economics* (IBFD 2011) p. 3 et seq., Online Books IBFD.
9. Since it is for the EU Member States to determine within what boundaries they tolerate non-compliance, I believe that the *Cadbury Schweppes* judgment of the European Court of Justice – ECJ, 12.9.2006, Case C-196/04, [2006] ECR, I-7995 – should not per se constitute an insurmountable obstacle to stronger CFC rules, at least to the extent that, as seems to be the case in the BEPS project, states decide to coordinate the exercise of their taxing powers with a view to achieving a more effective countering of the undesirable phenomena along a common standard and within a framework of global fiscal transparency that can comply with the standards of proportionality accepted by the supranational law of the European Union.

Union restricts the exercise of taxing powers by its Member States.[10] I also find it particular useful as it provides a clear overall picture of the relationship between the European Union and its Member States in direct tax matters. From a methodological perspective I found this contribution particularly important to enhance a more appropriate understanding of how legal and economic analysis should interact within the European Union. In particular, I submit that the role of legal research is not to be relegated to the mere implementation of solutions that are regarded as suitable from an economic and policy perspective. It also plays a role at a logically prior stage, since it restricts the field within which the solution to a given problem of international taxation may be found. The BEPS project seems to give this methodology a broader global relevance, insofar as it requires a prior technical coordination with supranational law within the European Union in order to make its solutions enforceable also in EU Member States.

The ambitions of BEPS are far-reaching and unprecedented and so is its potential impact on the future of international taxation. This project has the potential of turning into the apex of a complex system of true multilateralism in international tax law, bringing legal pluralism in line with a worldwide coordination in the exercise of taxing sovereignties across national borders. This alignment, which is to receive the final and decisive touch through the completion of BEPS Action Item 15[11] will hopefully secure a new and fair international tax worldwide equilibrium. Within the framework of coordination in the exercise of taxing powers in cross-border situations that could give rise to global international tax law.

Supporting this development, from the perspective of *the World Tax Journal*, means for us promptly offering our pages to the discussion, allowing them to become a forum for an independent and scientific assessment of the BEPS project at all stages. A forum characterized by constructive criticism, which in our view will enhance the quality of the final output. This is of the utmost importance to us all and to the world. If all this comes true, the era of bilateralism in international tax law will be marginal and mostly relegated to a dimension of mere implementation.

Good luck BEPS!

10. The article is a follow-up of a more extended analysis on this topic, which has been recently published. *See* M. Schaper, *The Structure and Organization of EU Law in the Field of Direct Taxes* (IBFD 2013), Online Books IBFD.
11. Action Item 15 aims at developing a multilateral instrument by December 2015.