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Policy Forum: BEPS One Year In—Taking Stock

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CONTENTS

"YOU ARE HERE"

The "You are here" arrow on the shopping mall map is an essential point of reference for someone entering that world. The geography of the shopping mall includes separate, self-interested "jurisdictions"—stores—which are connected by a warren of pathways navigated by the mall's "citizens" as they seek to deploy their financial resources as optimally as possible. Common areas, such as food courts, offer those citizens respite to conserve their resources as they formulate strategies for their next forays.

BEPS: WE ARE WHERE?

This short article is meant to be an arrow on the base erosion and profit shifting (BEPS) map.[1] It takes stock of where the BEPS inquiry now stands and how it is expected to unfold in the next several months, but not simply by adding another voice

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1 In this article, "BEPS" refers variously, according to the context, to the phenomenon of base erosion and profit shifting, or to the inquiry or project addressing that phenomenon, discussed

to the conversation as it is presently taking place. These comments offer a perspective on a very familiar tax policy notion seemingly at the core of the BEPS inquiry, undistracted by particular and particularly descriptive characterizations of BEPS symptoms styled as "treaty abuse," "treaty shopping," "hybrids," and "intangibles." The discussion that follows steps back from the rhetoric of the BEPS debate spawned partly by the imprecise term "globalization," to which the vulnerability of international tax rules essentially has been attributed, to consider some of the implications of a, if not the, key underlying BEPS theme: where income has its source and the effects of intangibles on this determination.

As mundane as this question may seem, it is the essence of BEPS. How source is addressed, particularly with reference to the implications of intangibles for the measurement and allocation of income among members of a multinational or global business and the tax claims that countries somehow connected to elements of that business would expect to be able to assert, is the underlying and continuous, though in some respects possibly understated, tax policy issue animating the vigorous BEPS conversation now taking place. It can be expected to affect both perceptions of and expectations for the success of the BEPS project. In any event, thinking about BEPS from this vantage point helps in understanding the coherence of the BEPS action plan, as well as what may be required for it to be influential and fairly effective.

A BEPS CHRONICLE

A little more than a year ago, the tax world's latest concerted examination of international tax rules and practices began in earnest with the publication by the Organisation for Economic Co-operation and Development (OECD) in February 2013 of its study (commissioned by the Group of Twenty [G20]) entitled *Addressing Base Erosion and Profit Shifting*.[2] This study offered sweeping observations about the adequacy of "the international common principles drawn from national experiences to share tax jurisdiction [which] may not have kept pace with the changing business environment,"[3] in the context of widely reported tax-planning practices of

in the text below at note 2 and following. The abbreviation, which has already has found a prominent place in the tax lexicon, is used here for convenience, even though doing so may make it easy to miss or avoid the intrinsic complexity of the issues and circumstances to which the term refers.

2 Organisation for Economic Co-operation and Development, *Addressing Base Erosion and Profit Shifting* (Paris: OECD, 2013).

3 Ibid., at 5. This statement is revealing for several reasons, not the least of which is the expectation, and assumption, that there are "international common principles." Indeed, the OECD is responsible for important guidance offered by its member governments' taxation and finance authorities found, for example, in the OECD *Model Tax Convention on Income and on Capital: Condensed Version* (Paris: OECD, July 2010) (herein referred to as "the OECD model tax convention") and the accompanying commentary, and in the *OECD Transfer Pricing*

multinational and global businesses resulting in what has come to be criticized as double non-taxation.

Following closely on the study's heels was the OECD's *Action Plan on Base Erosion and Profit Shifting*.[4] This formidable scoping document was published on July 19, 2013 shortly after the Group of Eight (G8) summit at Lough Erne, Northern Ireland, where the G8 leaders declared their support for the OECD's BEPS work and changes to national laws necessary to give it effect. In a communiqué issued on June 18, 2013, the G8 leaders emphasized

> the importance of the OECD developing an ambitious and comprehensive action plan for the Finance Ministers and Central Bank Governors of the G20 in July . . . look[ing] forward to the OECD recommendations and commit[ting] to take the necessary individual and collective action."[5]

The OECD's agenda provides for the delivery of several important reports in the next year, as it makes firm recommendations on 15 actions to be issued in two stages, in September 2014 and 2015.[6]

Guidelines for Multinational Enterprises and Tax Administrations (Paris: OECD, July 2010) (herein referred to as "the OECD transfer-pricing guidelines"). Whether this guidance, to some extent aspirational, necessarily reflects "principles" that, further, are "common" is perhaps the most formative, but a difficult, question in the dense fabric of BEPS issues, the texture and weave of which, in fact, is increasingly revealed by BEPS work by the OECD and others to reflect elements of inter-nation economic and fiscal self-interest. These elements of self-interest, often dubbed "tax competition," are inherently both difficult to reconcile and in some respects not reconcilable unless national economic interests somehow intersect to spawn a "tax bargain" that mutually and reciprocally serves certain of those interests—in particular, national commercial and trading interests.

4 Organisation for Economic Co-operation and Development, *Action Plan on Base Erosion and Profit Shifting* (Paris: OECD, 2013) (herein referred to as "the action plan"). The action plan sets out 15 numbered "actions" that governments may consider in addressing BEPS concerns.

5 Group of Eight, "G8 Lough Erne Leaders Communiqué," 2013 Lough Erne summit, Lough Erne, Northern Ireland, June 18, 2013, at paragraph 24. The G8 leaders declared that "[c]ountries should change rules that let companies shift their profits across borders to avoid taxes, and multinationals should report to tax authorities what tax they pay where": Group of Eight, "G8 Lough Erne Declaration," 2013 Lough Erne summit, Lough Erne, Northern Ireland, June 18, 2013, at paragraph 2. (G7 and G8 documents cited herein can be found at www.g8.utoronto.ca.) See also Organisation for Economic Co-operation and Development, *A Step Change in Tax Transparency: OECD Report for the G8 Summit Lough Erne, Enniskillen, June 2013* (Paris: OECD, June 2013).

6 *Action Plan*, supra note 4, at annex A; and Organisation for Economic Co-operation and Development, "OECD Issues Communication on Engagement with Stakeholders," March 12, 2013 (www.oecd.org/ctp/beps-oecd-engagement-with-stakeholders.htm), updated by "OECD Issues Release Dates of BEPS Discussion Drafts and Public Consultations," February 20, 2014 (www.oecd.org/tax/oecd-issues-dates-of-release-beps-discussion-drafts-public-consultations.htm).

CONTEXT AND CONTINUITY MATTER—THE OECD IS NOT JUST STARTING AND IS NOT ALONE

The essential simplicity but the possibly dramatic implications of even the most complex notions may be revealed, even to specialists, when that complexity reaches its outer limits so as to ignite dormant constituencies of self-interest. That is what is happening with BEPS. It is the reason why, despite facing formidable hurdles to translate aspirational guidance on complex international tax subjects into enforceable standards, BEPS is not just another international tax inquiry. In fact, the mere articulation of this guidance is an accomplishment in itself, and one that seemingly has touched, if not awakened, the interest of many organizations. If nothing else, the BEPS inquiry may be expected to raise standards of consciousness and indeed self-consciousness about what prevailing law and guidance actually mean, and, influenced by the texture of the BEPS debate, how they might be construed in a more contemporary context taking account comparatively of the origins of principles, rules, and practices underlying “international taxation.”

It would be a mistake in evaluating the direction or prospects of BEPS to think that it has just come upon us. The catchy BEPS acronym may be unique, but the undercurrents of base erosion and profit shifting have been present, for those who would notice, for quite some time. Indeed, meaning no disrespect, there is not that much new in the BEPS discussion except possibly its urgency and the fact that, engendered by widely reported hearings in the United Kingdom and the United States about questionable international tax planning apparently undertaken by certain multinational businesses, BEPS issues are no longer the exclusive preserve of tax specialists.[7] Another critical development, however, is that BEPS is not only, or in fact even, an OECD project, although the OECD is its main instrumentality. The impetus for this work lies in the interest and urging of the G20, 8 of the members of which are not OECD countries but are participating in the BEPS initiative as equals. As part of the project, the OECD is also actively and specifically taking account of the interests of developing as well as more developed countries.

It is worth noting several key aspects of the BEPS pedigree.

Interestingly, in 1991, acknowledging formative work of the League of Nations—the same work to which the recent BEPS reports refer—the OECD addressed BEPS, without actually saying so, in examining corporate income taxation from an international perspective. In a report on the taxation of profits in a global economy,[8] the OECD foreshadowed critical features of BEPS that underlie many, if not most, of the actions and the challenges faced when offering directional guidance meant to be probative in the context of intergovernmental interactions that are not easily or even

7 As a recent example, the Canadian Broadcasting Corporation dedicated the first hour of its Sunday Edition public affairs radio program on March 16, 2014 to multinational tax planning and BEPS.

8 Organisation for Economic Co-operation and Development, *Taxing Profits in a Global Economy: Domestic and International Issues* (Paris: OECD, 1991).

necessarily coordinated. Essential to this inquiry was the development of an understanding of how and where, and by whom, income is earned. The report noted:

> At the international level, the policy issues which arise are more difficult to discuss since *they involve not only the design of domestic tax systems, but also the need to take into account how different national systems interact*. Each government has to address two broad sets of policy issues. *The first is to protect the revenue yield from taxes on profit and to ensure that it gets its fair share of the tax base associated with international transactions*. The second goal is to maintain a favourable tax climate for inward investment and to avoid encouraging an outflow of domestic capital that would otherwise not have taken place.[9]

In 1998, the OECD published its report on harmful tax competition.[10] As that report notes, the Group of Seven (G7) countries had endorsed a particular initiative using language remarkably similar to how the BEPS initiative has been framed. In a communiqué issued at the 1996 Lyons summit, the G7 heads of state said:

> Finally, globalization is creating new challenges in the field of tax policy. Tax schemes aimed at attracting *financial and other geographically mobile activities* can create harmful tax competition between States, carrying *risks of distorting trade and investment* and could lead to the *erosion of national tax bases*. We strongly urge the OECD to vigorously pursue its work in this field, aimed at establishing *a multilateral approach* under which countries could operate individually and collectively to limit the extent of these practices. We will follow closely the progress on work by the OECD, which is due to produce a report by 1998.[11]

The 1998 report was followed by others, principally in 2001, 2004, and 2006, for which the 1998 report was the catalyst. These subsequent reports were similarly directed, though in some respects they reflected an evolution in the OECD's focus on harmful tax practices rather than competition, and in that regard access to information as much as preferential tax regimes and practices.[12]

9 Ibid., at 13 (emphasis added).

10 Organisation for Economic Co-operation and Development, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998). The exploration of tax competition as a global phenomenon in chapter 1 and the recommendations enumerated in chapter 3 dealing with it reflect eerie similarities to BEPS as it is unfolding, including a suite of recommendations dealing, variously, with controlled foreign corporations (CFCs), transfer pricing, entitlement to treaty benefits, the interaction of domestic anti-abuse rules and doctrines in tax treaties, harmful tax practices, and tax havens, along with proposals for increased cooperation among tax authorities.

11 Group of Seven, "Economic Communiqué: Making a Success of Globalization for the Benefit of All," 1996 Lyons summit, June 28, 1996, at paragraph 16 (emphasis added).

12 See Organisation for Economic Co-operation and Development, *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs* (Paris: OECD, 2000); *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report* (Paris: OECD, 2001); *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report* (Paris: OECD, 2004); and *The OECD's Project on Harmful Tax Practices: 2006 Update on Progress in Member Countries* (Paris: OECD, 2006).

There is a notable correspondence between the OECD's 1991 and 1998 reports, including their underlying political impetus, language, and in 1998 the menu of possible action items,[13] and the two BEPS reports in 2013 and their G20 inspiration. With respect to the latter, the similarity is found, most recently, in a communiqué issued by G20 finance ministers and central bank governors at their meeting in Moscow in July 2013,[14] a leaders' declaration and action plan issued at the meeting of G20 leaders in St. Petersburg in September 2013,[15] and a communiqué issued by G20 finance ministers and central bank governors at their meeting in Sydney in February 2014.[16] This continuity with the BEPS project reflects consistent attention to base erosion, in terms that mirror the present BEPS work, on the part of the OECD and its members over at least two decades, extending even to how governments and the OECD conceive of how seemingly problematic issues should be resolved. In important respects, BEPS effectively consolidates more than 20 years of work that, with the benefit of the BEPS spotlight, can be seen to have its own inertia.

Although it might not have been apparent at the time, indications of the onset of BEPS can be found in a number of separate OECD studies on specific tax issues featuring prominently in the BEPS reports[17] and also, not surprisingly, in recent work on innovation and growth[18] and trade.[19] Moreover, it is not only the OECD and the G20 that are midwives to the rebirth of international taxation standards. The International Monetary Fund and the European Union, in particular, have become

13 See supra note 10.

14 Summarized and reported in Organisation for Economic Co-operation and Development, *OECD Secretary-General Report to the G20 Leaders*, St. Petersburg, Russia, September 5-6, 2013 (Paris: OECD, 2013), at annex 1, "G20 Communiqués."

15 Group of Twenty, "G20 Leaders' Declaration," St. Petersburg, September 6, 2013, and "St. Petersburg Action Plan," St. Petersburg, September 2013 (G20 documents cited herein can be found at www.g20.utoronto.ca). See also *OECD Secretary-General Report to the G20 Leaders*, supra note 14.

16 Group of Twenty, "Communiqué: Meeting of Finance Ministers and Central Bank Governors," Sydney, February 23, 2014.

17 These include, for example, Organisation for Economic Co-operation and Development, *Building Transparent Tax Compliance by Banks* (Paris: OECD, July 2009), *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (Paris: OECD, March 2012), *Aggressive Tax Planning Based on After-Tax Hedging* (Paris: OECD, 2013), and *Corporate Loss Utilization Through Aggressive Tax Planning* (Paris: OECD, 2011).

18 Organisation for Economic Co-operation and Development, *Supporting Investment in Knowledge Capital, Growth and Innovation* (Paris: OECD, 2013). See in particular chapter 2, "Taxation and Knowledge-Based Capital," which considers, among other things, cross-border tax planning in ways that intersect with BEPS and the OECD's continuing work on intangibles.

19 Koen D. Backer and Sébastien Miroudot, *Mapping Global Value Chains*, OECD Trade Policy Papers no. 159 (Paris: OECD, 2013).

actively engaged in aspects of this debate, undertaking their own studies.[20] In addition, various countries are responding in one manner or another to BEPS, including the government of the Republic of Ireland (to explain its income tax system in the BEPS context)[21] and the tax authorities of Australia[22] and the United Kingdom[23] (to present their respective governments' views on BEPS issues).

Even the Vatican has commented on issues of world economic order, closely associated with BEPS symptoms if not the actions themselves, that are perceived to threaten spiritual as well as social, economic, and political well-being.[24]

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20 See International Monetary Fund, "Issues in International Taxation and the Role of the IMF," June 28, 2013 (www.imf.org/external/np/pp/eng/2013/062813.pdf); International Monetary Fund, "Consultation on Economic 'Spillovers' in International Taxation," February 12, 2014 (www.imf.org/external/np/exr/consult/2014/taxation); International Monetary Fund, *Global Prospects and Policy Challenges: Meetings of G-20 Finance Ministers and Central Bank Governors, February 22-23, 2014, Sydney, Australia* (Washington, DC: IMF, 2014); European Commission, "Speech: Fighting for the Single Market," Speech/14/119, February 11, 2014, by Joaquín Almunia, vice-president of the European Commission responsible for competition policy (http://europa.eu/rapid/press-release_SPEECH-14-119_en.htm); and European Commission, "Proposal for a Council Directive Amending Directive 2011/96/EU on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States," COM(2013) 814 final. See also commentary by Joe Kirwin, "Hybrid Loans, Letterbox Companies Targets of Proposal on EU Parent-Subsidiary Law" (2013) 22:15 *Tax Management Transfer Pricing Report* 911. In addition, the International Bar Association, among others, has drawn attention to larger social and economic policy issues related to BEPS: see International Bar Association, *Tax Abuses, Poverty and Human Rights: A Report of the International Bar Association's Human Rights Institute Task Force on Illicit Financial Flows, Poverty and Human Rights* (London: IBA, October 2013).

21 See Republic of Ireland, Department of Finance, *Ireland's International Tax Strategy* (Dublin: Department of Finance, 2014); and the policy paper by two Irish Finance and Revenue officials, Gary Tobin and Keith Walsh, "What Makes a Country a Tax Haven? An Assessment of International Standards Shows Why Ireland Is Not a Tax Haven" (2013) 44:3 *Economic and Social Review* 401-24.

22 See Australian Treasury, *Implications of the Modern Global Economy for the Taxation of Multinational Enterprises: Issues Paper* (Canberra: Australian Treasury, May 2013); Australian Treasury, "Tackling Base Erosion and Profit Shifting," *Media Release*, July 24, 2013; Australian Treasury, *Risks to the Sustainability of Australia's Corporate Tax Base: Scoping Paper* (Canberra: Australian Treasury, July 2013); and Australian Taxation Office, "Base Erosion and Profit Shifting," presentation by Deputy Commissioner Mark Konza, Macquarie University and Deloitte International Tax Forum, November 26, 2013 (www.ato.gov.au/Media-centre/Speeches/Other/Base-erosion-and-profit-shifting).

23 United Kingdom, HM Treasury and HM Revenue & Customs, *Tackling Aggressive Tax Planning in the Global Economy: UK Priorities for the G20-OECD Project for Countering Base Erosion and Profit Shifting* (London: HM Treasury, March 2014).

24 The Vatican, *Apostolic Exhortation Evangelii Gaudium of the Holy Father Francis to the Bishops, Clergy, Consecrated Persons and the Lay Faithful on the Proclamation of the Gospel in Today's World* (Rome: The Vatican, 2013), chapter 2.

THE BEPS ACTION PLAN—WHAT IS IN PLAY, AND WHERE DOES IT STAND?

The action plan represents an ambitious two-year, 15-point recalibration of international taxation principles and corresponding rules, including how to facilitate inter-nation collaboration and accommodations by tax authorities. It focuses in particular on the following concerns:

- jurisdictional issues presented by the earning of business income in the digital economy, and how that income would be allocated in relation to business presences (permanent establishments) in potential taxing countries somehow connected to the income or the taxpayers that earn it;
- the deductibility of payments that are not recognized in a timely manner, or at all, as income in other jurisdictions, including, but not limited to, tax effects arising from hybrid mismatch arrangements as a result of the imperfect intersection of characterization differences facilitated by countries' private-law and tax-law regimes;
- the adequacy and application of controlled foreign corporation (CFC) rules;
- harmful tax practices and treaty abuse; and
- substantive transfer-pricing issues, including, in particular, how to account for intangibles in the computation and allocation of international business income, as well as transfer-pricing documentation and the sharing among tax authorities of taxpayer information by country, to inform the understanding of those authorities of their taxpayers' business families,

as well as other matters to facilitate international tax coherence.

In some respects, the heavy lifting is only now under way, as substantive discussion drafts on various actions are being considered or being released. However, it is reasonable to infer that for actions with a September 2014 deadline—specifically, those dealing with the digital economy, hybrid mismatch arrangements, changes to the OECD model tax convention[25] to address treaty abuse (though recommendations concerning related domestic tax rules have a September 2015 deadline), transfer pricing and value-creation intangibles (but not "risks and capital" and "other high-risk transactions," which also have a September 2015 deadline), and transfer-pricing documentation—the period for reflection and consultation before firm recommendations must be decided will be short.

Much of the focus, so far, has been on general discussions concerning the BEPS action plan as a whole, with particular attention being directed to the OECD's continuing work on intangibles in the transfer-pricing context, which affects a number of the BEPS action items, and to a controversial action concerning how multinational businesses would be expected to acquaint tax authorities with a picture of

25 Supra note 3.

the global business circumstances in which a member operates by making a suite of information available to be shared with tax authorities according to a template for country-by-country (CbC) reporting.[26] To date, either as part of BEPS or in any event, the OECD has released a revised discussion draft on the transfer pricing of intangibles, work on which predates the BEPS initiative but is fundamental to it and affects as many as 7 of the 15 actions.[27] As well, the OECD has requested, with limited response, comments on the artificial avoidance of "permanent establishment" status (action 7). In July 2013, a white paper on transfer-pricing documentation[28] was released for comment; and importantly, in January 2014, the OECD released its discussion draft on transfer-pricing documentation and CbC reporting,[29] which has elicited a voluminous (though seemingly not entirely consistent) response from the business and advisory communities. In March 2014, the OECD released a BEPS consultation document on treaty abuse,[30] requesting comments on the adoption of specific limitation-on-benefits provisions in tax treaties and various other ways in which it may be made clear that treaties intrinsically are not and are not meant to be instruments of tax avoidance (that is, of double non-taxation). Most recently published are OECD discussion drafts on the tax challenges of the digital economy

26 *Action Plan*, supra note 4, action 13 ("Re-Examine Transfer Pricing Documentation"). See Organisation for Economic Co-operation and Development, *Discussion Draft on Transfer Pricing Documentation and CbC Reporting* (Paris: OECD, January 30, 2014) (available at www.oecd.org/tax/beps.htm) and the considerable number of responses to this discussion document posted on the OECD's website under "Taxation" and "Transfer Pricing."

27 Organisation for Economic Co-operation and Development, *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles* (Paris: OECD, July 30, 2013); and *Action Plan*, supra note 4, actions 8 ("Intangibles"), 9 ("Risks and Capital"), and 10 ("Other High-Risk Transactions") in particular. Other actions also touch on transfer pricing in one way or another and might be said to be particularly concerned (even if this is not stated directly) with the effects of intangibles, including how they arise and how they are deployed; see action 6 ("Prevent Treaty Abuse"), action 7 ("Prevent the Artificial Avoidance of PE Status"), action 12 ("Require Taxpayers To Disclose Their Aggressive Tax Planning Arrangements"), and action 13 ("Re-Examine Transfer Pricing Documentation"). It is notable, and noted (as the comments in this article reflect), that these actions, among the others, all touch on aspects of the source of income, including determining where that source is and whether, as a result, a business presence exists, and then providing sufficient tax reporting to allow this determination to be made and verified. Notions threading through these actions are also found in or underlying the discussion in the OECD's *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles*, supra.

28 Organisation for Economic Co-operation and Development, *White Paper on Transfer Pricing Documentation* (Paris: OECD, July 30, 2013).

29 *Discussion Draft*, supra note 26.

30 Organisation for Economic Co-operation and Development, *BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (Paris: OECD, March 14, 2014). It is interesting to compare the approach taken by the Canadian Department of Finance in its consultation paper on treaty shopping: see Canada, Department of Finance, *Treaty Shopping—The Problem and Possible Solutions* (Ottawa: Department of Finance, August 12, 2013).

and hybrid mismatch arrangements, relating to two prominent BEPS actions.[31] Each, in its own way, is concerned with where income should be considered to arise—in other words, its source—in the face of complex arrangements, in both legal and commercial terms, that test the utility and reliability of longstanding jurisdictional norms.

BEPS IS ABOUT SOURCE

Even though the substantive development of the BEPS actions is just taking shape, it is not premature to observe that, fundamentally, BEPS is about the source of income. In one way or another, all of the actions have and, on reflection, must have this orientation. Whether the concern is with how commerce in the digital economy affects where business profits should be considered to be earned, how different legal characterizations of taxpayers and transactions (hybridity) affect the existence and recognition of income, intermediation via tax treaties effectively to "re-source" or change the character of income, or transfer pricing to address how income associated with intangible contributions by members of multinational businesses should be compensated, the inherent common issue is where income should be considered to be earned in light of changing patterns of business, and how that determination can reliably be made.

Though the question at the centre of BEPS is really not more complicated than this, because source is so elemental to income taxation, the issue is in fact very complicated, multifaceted, and intricately textured. Not unlike many things that we do for a long time without thinking much about how or why we do them, it turns out that we may not actually know what "source" really means, if we ever did. BEPS confronts us with a relief map—a stark awareness—of how economic elements embedded in transactions seemingly can be and have been unlocked by not particularly sophisticated applications of private law and prescriptive tax law, so as to permit, if not direct, "income" to be "somewhere" for tax purposes other than where it might be expected to be, regardless of what many may accept to be "inevitable" legal outcomes.

As a key, if not possibly the, latent engine of BEPS, source is not very exotic—much less so than the vigorous discussion enlivened by tales of multinational tax planning might suggest. But source *is* at the heart of income taxation and international taxation generally, and percolates beneath and through all the BEPS action plan initiatives and the apparent concerns to which they are directed.

How should the source of income be determined, taking into account various private-law notions that affect the transmission of value between economic actors in different places and therefore between the countries—the tax jurisdictions—that

31 See Organisation for Economic Co-operation and Development, *Public Discussion Draft BEPS Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements (Recommendations for Domestic Laws)* (Paris: OECD, March 19, 2014), and *Public Discussion Draft BEPS Action 1: Address the Tax Challenges of the Digital Economy* (Paris: OECD, March 24, 2014).

host them and their income-earning opportunities? We have tended not to think about this very much; perhaps, absent the sorts of corporate tax planning with which the BEPS initiative is so closely identified, there has not been—or at least perceived to be—a need. After all, there is no overarching principle or convention by which the source of income should be determined, and certainly no imperative enforcing any particular approach. To paraphrase the observation of a renowned international tax scholar, expressed in informal conversations and reflected in his writing, "There is no natural law of source."[32] Indeed, countries take different approaches: some, like the United States, adopt complex statutory and regulatory frameworks; others, like Canada, rely on a much less prescriptive approach that more or less takes its cue from inferences drawn from how income-earning activities observably take place and the connotations of parties' legal rights and obligations as determined by the general law and by the contracts between these parties.

The fundamental BEPS question is whether prevailing uncoordinated legal conventions by which the taxable presence and scope of income-earning contributions typically would be determined not only are outmoded but in fact facilitate the "resourcing" of income and changes of its character, as seen and understood according to the parameters of tax regimes. A particular example is, possibly, whether and how intangible manifestations of value may be separated from other elements of business transfers according to intrafirm contracts that determine where entrepreneurial entitlement is owned and risk undertaken.

BACK TO BASICS

This is hardly our first awareness that in the absence of a world tax order or a world tax authority, opportunities exist to limit business costs attributable to taxation while (and in any event as the OECD is apparently prepared to assume) ostensibly operating entirely within the expectations of countries' laws—laws that do not coincide and have no particular reason to do so. This creates an even more significant international economic problem to the extent that it engenders irresistible competitive pressure on businesses to capture available tax-induced cost savings—in effect, as bottom-line returns—or risk falling behind their competitors.

There is a heightened awareness, to which the BEPS initiative contributes by making this awareness impossible to avoid, that countries' private-law regimes, which supply the legal infrastructure for business organization and the plumbing for transactions in goods and services, and countries' tax regimes do not necessarily align, intersect with, or anticipate each other systematically, constructively, or even well. Perhaps more to the point, there is no particular reason why they should or why we should expect that they would, despite various conventions modelled and

32 I attribute this comment to Professor Emeritus Hugh Ault of Boston College, a leading commentator on international tax matters and the work of the OECD.

guidance provided by supranational organizations such as the OECD, which offer a framework for international fiscal comity that commonly also is taken into account by and often reflected in countries' domestic tax laws.

As the OECD's 2013 BEPS reports reflect, modern principles, conventions, practices, and rules associated with international taxation arose effectively for this reason (that is, because of the disjunction between private law and tax law) in the early part of the 20th century when tax work sponsored by the League of Nations was directed to rationalizing and abridging the coincident application of countries' taxation of income and taxpayers who, and the income-earning activities of whom, straddled political borders and geographic expanses.

It is important to note that the league's contribution was not altruistic, nor did it anticipate the harmonization of countries' tax regimes, although certain enduring expectations about—or possibly norms for—the ways in which countries' tax systems should engage with each other without colliding did result and are more or less intact even today.[33] In a world without compelling normative international tax standards, there were at least two principal reasons why countries might limit the exercise of their fiscal sovereignty—or, to put it a little differently, why they might exercise that sovereignty by in fact not exercising it in order to advance their economic self-interest. One reason was to mitigate trade impediments arising from excessive or (as it is more casually expressed) duplicative or double taxation. The other reason was to recognize that countries, as fiscal sovereigns, are entitled to, and will, make and fund institutionally "personal" economic choices particular, if not unique to, each of them, and in so doing spend their fiscal resources as currency, along the way effecting what amount to inter-nation "bargains" for reciprocal and mutual advantage (or, possibly,

33 International taxation largely concerns the income tax. This is reflected in tax treaties, and in deliberate and to some extent arbitrary choices made when model tax treaties were in gestation. (See, for example, John F. Avery Jones, "The David R. Tillinghast Lecture: Are Tax Treaties Necessary?" (1999) 53:1 *Tax Law Review* 1-38, John F. Avery Jones, "Problems of Categorising Income and Gains for Tax Treaty Purposes" [2001] no. 5 *British Tax Review* 382-99, and John F. Avery Jones, "The History of the United Kingdom's First Comprehensive Double Taxation Agreement" [2007] no. 3 *British Tax Review* 211-54, to appreciate some of the factors and history at play in devising treaties' distributive rules and notions of origin and entitlement, associated with source and residence, respectively, that are so important to international taxation as we understand it.) We separate how we tax income and allocate taxing regimes among countries—the legitimacy and scope of countries' tax claims and how they compete with each other—according to where taxpayers exert themselves to earn income—that is, where income-earning activities *of the taxpayer* take place. In short, we distinguish between active and passive (investment or portfolio) income in relation to how a taxpayer earns it. This division is the basic building block for distributive rules in tax treaties, taxation of inbound investment (from carrying on a local business or earning a return subject to withholding tax), and taxation of outbound investment, including the degree to which foreign tax recognition by credit or otherwise offsets domestic taxation of foreign income and the architecture of CFC and offshore investment entity rules widely present in countries' tax regimes.

in order to at least avoid reciprocal and mutual disadvantage) while still satisfying their economic self-interest.[34]

It is also important to note, as the OECD's current work reflects, that formerly there were "natural" jurisdictional barriers on which tax systems effectively could rely to determine where income was earned, because of how trade took place and in fact how it could only take place. Trade was physical; means of communication were limited or cumbersome, and even until relatively recently, could be relied on to have certain geographic connections familiar to tax systems. Those connections are now much less clear because of what the OECD refers to in action 1 as the "digital economy" or the effects of intangibles as contemplated by the OECD principally in actions 8, 9, and 10. There was much less capacity, or indeed propensity, to subdivide "bundles" of transferred value into their tangible and intangible components. In short, formerly transactions were more likely to be what they appeared to be, and to have been undertaken by the parties ostensibly participating in them; source rules and conventions tended to reflect the characteristics of those observable transactions and to be consistent with the typical expectations of their legal forms. Distortions in the expected allocation of income and tax base shared among countries were cruder, but likely corresponded more closely to the expectations of tax treaties' distributive rules—a barometer of international consensus on these sorts of issues—and, for intrafirm transactions, seemingly could be addressed by the most commonly applied comparative methodologies that enlivened transfer pricing's arm's-length standard. In short, in a manner of speaking, source could take care of itself.

REFOCUSING ON THE MEANING OF "SOURCE"

The BEPS actions in one way or another are deliberately reaching out for "new" source conventions that emphasize the significance of observable business activity "of a taxpayer" "in a place" so as necessarily to result in commensurate meaningful income taxation "somewhere." This brings together a number of the BEPS notions, including how to evaluate contributions of or to intangibles in a transfer-pricing context, the amplification of anti-abuse tenets of tax treaties (that is, the prevention of double non-taxation, a deliberate focus of BEPS that previously was more often a subject of academic conversation) that the OECD clearly believes are already woven into the fabric of treaties, and whether and to what extent through the digital economy taxpayers have constructive business presence where typical "physical" or digital products and services are sold.

Faced with the improbable alternative of harmonizing countries' private-law and tax-law rules to address BEPS concerns, the BEPS inquiry instead focuses on the nature of income and how it is earned, to guide reasonable inferences about where income

34 See J. Scott Wilkie, "An International Fiscal Revolution in the Making? Some Musings on Tax Policy and Its Economic Foundations," University of Calgary School of Public Policy blog post, September 26, 2013.

should be considered to have its source cognizable in terms of how tax systems would, at least in the first instance, make such a determination. This focus is particularly acute for intrafirm income in a transfer-pricing context, where the OECD's recent work has perhaps been the most penetrating, venturing to consider how income is earned regardless of any legal or accounting preconceptions about where, otherwise, it might be said by group members to be earned according to the formulation of transfers and therefore accounted for jurisdictionally.[35] If it is not possible to establish a world tax order by legal design, the next best, or perhaps at least the most

35 See *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles*, supra note 27. The commentary underlying actions 8, 9, and 10 is particularly important. In a paragraph beginning with the sentence "Alternative income allocation systems, including formula based systems, are sometimes suggested" (*Action Plan*, supra note 4, at 20), the OECD adverts to the possibility that departures from transfer pricing's arm's-length principle as it has typically been understood may be required via "special measures" that may or may not be accommodated by that principle, to address "intangible assets, risk and over-capitalisation" with reference to flaws in transfer pricing. This, of course, directly implicates determinations about the source of income and resulting tax jurisdiction. This statement has been controversial, since it may be seen to invite by name or design the adoption of formulary methods to apportion income among tax jurisdictions, although the OECD has indicated throughout this process that the arm's-length principle remains the guiding approach for transfer pricing. Even so, particularly as the arm's-length principle applies generally to profit splits and comparisons according to the OECD transfer-pricing guidelines, supra note 3, and particularly in respect of intangibles it may be that the significance, meaning, and application of that principle has changed. See J. Scott Wilkie, "Reflecting on the 'Arm's Length Principle': What Is the 'Principle'? Where Next?" in Wolfgang Schön and Kai A. Konrad, eds., *Fundamentals of International Transfer Pricing in Law and Economics* (Berlin: Springer, 2012), 137-58; Scott Wilkie, "The Definition and Ownership of Intangibles: Inside the Box? Outside the Box? What Is the Box?" (2012) 4:3 *World Tax Journal* 222-48; J. Scott Wilkie, "Intangibles and Location Benefits (Customer Base)," *Bulletin for International Taxation: BEPS Special Issue* (forthcoming); and Robert Couzin, "Policy Forum: The End of Transfer Pricing?" (2013) 61:1 *Canadian Tax Journal* 159-78. See a series of papers by M.C. Durst concerning formulary apportionment, the most recent and last of which is *Analysis of a Formulary System, Part VIII: Suggested Statutory, Regulatory Language for Implementing Formulary Apportionment*, Tax Management Transfer Pricing Report 2014, Bloomberg BNA (April 29, 2014); the others may be found in the following issues of Tax Management Transfer Pricing Report, Bloomberg BNA: part I, May 16, 2013; part II, June 27, 2013; part III, September 5, 2013; part IV, October 17, 2013; part V, November 28, 2013; part VI, January 23, 2014; and part VII, March 20, 2014. The question of formulary apportionment has arisen in the BEPS context through observations focused in particular on the reference to "special measures" in the preamble commentary to actions 8, 9, and 10, foreshadowing situations in which typical transfer-pricing methods—that is, the common approach to transfer pricing's arm's-length principle—may not be sufficient to deal with some of the most difficult pressures on international income allocation among members of global businesses: "Nevertheless, special measures, either within or beyond the arm's length principle, may be required with respect to intangible assets, risk and over-capitalisation to address these flaws [that is, flaws in the current system in dealing with these concerns]" (*Action Plan*, supra note 4). In this connection, see, for example, R. Mitchell, *OECD Discussions on Special Measures Still in "Very Early Stages," de Ruiter Says*, Tax Management Transfer Pricing Report 2014, Bloomberg BNA (April 9, 2014).

practical, alternative might be to adopt common standards or expectations concerning the most fundamental notion underlying all income tax regimes—namely, what it means to "earn" income—which inevitably coincides with establishing the source of that income, standards that are agnostic to the interests and features of any particular tax or legal system, but in a manner of speaking are conceptually universal to all of them.

There are indications that BEPS in its various guises has this outlook. In one way or another, BEPS is concerned with detecting and evaluating whether and how income associated with identifiable productive sources—economic, geographic, qualitative, and "legal" sources objectively determined by reference to relevant factors of production, and not merely according to the seeming dictates of contracts—is by force of circumstance or convention being diverted from those intrinsic sources to the detriment of countries that actually host those sources, possibly abetted by countries' fiscal and tax policy formulated to advance their own national economic objectives, including via the medium of their taxpayers, as is commonly associated with tax competition.[36] Put more positively, as the work to date on CbC reporting reflects, the OECD's and G20's emphasis seems to be on where observable business and commercial activities take place, with reference to not particularly arcane measures of business presence such as the involvement of employees, the location of sales, the deployment of assets, and the like.[37]

Is this merely surmise, or are there objective indications, even apart from BEPS, that this is a continuing and consistent focus that has merely been sharpened by BEPS? There seems to be clear enough evidence that functional analysis, akin to that familiar in a transfer-pricing setting but unlimited by legal or accounting rules or conventions, is the expected foundation for determining where income will be considered to be earned—in other words, its source—and that this is the tax notion being renovated by BEPS.

It may seem strange that the determination of source would be disconnected from the kinds of legal standards and accounting guidance that typically inform how source is conceived by a tax system. Yet, as noted earlier, there is no necessary "law of source"; approaches to determining where income is earned, whether prescriptive or otherwise, tend to be developed in response to how transactions are seen to actually take place, subject, of course, to supervening tax policy considerations that modify these otherwise unadulterated outcomes for particular fiscal and tax policy reasons. Put slightly differently, functions (including actual functions associated with capital formation and risk bearing), understood with reference to the forms in which they take place or otherwise are manifest, are already more or less the basis even of the source rules and conventions that we typically rely on. It would not be terribly surprising then, particularly given the absence of normative conventions, if source rules were recalibrated from time to time to take account of changing business

36 See generally the commentary by Wilkie, supra note 34.

37 See *Discussion Draft on Transfer Pricing Documentation and CbC Reporting*, supra note 26.

and commercial influences that affect whether and to what extent those rules accurately capture how income is actually earned—not only according to agnostic commercial, accounting, and legal standards, but also with reference to how businesses are actually organized and operate despite compliance with legal forms of business organization and transactions. However, relegating traditional legal factors or accounting conventions to a subordinate but clearly not irrelevant role[38] is not necessarily a subjugation of taxation to unlimited dictates of "substance." Source rules did not simply spring from nowhere. Lacking, as noted, a normative imperative, in one way or another they always have been influenced by substance, aided or validated by the implications of discernibly relevant legal form, which not surprisingly often tended to align with "substantial" connotations of how income was earned.

A recent indication in already developed OECD tax policy of the increasing significance of functions in determining where income is earned can be found in the reliance on "people functions" to attribute business profits, under article 7 of the model tax convention, to a permanent establishment in accordance with the "accepted OECD approach" set out in the OECD's July 2010 report on the attribution of profits to permanent establishments.[39] Generally, that report adopted the OECD's transfer-pricing guidance for this purpose, and specifically adverted to the relevance of people functions—people being where they are and where they need to be to facilitate the earning of business income—even in situations where risk is being evaluated and managed.[40] It is notable, in gauging Canada's likely reaction to the BEPS action plan, that Canada has adopted this approach for applying its tax treaty with the United States.[41]

38 See generally *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles*, supra note 27. In its intangibles work and also in chapter IX of the OECD transfer-pricing guidelines, supra note 3, the OECD reflects its general respect for contracts, though only as a starting point for the more involved transfer-pricing analysis that focuses on contributions to income earning made by members of a multinational firm, albeit within the ambit of the methodological approaches set out in chapters I to III of the guidelines that enliven the arm's-length principle; see, in particular, the draft revision of chapter VI of the guidelines in the *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles*, supra, at paragraphs 65, 73-81, and 90. See also Wilkie, "Intangibles and Location Benefits (Customer Base)," supra note 35.

39 Organisation for Economic Co-operation and Development, *2010 Report on the Attribution of Profits to Permanent Establishments* (Paris: OECD, July 22, 2010).

40 Ibid., notably, for example, at paragraphs 14-17, 62, and 68 (including how this sort of analysis applies to risk, with the expectation that being responsible for risk entails being more than contractually responsible and contemplates having the actual resources and facilities to evaluate and manage the assumption of that risk).

41 See paragraph 9 of Diplomatic Notes to Fifth Protocol (Annex B), The Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, July 29, 1997, and September 21, 2007; and "Canada-U.S. Income Tax Convention—Agreement Between Competent Authorities on the Interpretation of Article VII (Business Profits)," agreed June 26, 2012 and announced on July 19, 2012 (www.cra-arc.gc.ca/tx/nnrsdnts/ntcs/cndntdstts-cmptntgrmt-2012-eng.html).

Another indication is found in the most recent revision of the OECD's discussion draft on intangibles, which notably takes on the formidable task of addressing varieties of so-called soft intangibles that uniquely complicate the parsing of where income of a multinational firm is earned and how it would be attributed to the members of that firm. There is a clear and seemingly deliberate focus on where members of multinational businesses make observable and substantial contributions to the earning of group income, even within the "separate entity," transaction-based transfer-pricing paradigm.[42] A collateral but important point is whether and how the members of a multinational firm use their own resources to make contributions commensurate with the income that they ostensibly derive or possibly should derive. The emphasis, in other words, is on the functional source of income. Pointedly, an evaluation of transfers of intangible value is not to be limited or indeed defined by legal standards or accounting conventions of the sort that likely have been pertinent to establish the source of income.[43] The transfer-pricing exercise here is, essentially, addressing source.

Finally, the encouragement of the BEPS initiative by the G20 reflects a noticeable expectation that income will come to rest jurisdictionally where it is functionally earned. As earlier comments in this article reflect, there is a strong connection in the G20's institutional mind between attending to the accurate determination of the source of income and the mobility of certain kinds of income typically associated with financial assets and intangibles. The G20 finance ministers and central bank governors said in their July 2013 Moscow communiqué:

> We acknowledge that effective taxation of *mobile income* is one of the key [BEPS] challenges. *Profit should be taxed where functions deriving the profit are performed and where value is created*. In order to minimize BEPS we call on member countries *to examine how our own domestic laws contribute to BEPS* and to ensure that international and our own tax rules do not allow or encourage multinational enterprises to reduce overall taxes paid by artificially shifting profits to low-tax jurisdictions.[44]

The G20 leaders repeated this sentiment at their September 2013 St. Petersburg meeting, saying in their Declaration:

> *Profits should be taxed where economic activities deriving the profits are performed and where value is created*. In order to minimize BEPS, we call on member countries *to examine how our own domestic laws contribute to BEPS* and to ensure that international and our own tax rules do not allow or encourage multinational enterprise to reduce overall taxes paid by artificially shifting profits to low-tax jurisdictions. *We acknowledge that effective taxation*

42 See supra note 35, and the discussion in *Action Plan*, supra note 4, at 20, relating to "special measures" preceding action 8.

43 See supra notes 38 and 40.

44 G20, "Communiqué: G20 Meeting of Finance Ministers and Central Bank Governors," Moscow, July 20, 2013, at paragraph 18 (emphasis added).

> *of mobile income is one of the key challenges*. We look to regular reporting on the development of proposals and recommendations to tackle the 15 issues identified in the Action Plan and commit to take the necessary individual and collective action with the paradigm of sovereignty taken into consideration.[45]

Most recently, at their February 2014 meeting in Sydney, the G20 finance ministers and central bank governors amplified their Moscow commitment and that of their countries' leaders in St. Petersburg, with this undertaking in their communiqué:

> We are committed to a global response to Base Erosion and Profit Shifting (BEPS) based on sound tax policy principles. Profits should be taxed where economic activities deriving the profits are performed and where value is created. We continue our full support for the G20/OECD BEPS Action Plan, and look forward to progress as set out in the agreed timetable. By the Brisbane summit [in 2014], we will start to deliver effective, practical and sustainable measures to counter BEPS across all industries, including traditional, digital and digitalised firms, in an increasingly globalised economy.[46]

This is ample evidence, not only that source is to be seen in functional terms, but that fundamentally the BEPS project is concerned with assigning the source of income to countries where meaningful, observable contributions to the earning of income take place.[47]

However, for source rules and conventions to accommodate the BEPS direction, it may be insufficient to express only aspirational guidance about where income is earned. As the G20 finance ministers and leaders themselves recognize, countries may need to change their laws to give effect to this guidance and its underlying objectives. This observation may be made about a number of the BEPS actions.[48] It potentially also sheds light on a secondary but substantial potential hurdle to the achievement of a number of the BEPS objectives. Determining the source of income, for example, is critical to the ability to determine whether and to what extent tax treaties apply effectively—that is, whether there is taxation "in accordance with" a tax treaty, and if the answer to this question is negative, whether taxation not in accordance with the treaty can be resolved through a mutual agreement procedure. Fundamental to both those determinations is whether taxation is correctly asserted in the first place under a treaty partner's domestic tax law, a question that most importantly entails determining the source of assessed income and a treaty partner's entitlement within its law to actually make the tax claim.

45 "G20 Leaders' Declaration," supra note 15, at paragraph 50 (emphasis added).

46 G20, "Communiqué," supra note 16, at paragraph 9.

47 See, for example, Backer and Miroudot, supra note 19.

48 See Wilkie, "The Definition and Ownership of Intangibles," supra note 35, and "Intangibles and Location Benefits (Customer Base)," ibid. While these articles address the OECD's work on intangibles, the comments therein concerning the need to activate guidance in countries' relevant law, even if this requires legislative change, are apt here.

There is another consideration with a similar flavour that has been described by a noted Canadian tax commentator as a "first mover" problem.[49] The essence of BEPS, as action 15 concerning a multilateral convention reflects, is the adoption of consistent standards by countries to mitigate base erosion and, presumably, to be able to enforce those standards in relation to each other as well as to taxpayers. This foreshadows a not insignificant need for contemporaneous reactions by countries, which may, for various reasons, be difficult to achieve, particularly if a legislative response is required or tax treaties or their application need to be somehow modified. These challenges are compounded where, as with determining the source of income, important legal questions arise that involve both private-law and tax-law considerations.

TAKING STOCK: A CONCLUDING COMMENT

The OECD's work plan is clear, and discussions have begun within the 15-point framework of the action plan to address particular substantive concerns. The best and the most intense debate, however, is yet to come. Within the next few months, an opportunity will be presented to consider a kaleidoscope of the OECD's analysis of key actions as discussion drafts are presented and commentators engage with the OECD and with each other to consider that analysis.

That said, we do not have to wait to anticipate how the actions may unfold. Fundamentally, the action plan is concerned with reorienting how the source of income is determined. According to the premises of the action plan, this necessarily includes excising unwarranted effects of intermediation between the owners of income and its source, whether these effects arise from the imperfect intersection of countries' private law and tax law, through reliance, for example, on various manifestations of hybridity, from the transfer-pricing practices associated with intangibles, or from arrangements that allow treaties to be invoked where relevant jurisdictional connections are slight.

It is appropriate, as a final thought, to consider where Canada fits in the BEPS world. Key BEPS themes include hybridity and other harmful tax practices; income shifting and domestic base erosion through deductions and CFC (foreign affiliate) rules that abet the erosion of other countries' tax bases without timely (if any) taxation of the eroded income; tax reporting; treaty abuse; and business conducted through digital transactions. It is notable that Canada has taken considered action in all of the BEPS categories, even before the commencement of the BEPS project.

Canada's actions are not altruistic, though no doubt they do take account of expectations that Canada might have of other countries in return. As even the G20 finance ministers and leaders have noted, countries will make their BEPS determinations as sovereigns—collaborative and cooperative sovereigns perhaps, but sovereigns

49 Robert Couzin mentioned this most recently in his remarks as a panel member at a joint seminar sponsored by the International Fiscal Association (Canadian branch) and the Canadian Tax Foundation in Calgary, February 3, 2014, and Toronto, February 5, 2014.

nonetheless. It is recognized that countries develop their tax policy in a larger public economic context, considering how to calibrate tax rules to address important revenue threats and to assist in the achievement of national economic objectives. In other words, a country will pay attention to what matters to it, carefully evaluate important economic and fiscal developments at home and internationally as they may affect its economic course and prospects, and respond accordingly—though not in the same way, necessarily, as would other countries facing their own pressures, possibly activating different economic interests according to their priorities, and operating within different legal regimes.

There is every indication that Canada has been addressing BEPS issues for some time. Several examples suffice to make this point.

Recently, Canada has adopted a targeted response to "foreign tax credit generators" and income-timing and character-transformation arrangements. Together with the important addition of articles IV(6) and (7) to its tax treaty with the United States,[50] Canada has addressed elements of hybridization and flowthrough that it considers important to the integrity of its tax base, including changes to the computation of partnership income and the relevant expenses to be taken into account in the thin capitalization calculation.

Since the mid-1990s, other elements of the foreign affiliate regime (including the deployment of taxable surplus via upstream loans, rules applicable to loans made by Canadians to non-residents, and the thin capitalization rules) have been amended to address aspects of base erosion—that is, to confine certain tax effects within an intended and increasingly well-defined scope that anticipates, for example, the need for substantial degrees of ownership of or involvement by Canadian taxpayers in offshore interests to fully benefit from the territorial effects of the foreign affiliate regime, but also limits the benefits of that system for income that within its terms has a Canadian source where those benefits would inure to non-residents without a commensurate Canadian business or economic interest or presence. One of the most profound limitations on base erosion recently introduced by Canada, which indirectly affects the deductibility of expenses associated with the earning of foreign income but more generally mitigates the appropriation of Canadian tax base by non-residents, is the enactment of the foreign affiliate dumping regime, which in many respects is simply an extension of pre-existing but more limited anti-base-stripping limitations.

These changes, which continue to be refined, correspond to various BEPS actions, including those directed to CFC rules, harmful tax practices, overstatement of deductions, and the like. Key to some of these rules is business functionality, which in certain cases provides relief from limitations for demonstrable business activities consistent with adopted legal form where it can be determined objectively that undue base erosion does not take place and potential national economic benefits exist; a case

50 Supra note 41.

in point is how the foreign affiliate base erosion rules operate as they are changing, particularly, to accommodate how Canadian banks operate internationally.

Canada undertook a considered study of the effects of electronic commerce (reincarnated now as "the digital economy" in the BEPS context) on taxation in the 1990s, and at present is considering treaty shopping, touching at least two of the key BEPS actions. Canada (which, in any event, has undertaken its own examination of treaty shopping, shaped somewhat differently than the OECD's) has experience with the kinds of treaty benefit limits contemplated in the OECD's March 14, 2014 discussion draft on treaty abuse,[51] in the Canada-US tax treaty, and to a lesser extent in a number of Canada's other tax treaties where benefit limitations are expressed more directionally. And, at least since the mid- to late 1990s, Canada has had in place and has continued to refine robust foreign, as well as specific transfer-pricing, reporting regimes that have recently been extended with respect to portfolio investments by Canadian residents.

This list could be extended. The point of noting these examples is to recognize that as we take stock of BEPS, Canada has already taken stock of many of the factors raised by the BEPS project in relation to its national economic, fiscal, and tax interests.

51 *BEPS Action 6*, supra note 30.