

The Parallel Rise of Multinational Enterprises and the Historical Development of International Tax Rules – Introspection for the New Rules to Tax the Digital Economy

This article traces the rise of multinational enterprises (MNEs) and the effectiveness of measures that countries have employed to ensure that MNEs pay taxes in the jurisdictions in which they transact. The article shows that, as countries enacted various taxing measures, MNEs devised tax avoidance schemes to exploit arising loopholes.

1. Introduction

Multinational enterprises (MNEs) can be defined as enterprises which own or control subsidiaries in other jurisdictions where they engage in foreign direct investment or carry out activities to produce goods or services in more than one country.¹ MNEs have been referred to as the “big players” in international trade that drive the globalization process forward, accompanied by an increasing number of medium-sized companies that participate in cross-border joint ventures.² Countries normally enact tax laws that require MNEs transacting within their borders to pay taxes so that they contribute to economic and infrastructural development. Because taxes have always varied from country to country, MNEs have historically exploited the variations across international tax systems to reduce their global tax exposure. These variations include differences between countries’ tax rates, legal concepts, standards of administration, reporting and enforcement, and governments’ attitudes towards the confidentiality of financial and business transactions.³ Although countries’ tax systems entail various taxes that can be levied on the international transactions of MNEs (for example, excise duties and value added tax), this article focuses only on income tax. Historically, countries’ income tax policies were initially developed to deal mainly with domestic economic and social concerns. Although some countries’ domes-

tic tax systems had an international dimension that dealt with the foreign-source income of domestic residents, international tax rules were not that developed because there was limited mobility of capital.⁴ This changed over the centuries with the acceleration of the globalization of trade and investment, which was driven by the rise of MNEs.⁵

This article traces and analyses the parallel rise of MNEs over the centuries and the measures that countries put in place to ensure that MNEs pay taxes in the jurisdictions they transact in. It shows that, with increasing demands on countries to ensure economic development, countries began to introduce laws to regulate and tax MNEs so that they can contribute to the economic development.⁶ As MNEs faced increasing taxes in the countries they were transacting in, they began developing tax avoidance schemes to reduce their global tax exposure⁷ and their contact with jurisdictions that had suitable tax environment become a necessary component of their international tax planning.⁸ In response, countries developed domestic and international tax laws to curtail MNE tax avoidance schemes. This cycle kept on going, with MNEs invariably always a step ahead as they devised more complex tax schemes to suit their evolving globally integrated business models. Over the years, countries’ tax rules could not adequately curtail these schemes as they were still grounded in an economic environment characterized by a lower degree of economic integration across borders.⁹ Today’s digital economy has made matters worse, with the rise of cutting-edge digitalized MNEs that use intangible assets as their key value driver.¹⁰ Current international tax laws were developed when the economic environment was based on physical presence in a jurisdiction for the tax laws to be enforceable, and

* Professor, Department of Taxation and the African Tax Institute in the Faculty of Economic and Management Sciences at the University of Pretoria (LLD in Tax law (UNISA), LL.M with Specialization in Tax Law (UNISA), LL.B (Makerere University, Uganda), H Dip International Tax Law (University of Johannesburg) and Dip in Legal Practice (Law Development Centre Makerere)). The author can be contacted at Annet.oguttu@up.ac.za.

1. J.H. Dunning & S.M. Lundan, *Multinational Enterprises and the Global Economy* 2nd edn., p. 3 (Edward Elgar Publ. 2008).
2. D. Hay, F. Horner & J. Owens, *Past and Present Work in the OECD on Transfer Pricing and Selected Issues*, Intertax 10, p. 423 (1994).
3. A.W. Oguttu, *International Tax Law: Offshore Tax Avoidance in South Africa* p. 19 (Juta & Co 2015).

4. OECD, *Harmful Tax Competition: An Emerging Global Issue* pp.13-14 (OECD 1998) [hereinafter *Harmful Tax Competition*].
5. Dunning & Lundan, *supra* n. 1, at p. 3.
6. OECD, *Harmful Tax Competition*, *supra* n. 4.
7. M. Grundy, *The World of International Tax Planning* pp. 1-2 (Cambridge U. Press 1984) and A Ginsberg, *International Tax Havens* 2nd edn., p. 5 (Butterworths 1997).
8. Ginsberg, *supra* n. 7 and M.W.E. Glautier & F.W. Bassinger, *A Reference Guide to International Taxation: Profiting from Your International Operations* p. 228 (Lexington Books 1987).
9. OECD, *Action Plan on Base Erosion and Profits Shifting* p. 47 (OECD 2013), Primary Sources IBFD [hereinafter the *Action Plan on BEPS*].
10. OECD, *Action 1 Final Report 2015 – Addressing the Tax Challenges of the Digital Economy*, OECD/G20 Base Erosion and Profit Shifting Project para. 248 (OECD 2015), Primary Sources IBFD [hereinafter the *Action 1 Final Report* (2015)].

where cross-border transactions involved mostly tangible products.¹¹ However, the mobility of the digital economy enables MNEs to easily relocate their intangible assets and core business functions from one jurisdiction to another and to conduct substantial sales in market jurisdictions from remote locations, with minimum tax implications.¹² This has exacerbated the ability of MNEs to engage in “base erosion and profit shifting” (BEPS) schemes by exploiting gaps in the interaction of different tax systems to artificially reduce their taxable income and shift profits to low-tax jurisdictions in which little or no economic activity is performed.¹³ This is illustrated in this article by a notorious tax avoidance structure, which many digital MNEs have used to lower their global tax exposure.¹⁴ BEPS is encouraged by the fact that international tax rules have not kept pace with the modern business models¹⁵ and the fact that countries themselves were complacent, as some of them benefited from MNE BEPS schemes. To address the ensuing BEPS concerns, in 2015, the Organisation for Economic Cooperation and Development (OECD) came up with measures to ensure that MNEs’ profits are taxed where economic activities generating the profits are performed and where value is created.¹⁶ However, the OECD’s 2018 review of these measures shows that BEPS risks by digitized MNEs still remain.¹⁷ Realizing that merely strengthening the anti-avoidance rules will not fully resolve the problem, the international community embarked on crafting new rules for taxing the digital economy. As the new international tax rules are being deliberated, MNEs are involved as stakeholders, which gives them insider understanding of any loopholes in the proposed rules.

The purpose of the article is to provide tax policy makers, tax administrators, tax academics and researchers with a historic overview of why international tax laws were developed, and why those laws lost their effectiveness over the centuries with the rise of globalization and modern business models. The holistic analysis of past developments provides lessons from which international tax norm makers, tax policy makers and other stakeholders can draw from regarding the perspectives that should inform some of the decisions they should make in the development of sustainable and effective new international tax rules for the digital economy so as not to perpetuate the status quo.

11. A. Oguttu & B. van der Merwe, *Electronic Commerce: Challenging the Income Tax Base*, 17 SA Mercantile L. J. 3, pp. 305-339 (2005).

12. OECD, *Action 1 Final Report* (2015), *supra* n. 10, at paras. 159-160.

13. OECD, *Action 8-10 Final Report 2015 – Aligning Transfer Pricing Outcomes with Value Creation* OECD/G20 Base Erosion and Profit Shifting Project (OECD 2015), Primary Sources IBFD [hereinafter the *Action 8-10 Final Report* (2015)].

14. OECD, *Action 1 Final Report* (2015), *supra* n. 10, at para. 248.

15. OECD, *Action Plan on BEPS*, *supra* n. 9, at p. 47.

16. OECD, *Addressing Base Erosion and Profit Shifting* pp. 7-8 (OECD 2013), Primary Sources IBFD [hereinafter *Addressing BEPS*].

17. OECD, *Tax Challenges Arising from Digitalisation – Interim Report* p. 3 (OECD 2018), Primary Sources IBFD [hereinafter the *2018 Interim Report*].

2. The Evolution of International Trade: The Emergence of Companies and Tax-Free Environments

The history of the birth of political entities (nations) shows that nations have always imposed taxes on their subjects and the latter have always looked for ways to minimize their tax exposure. Records of some of the earliest taxes levied on subjects can be traced from Mesopotamia¹⁸ (credited with the earliest known human civilization), which levied tax on farmers, craftsmen, artisans and traders.¹⁹ As stronger nations begun conquering weaker ones, empires (such as the Babylonian and Persian) were formed, which propelled the growth of international trade and levying of taxes on conquered nations.²⁰

By the time of the Roman Empire, international trade was propelled by the emergence of the concept of a company involving craftsmen, artisans and traders who banded together in pursuance of collective business objectives.²¹ The concept of a company was by then understood to take on an independent existence separate, although intangible, from the constituent members who continued to retain their own *species* although constituting parts of the *corpora*.²² The concept of a company was, for instance, used by the association of merchants in the cities of the Hanseatic League that, by the 12th century, sought a conducive tax environment in the city of London, which exempted them from taxes.²³ These cities owed much of their prosperity to the favourable tax treatment given to commerce.²⁴ In the 15th century, Flanders (now a part of Belgium) lifted the duties on much of its trade and imposed very few exchange restrictions. As a result, it became a flourishing international commercial centre in which many English merchants sold their wool rather than in England, where they were taxed heavily.²⁵

18. Mesopotamia is a region of southwest Asia in the Tigris and Euphrates river system. It is located in the Middle East region and includes parts of southwest Asia and the eastern Mediterranean Sea. It is known as the “Cradle of Civilization” for the number of innovations that arose from the early societies in this region, which are among some of the earliest known human civilizations on earth. See *Mesopotamia* (30 Sept. 2019), History.com, available at www.history.com/topics/ancient-middle-east/mesopotamia (accessed 28 Sept. 2022).

19. M. deJ Ellis, *Taxation in Ancient Mesopotamia: The History of the Term miksū*, 26 *J. Cuneiform Stud.* 4, pp. 211-250 (1974).

20. *Mesopotamia*, History.com, *supra* n. 18.

21. J.L. Patterson. *The Development of the Concept of Corporation from Earliest Roman Times to A.D. 476*, 10 *Acctg. Historians J.* 1, p. 92 (1983).

22. Id.

23. The Hanseatic League was a confederation of northern European trading cities which flourished from the 12th century to 1669. At the height of its power in the late 14th century, the Hanseatic League included over 160 cities and towns, among them Lübeck, Hamburg, Cologne, Breslau, Kraków, Visby, Bruges, Bergen and Novgorod. See J. Mills, *The Hanseatic League in The Eastern Baltic* (U. Wash. May 1998), available at http://www.conflicts.rem33.com/images/The%20Baltic%20States/hansa_ost.htm (accessed 28 Sept. 2022).

24. C. Daggart, *Tax Havens and Their Uses*, Economist Publication 1, Special Report No. 1191 (1990).

25. Id., at p. 1.

3. The 16th to 18th Centuries: The Mercantile Age, the Rise of MNEs and Initial Regulatory Measures

During the Mercantile Age (the 16th to 18th Centuries), MNEs evolved by using a business model of overseas voyages in search of business and trade.²⁶ At the height of the Mercantile Age, notable MNEs such as the British East India Company, which was formed in 1600²⁷ and the Dutch East India Company, which was formed in 1602,²⁸ gained power and autonomy when they became the prime drivers of international trade and economic development in Europe.²⁹ These MNEs operated across several continents as they made stop-overs to outposts on their voyages to the Americas, Africa and Asia in search of resources like spices, gold, slaves and ivory.³⁰ Ultimately, it was the foreign trade by these MNEs that propelled the interconnectedness and integration of the world's economies.³¹ This was the precursor of globalization as we know it today.

These first MNEs operated using the concept of capital pooling whereby they sourced funds from the general public through issuing bonds for their initial voyages and later by issuing shares of stock to the general public, who would become entitled to dividends and could transfer their shares.³² The Dutch East India Company was, in fact, the first MNE to be listed on the first official stock exchange established in the Netherlands in the 17th century, when its city of Amsterdam became the world's leading financial centre.³³ By that time, Amsterdam was already a sought after tax haven that attracted thriving trade to its ports because it imposed very low duties and few trade restrictions.³⁴ In the 18th century, mercantilism was driven by the "laissez-faire" economic theory (a French term that translates as "leave alone") that opposed any government intervention in business affairs.³⁵ The free market capitalism promoted by this economic theory saw an increase of many other MNEs, which led to a capital market crash in 1720.³⁶ This is what prompted the governments of the day to begin passing legislation that made it illegal to issue or raise transferable shares without operating under a royal charter or authority of an Act of parliament.³⁷ The royal charter required all companies to be registered in the countries they were incorporated in. This legislation became the precursor of present-day

company laws.³⁸ During that time, Adam Smith, a British economist, opposed the "laissez-faire" economic policies, noting in his 1776 work on "The Wealth of Nations" that:

The subjects of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities that is in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of government to the individuals of a great nation is like the expense of management to the joint ventures of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observance or neglect of this maxim consists what is called the equality or inequality of taxation.³⁹

It is, thus, no wonder that in 1799, the United Kingdom was the first country to introduce a tax on income to finance its expenditures during its war against Napoleon in France.⁴⁰ The tax was widely evaded by merchants.⁴¹

4. Nineteenth Century MNEs: The Industrial Revolution, the Development of Territorial Taxation and the Role of MNEs in Integrating World Economies

The Industrial Revolution, which began in the United Kingdom in the 18th century through the 19th century, saw increased innovations, mechanization, industrial and infrastructural developments, manufacturing, development of trade and the rise of many businesses. The need for taxes to drive the Industrial Revolution resulted in the United Kingdom enacting the first Income Tax Act in 1842.⁴² The initial income tax policies developed by the United Kingdom were territorial in nature in that they dealt mainly with domestic economic and social concerns.⁴³ Territorial (or source) taxation implied that persons such as chartered companies that were registered in the United Kingdom, were taxed on income that originated within the territorial or geographical confines of the country.⁴⁴ In the 1889 UK case of *Colquhoun v. Brooks*,⁴⁵ it was held that the:

Income Tax Act imposes a territorial limit, in that either the source from which the taxable income is derived must be situated in the United Kingdom, or the person whose income is to be taxed must be resident in the United Kingdom.

Territorial taxation was based on the proposition that a country has the right to tax income that has arisen within its borders,⁴⁶ and that a taxpayer can be expected to share

26. G. Fuller, *The Law and Practice of Capital Markets* 2nd edn., pp. 86-87 (Lexis Nexis 2009).
27. Fuller, *supra* n. 26. See also W. Dalrymple, *The Anarchy: The Relentless Rise of the East India Company* (Bloomsbury Publ. 2019) for the East India Company as an "aggressive" "multinational business".
28. Fuller, *supra* n. 26.
29. H.T. Laski, *The Early History of the Corporation in England*, 30 Harvard L. Rev. 6., p. 564 (1917).
30. Id.
31. J. Stiglitz, *Making Globalization Work* p. 11 (Penguin Books 2007).
32. Fuller, *supra* n. 26, at p. 86.
33. Id., at p. 87.
34. Id., at p. 86.
35. Rakesh Sharma, *Who was Adam Smith?*, Investopedia (11 Apr. 2020), available at www.investopedia.com/updates/adam-smith-economics/ (accessed 28 Sept. 2022).
36. Laski, *supra* n. 29, at p. 564.
37. Id.

38. Id.
39. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* vol. 2, pp. 350-351 (R.H. Campbell, A.S. Skinner & W.B. Todd eds., Clarendon Press 1976) (originally published in 1776).
40. UK Parliament, *War and the coming of income tax*, available at www.parliament.uk/about/living-heritage/transformingsociety/private-lives/taxation/overview/incometax/ (accessed 28 Sept. 2022).
41. Id.
42. Id.
43. OECD, *Harmful Tax Competition*, *supra* n. 4, at pp. 13-14.
44. B.J. Arnold & M.J. McIntyre, *International Tax Primer* 2nd edn., p. 15 (Kluwer L. Intl. 2000).
45. See the decision of the UK House of Lords (UKHL) in UK: UKHL, 9 Aug. 1889, *Colquhoun v. Brooks*, [1889] 14 App Cas 493 at 503. See also UK: UKHL, 13 Mar. 1925, *Swedish Central Railway Company v. Thompson*, [1924] 2 K.B. 255.
46. W.B. Barker, *Optimal International Taxation and Tax Competition: Overcoming the Contradictions*, 22 Nw. J. Intl. L. & Bus. 2, p. 181 (2002).

the costs of running the country which makes it possible for the taxpayer to produce an income.⁴⁷

With these tax policies in place, the United Kingdom tightened its control over its chartered MNEs. Like the United Kingdom, other European countries used the chartered MNEs registered in their jurisdictions to advance their industrial developments. As these MNEs went on voyages to search for colonial territories, they provided Europe and the Americas resources to fuel their industrial endeavours. European countries extended their industrial era infrastructural developments (such as railways) to their colonies to transport resources to coastal towns for shipping to Europe. The British government, for example, mandated the British South Africa company to build railways in South-Central Africa for the exploitation of diamonds that were exported to Britain.⁴⁸ These colonial endeavours further propelled the interconnectivity and integration of the world's economies, thereby creating the bed-rock for the introduction of international tax laws.⁴⁹

5. Twentieth Century MNEs: International Tax Measures, Globalization and Rise of Tax Avoidance Schemes

The colonial power struggles, however, were one of the main causes of World War 1 in 1914 to 1918, which ended when the allied victors formed the League of Nations at the Paris Peace Conference on 10 January 1920.⁵⁰ The Treaty of Versailles was also signed which resulted in the reduction of the size of Germany because it was held responsible for causing the war.⁵¹ The economic destruction posed by the war necessitated countries to come up with measures to finance the rebuilding of their economies. One of the main measures they came up with was to get the chartered MNEs to pay taxes. They, therefore, began introducing corporate income taxes.⁵² One of the earliest corporate tax principles that was adopted was the "permanent establishment" (PE) concept which had been developed in the 19th century under German domestic law, based on the judicial practice in Prussia.⁵³ The PE concept was used as a means of taxing the foreign trade of chartered MNEs if they set up physical presences, such as branches, in a foreign country.⁵⁴ The foreign country could, thus, be entitled to tax the business profits that were

attributable to the physical presence that the MNE had created in that country.⁵⁵

By that time, chartered MNEs had also begun carrying out business activities in foreign countries by setting up subsidiary companies in foreign jurisdictions, which were used as a means of conducting business outside the country of incorporation of the parent company.⁵⁶ The subsidiaries operated as separate legal enterprises⁵⁷ that held legal title belonging to the parent companies⁵⁸ so as to be able to conduct business outside the country of incorporation of the parent company.⁵⁹ In response, some countries started introducing worldwide systems of taxation which would tax the foreign source income of domestic residents. The United States was the first country to introduce such legislation in 1861 when it was struggling to raise revenue for its Civil War.⁶⁰ Consequently the United States enacted its first federal income tax legislation (Revenue Act of 1862) to ensure that American citizens living outside the country were not avoiding their duties to the United States in a time of need. They were required to pay taxes on their worldwide income and not just their US-source earnings.⁶¹ The justification for this basis of taxation, as set out in the 1924 US case of *Cook v. Tait*,⁶² is that the United States provides benefits to its citizens (for example, protection by the state) irrespective of where they live. They should, therefore, contribute towards the cost of the government of the country in which they reside, even if income is earned outside that country.⁶³ The US extended its worldwide taxation to tax the income of companies incorporated in the United States regardless of their geographical location.⁶⁴

Where the management of foreign subsidiaries was carried on by the parent company, some countries came up with measures that extended their taxing rights to such foreign entities. For example, in 1906, the Court of Appeal of England and Wales (CAEW) ruled in the case of *De Beers Consolidated Mines Ltd v. Howe*⁶⁵ that, where a company was centrally managed and controlled in the United Kingdom (where its board of directors met to make

47. See the decision of the UK: AD, 15 June 1939, *Kergeulen Sealing & Whaling Co Ltd v. CIR*, [1939] AD 487 at p. 507.
48. *British South Africa Company*, Encyclopedia Britannica, available at www.britannica.com/topic/British-South-Africa-Company (accessed 5 May 2022).
49. Stiglitz, *supra* n. 31.
50. M. Kelly, *5 Top Causes of World War 1*, (2019), available at <http://americanhistory.about.com/od/worldwari/tp/causes-of-world-war-1.htm> (accessed 26 Aug. 2019).
51. Id.
52. R.S. Avi-Yonah, *Advanced Introduction to International Tax Law* p. 3 (Edward Elgar Publ. 2015).
53. A.A. Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle*, Series of International Taxation pp. 72-75 (Kluwer L. & Taxn. Publishers 1991) and R. Rawal, *The Taxation of Permanent Establishments: An International Perspective* p. 35 (Spiramus Press Ltd. 2006).
54. J. Huston & L. Williams, *Permanent Establishments: A Planning Primer* pp. 1-10 (Kluwer L. & Taxn. Publishers 1993).

55. Skaar, *supra* n. 53, at pp. 65-101.
56. J.E. Bischel & R. Feinschreiber, *Fundamentals of International Taxation* 2nd edn., pp. 83-85 (Practising L. Inst. 1985) and P. Roper, *Offshore Options* p. 2 (Butterworths 1999).
57. OECD, *Review of Comparability and Profits Methods: Revision of Chapters I-III of The Transfer Pricing Guidelines* para. 1.10 (OECD 2010), available at www.oecd.org/tax/transfer-pricing/45763692.pdf.
58. Arnold & McIntyre, *supra* n. 44, at p. 87.
59. Bischel & Feinschreiber, *supra* n. 56, at pp. 83-85 and Roper, *supra* n. 56, at p. 2.
60. S.D. Pollack, *The First National Income Tax, 1861-1872*, 67 Tax Law. 2, p. 2 (2013).
61. J.A. Hill, *The Civil War Income Tax Act*, 8 Q. J. Econ. 4, pp. 416-452 (1894).
62. See the decision of the US Supreme Court (USSC) in US: USSC, 5 May 1924, *Cook v. Tait*, 265 US 49 (1924).
63. D. Meyerowitz, *Meyerowitz on Income Tax* para. 7.1 (Taxpayer CC, 2006-2007).
64. W.F. O'Conner, *An Inquiry into the Foreign Tax Burdens of US Based Multinational Corporations* p. 24 (Arno Press 1980).
65. UK: CAEW, 17 Apr. 1906, *De Beers Consolidated Mines Ltd v. Howe*, [1906] AC 455.

fundamental policy decisions), such a company would be taxed in the United Kingdom.⁶⁶

Since parent companies and the subsidiaries were connected entities, they began to engage in “transfer pricing”⁶⁷ schemes by setting the prices at which they sold, bought or shared resources between each other.⁶⁸ In this way, their profits would appear lower in a country with higher tax rates and higher in a country with lower tax rates.⁶⁹ In response to these schemes, countries began enacting transfer pricing legislation which entails the use of the arm’s-length principle (ALP) to ensure that prices charged by connected entities are comparable to arm’s-length prices that are set in the marketplace between unconnected entities, where each entity strives to get the utmost possible benefit from the transaction.⁷⁰ Essentially, arriving at an arm’s-length price requires carrying out a “comparability analysis” of the controlled transactions between connected entities and the uncontrolled transactions of unconnected entities, by comparing the functions performed, assets used and the risks assumed.⁷¹ Transfer pricing legislation was first introduced by the United Kingdom under Finance Act (FA) No. 2 of 1915.⁷² It was followed by the United States,⁷³ which introduced transfer pricing legislation under its War Revenue Act of 1917.⁷⁴ Later on, other countries also began enacting transfer pricing legislation.⁷⁵

However, the various domestic measures that countries enacted resulted in the double taxation of international trade due to the overlap of the worldwide (residence) and the territorial (source) bases of taxation in the countries in which the MNEs invested.⁷⁶ This led to calls to prevent double taxation from businesses under the auspices of the International Chamber of Commerce, which had been set

up in 1917 to govern their international trade and investment relations.⁷⁷ Countries were also concerned that MNEs were avoiding taxes in their jurisdictions and they expressed the importance of developing international rules that would ensure fair allocation of taxing rights among countries from the income derived by MNEs that operated in their jurisdictions.⁷⁸ At the 1920 Brussels International Financial conference, the then industrialized countries appealed to the Financial Committee of the League of Nations to address tax avoidance schemes by MNEs and to take action to eliminate double taxation by ensuring proper allocation of taxing rights among states.⁷⁹ Consequently, the League of Nations passed Resolution 12 to ensure “due payment by everyone of his fair share of taxes” and Resolution 13, which called for action to be taken to “prevent the flight of capital in order to avoid taxation”.⁸⁰ In response, in 1921, the League of Nations appointed a team of four economists⁸¹ known as the “Committee of Technical Experts on Double Taxation and Evasion” to prepare a report on the economic aspects of international double taxation. The League of Nations used the outcomes of this report to draft a Model Tax Convention (MTC) in 1928,⁸² which formed the foundation for the development of double tax treaty provisions that allocate cross-border taxing rights among nations.⁸³ Indeed, these measures taken by the League of Nations marked the beginning of the development of international corporate tax laws as they are applied today.⁸⁴ The 1928 League of Nations’ MTC adopted the PE concept which (as alluded to previously in this section) had been developed in German domestic law,⁸⁵ and was applied in the first 1899 double tax treaty between Austria-Hungary and Prussia⁸⁶ to tax business activities of a foreign enterprise in a source state if that enterprise had a significant and substantial economic presence in that state.⁸⁷ Under the 1928 MTC, the allocation of taxing rights was accomplished by the competent authorities of two contracting states, using some form of formulary apportionment to allocate income between the contracting states.⁸⁸

66. H.J. Ault, *Comparative Income Taxation: A Structural Analysis* p. 372 (Kluwer L. Intl. 1997).

67. OECD, *Addressing BEPS*, *supra* n. 16, at p. 36.

68. Arnold & McIntyre, *supra* n. 44, at p. 53 and A.W. Oguttu, *Transfer Pricing and Tax Avoidance: Is the Arm’s Length Principle still relevant in the E-commerce Era?*, 18 SA Mercantile L. J. 2, p. 139 (2006).

69. Ginsberg, *supra* n. 7, at p. 20 and A. Rappako, *Base Company Taxation* p. 16 (Kluwer L. & Taxn. Publishers 1989).

70. V.H. Miesel, H.H. Higinbotham & C.W. Yi, *International Transfer Pricing: Practical Solutions for Inter-Company Pricing – Part II*, 29 Intl. Tax J. 1, p. 45 (2003).

71. Arnold & McIntyre, *supra* n. 44, at p. 55.

72. R. Dwarkasing, *Comments on the Revised Discussion Draft on Transfer Pricing Aspects of Intangibles* (Maastricht U. 2013), available at www.oecd.org/ctp/transfer-pricing/dwarkasing-maastricht-university.pdf.

73. UN, *Practical Manual on Transfer Pricing for Developing Countries* para. B 8.1.1. (UN 2017) [hereinafter the *Practical Manual*].

74. Subsequent transfer pricing legislation was enacted by the US in 1928 under US: Internal Revenue Code 1954 (IRC), sec. 45, which later became section 482 of the IRC. See M.A. Heimert & M. Johnson, *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* p. 5 (Kluwer L. Intl. 2010) and T. Althunayan, *Dealing with the Fragmented International Legal Environment: WTO, International Tax and Internal Tax Regulations* p. 116 (Springer 2010).

75. The next country was France, which enacted transfer pricing provisions in article 57 of its 1933 tax code. See K. Vogel & P. Kirchhoff, *Solutions to the Transfer Pricing Problem*, in *International and Comparative Taxation: Essays in Honour of Klaus Vogel* p. 51 (K. Vogel et al. eds., Kluwer L. Intl. 2002).

76. M. Kobetsky, *International Taxation of Permanent Establishments: Principles and Policy* p. 106 (Cambridge U. Press 2011) and Sunita Jogarajan, *Double Taxation and the League of Nations* pp. 85-97 (Cambridge U. Press 2018).

77. Kobetsky, *supra* n. 76, at p. 106 and International Chamber of Commerce (ICC), First Congress, Brochure No. 18 (ICC 27 July 1921).

78. J.A. Becerra, *Interpretation and Application of Tax Treaties in North America*, 2nd edn, sec. 2.1. (IBFD 2013), Books IBFD and Avi-Yonah, *supra* n. 52, at p. 3.

79. League of Nations, *Economic and Financial Committee Report on Double Taxation: E.F.S.73.F.19* (5 Apr. 1923), available at <http://adc.library.usyd.edu.au/view?docId=law/xml-main-texts/brulegi.xml&chunk.id=d640e396&toc.id=d640e396&database=&collection=&brand=ozfed> (accessed 25 May 2020).

80. Id.

81. Consisting of Prof Einaudi, Italy; Prof. Bruins, the Netherlands; Sir. J. Stamp, the United Kingdom; and Prof. Seligman, the United States. See Avi-Yonah, *supra* n. 52, at p. 3.

82. League of Nations, *Report on the Work of the Tenth Session, held in London from March 20th to 26th, 1946* (C.37.M37.1946.II.A) p. 8 (1946) [hereinafter the *Report on the Work of the Tenth Session*].

83. G. George, *The League of Nations: From 1929 to 1946* p. 25 (Avery Publ. Group 1996). See also OECD, *60 Years*, available at www.oecd.org/about/history/ (accessed 30 Aug. 2019).

84. OECD, *Addressing BEPS*, *supra* n. 16, at p. 3.

85. Skaar, *supra* n. 53, at pp. 72-75.

86. Id., at pp. 75-77.

87. K. Vogel, *Klaus Vogel on Double Tax Conventions* 3rd edn., p. 280 (Kluwer L. & Taxn. Publishers 1997).

88. M.J. McIntyre, *Developing Countries and International Cooperation on Income Tax Matters: A Historical View* p. 3, (Tax Policy for Developing

While these international tax provisions were being developed, as early as 1928, the UK House of Lords (UKHL) in the case of *Levene v. IRC*⁸⁹ had ruled on the legality of tax avoidance, and held that:

[i]t is trite law that His Majesty's subjects are free, if they can, to make their own arrangements so that their cases may fall outside the scope of the taxing Act. They incur no legal penalties, and they, strictly speaking, no moral censure if having considered the lines drawn by the legislature for the imposition of taxes, they make it their business to walk outside them.

In 1929, the UKHL held in the case of *Ayrshire Pullman Motors Services and D M Ritchie v. IRC*⁹⁰ that:

[n]o man in this country is under the smallest obligation, moral or otherwise, to arrange his legal relations to his business or to his property so as to enable the In-land Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow – and quite rightly – to take advantage, which is open to it under the taxing Statutes for the purpose of depleting the taxpayer's pocket. The taxpayer is in the like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue.

And, in the 1935, in the celebrated case of *Duke of Westminster*,⁹¹ it was held that:

[e]very man is entitled if he can to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however inappropriate to the Commissioner of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

These UK court decisions gave credence to MNEs to legally continue their tax avoidance schemes. While all these domestic and tax treaty developments were going on, Germany was not faring well due to the loss reduction of its size under the Treaty of Versailles, which caused dire financial consequences. It, therefore, began to develop aggressive foreign policies which led to World War II in 1939 to 1945.⁹² The need for finances to rebuild after the war necessitated countries engaging in further development of international tax rules to ensure proper allocation of taxing rights.⁹³ The League of Nations carried out further work in the 1940s on its first MTC. In 1943, it issued the “Mexico Draft”, which took the position that the primary jurisdiction to tax should be assigned to the source state – a position which favoured capital importing countries (largely source based countries). Then, in 1946, it issued the “London Draft”,⁹⁴ which reversed what was set out in the Mexico Draft by assigning more taxing

rights to residence states. The London Draft reaffirmed that source states could only tax the business profits of an enterprise resident in the other state if that enterprise had created a PE in the source state.⁹⁵ The London Draft was, therefore, in favour of capital exporting countries (largely residence-based countries).⁹⁶

When the League of Nations was dissolved in 1945 (after the end of World War II),⁹⁷ work on further development of the MTC was passed to the Organisation for European Economic Cooperation (OEEC), which was created in 1948.⁹⁸ The Fiscal Committee of the OEEC carried out further work on matters of determining the tax residence of a company that was dual resident in that it was registered in one country and yet it was managed in another – and, thus, fully liable to tax in both States.⁹⁹ In May 1957,¹⁰⁰ the OEEC issued a report which introduced a tie-breaker rule in article 4(3) of the draft model giving tax priority to the country in which the company's business is “managed and controlled”. This rule was based on the concept of “central management and control” which had been developed earlier by the UK courts and was used in the United Kingdom's tax treaties.¹⁰¹ By adopting this tie-breaker rule, the OEEC sought not to attach importance to a purely formal criterion like registration to determine tax residence, but importance was placed on the state in which the corporation was actually managed. This approach was not only intended to prevent double taxation but it was also intended to prevent tax avoidance when MNEs set up shell companies in other jurisdictions that were actually managed by the parent companies.¹⁰² The May 1957 OEEC report further noted that, where there were uncertainties in determining corporate residence based on the location of the company's “management and control”, “the competent authorities of the contracting states shall determine the question by agreement between themselves”.¹⁰³ In its fourth report dated 5 November 1957,¹⁰⁴ the OEEC replaced the concept of “central management and control” with “place of effective

and Transitional Countries in the Global Economy, Working Paper, 2005) www.michielse.com/files/mcintyre_intl_cooperation.pdf.

89. UK: UKHL, 9 Mar. 1928, *Levene v. IRC*, [1928] AC 21.

90. UK: UKHL, 21 Apr. 1929, *Ayrshire Pullman Motors Services and D M Ritchie v. IRC*, [1929] 14 TC 754.

91. UK: UKHL, 7 May 1935, *ICR v. Duke of Westminster*, [1935] All ER 259 (H.L.).

92. The Nazi invasion of Poland in 1939 led to World War II, which was fought by the Axis Powers (Germany, Italy and Japan) and their allies against the Allied Powers (the United Kingdom, France, Russia and the United States) and their allies. See J. Kiprop, *What Were the Main Causes of World War II?*, WorldAtlas (26 July 2018), available at www.worldatlas.com/articles/what-were-the-main-causes-of-world-war-ii.html (accessed 20 May 2020).

93. Jogarajan, *supra* n. 76, at p. 5.

94. League of Nations, *Report on the Work of the Tenth Session*, *supra* n. 82, at p. 8.

95. M. Lennard, *The Purpose and Current Status of the United Nations Tax Work*, 14 Asia-Pac. Tax Bull. 1, sec. 1. (2008), Journal Articles & Opinion Pieces IBFD.

96. D.R. Whittaker, *An Examination of the OECD and UN Model Tax Treaties: History, Provisions and Application to US Foreign Policy*, 8 N.C. J. Intl. L. & Com. Reg. 4, pp. 43-44 (1982).

97. George, *supra* n. 83, at p. 25.

98. The OEEC was formed in 1948 to administer American and Canadian aid under the Marshall Plan for the reconstruction of Europe after World War II. See Becerra, *supra* n. 78, at sec. 2.4.

99. FC/WP2(57)1 dated 27 May 1957; FC/WP2(57)2 dated 19 September 1957; FC/WP2(57)3 dated 5 November 1957; and FC/WP2(58)1 dated 10 January 1958. These reports may be consulted at www.taxtreatieshistory.org/ (accessed 24 Apr. 2020).

100. FC/WP2(57)1 dated 27 May 1957, available at www.taxtreatieshistory.org/ (accessed 24 Apr. 2020).

101. J.F. Avery Jones, *2008 OECD Model: Place of Effective Management – What One Can Learn from The History*, 63 Bull. Intl. Taxn. 5, sec. 5. (2009), Journal Articles & Opinion Pieces IBFD.

102. J. Sullivan, *A Study on the Interpretation and Limitations of the Concept “Place of Effective Management” as Laid Down in Article 4(3) of the OECD Model Tax Convention*, MA in Taxation, Institute of Advanced Legal Studies, University of London p. 17 (Sept. 2011).

103. FC/WP2(57)1 dated 27 May 1957, available at www.taxtreatieshistory.org/ (accessed 24 Apr. 2022).

104. FC/WP2(57)3 dated 5 November 1957, available at www.taxtreatieshistory.org/ (accessed 24 Apr. 2022).

management”,¹⁰⁵ which was defined as meaning the place where the key management and commercial decisions that are necessary for the conduct of the entity’s business are in substance made.¹⁰⁶ Thus, where a controlling shareholder’s decisions influenced how a company’s transactions are dealt with, such a shareholder could be looked at in order to determine the place of effective management of a company.¹⁰⁷

In 1961, the OEEC became the OECD,¹⁰⁸ which published the OECD Draft (1963)¹⁰⁹ – largely in favour of developed countries. The final version was published in the OECD Model (1977)¹¹⁰ and has been revised over the years in response to the changes brought about by globalization.¹¹¹ In 1967, developing countries started advocating for their own MTC,¹¹² which culminated in the UN Model Double Taxation Convention between Developed and Developing Countries (the UN Model) which was first published as the UN Model (1980).¹¹³ These MTCs are the main models used for signing double tax treaties that become legally enforceable in the contracting states and are an important part of countries’ international tax laws.

It is particularly important to note that, from the 1960s, globalization took on a different note as decolonization efforts strengthened and European states became more inclined to use liberalized global markets to drive developments in the mid-20th century.¹¹⁴ This saw the rise of international organizations which encouraged the removal of barriers to international trade and investment through negotiations around the General Agreement on Tariffs and Trade, and then later the World Trade Orga-

nization.¹¹⁵ The new form of globalization opened countries’ economies to the free movement of capital, goods and services to global markets.¹¹⁶ This brought about unrivalled diffusion of people, cultures, informational and communication technologies at an international scale.¹¹⁷ The result was increased competition among businesses in the global marketplace which encouraged MNEs to increasingly develop strategies to maximize profits and reduce their global tax exposure. In this liberalized environment, MNEs’ links with any country that offered a favourable tax climate became an essential part of their international tax planning.¹¹⁸ This promoted an exponential rise of MNE investments in tax haven jurisdictions, which are jurisdictions that actively availed themselves for the avoidance of tax that would have been paid in high-tax countries.¹¹⁹ Giving a precise meaning to the term “tax haven” is, however, difficult as any given country can be deemed a tax haven in some respects if it has a lower tax rate on some activity than another country’s rate on the same activity.¹²⁰ Although tax havens were already in existence in past centuries, for example, the Netherlands¹²¹ and Switzerland, which were historically known tax havens for capital flight dating back to Roman times, their number and unprecedented use by MNEs rose in the 20th century.¹²² By the 1960s and 1970s, many international banks had set up branches in Caribbean tax havens.¹²³ Core tax havens (usually islands located off the shores of the mainland continents), increasingly became bases for subsidiary companies of major MNEs involved in shipping, financing, investment and captive insurance activities.¹²⁴

With the increased MNE investments in tax havens, many countries that previously relied on the territorial basis of taxation realized that this basis of taxation limited their ability to prevent tax avoidance when their residents invested offshore.¹²⁵ Countries began deviating from territorial tax systems to residence based systems (worldwide taxation) or hybrids between the two (that allowed the worldwide taxation of certain types of income).¹²⁶ The

105. Sullivan, *supra* n. 102, at p. 17.

106. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 4 (3)* para. 24 (15 July 2005), Treaties & Models IBFD.

107. Vogel, *supra* n. 87, at p. 183.

108. OECD, *A Brief History*, available at <https://www.oecd.org/60-years/> (accessed 24 Sept. 2022).

109. *OECD Draft Tax Convention on Income and on Capital* (30 July 1963), Treaties & Models IBFD.

110. *OECD Model Tax Convention on Income and on Capital* (11 Apr. 1977), Treaties & Models IBFD. See also J. Owens & M. Bennette, *OECD Model Tax Convention*, OECD Observer, available at www.oecdobserver.org/news/archivestory.php/aid/2756/OECD_Model_Tax_Convention.html (accessed 31 July 2022).

111. The *OECD Model* (1977) underwent revisions in 1992, 1994, 1995, 1997, 2000, 2003, 2005, 2008, 2010, 2014 and the latest in 2017, which included recommendations of the OECD/G20 BEPS Project. For the latter (and the most recent), see *OECD Model Tax Convention on Income and on Capital*, Introduction (21 Nov. 2017), Treaties & Models IBFD.

112. On 4 August 1967, a resolution of the UN Economic and Social Council was passed, requesting the Secretary General to create an Ad hoc working group of tax experts and tax administrators to formulate guidelines for tax treaties between developed and developing countries. See M. Ylönen, *Back from Oblivion? The Rise and Fall of the Early Initiatives Against Corporate Tax Avoidance from the 1960s to the 1980s*, 23 *Transnatl. Corporations* 3, p. 35 (2017).

113. *UN Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 1980), Treaties & Models IBFD. The UN Model (1980) was revised in 2001, 2014 and in 2017, the latter in the light of OECD/G20 BEPS Project. For the latter (and the most recent), see *UN Model Double Taxation Convention between Developed and Developing Countries* para. 18, Introduction (1 Jan. 2017), Treaties & Models IBFD.

114. International Monetary Fund (IMF), *Global Trade Liberalization and the Developing Countries* (IMF 2001), available at www.imf.org/external/np/exr/ib/2001/110801.htm (accessed 24 Apr. 2022) [hereinafter *Global Trade Liberalization*] and S. Matusz & D. Tarr, *Adjusting to Trade Policy Reform*, World Bank Policy Research Working Paper No. 2142 (July 1999).

115. The General Agreement on Tariffs and Trade was formed in 1947 and the World Trade Organization was formed in 1994. See V. Thuronyi, *Tax Law Design and Drafting* ch. 18, sec. II A (IMF 1998).

116. Thuronyi, *supra* n. 115, at ch. 18, sec. II A.

117. IMF, *Global Trade Liberalization*, *supra* n. 114.

118. Grundy, *supra* n. 7, at pp. 1-2 and Ginsberg, *supra* n. 7, at p. 5.

119. OECD, *Issues in International Taxation No. 1: International Tax Avoidance and Evasion* p. 20 (OECD 1987) [hereinafter *Issues in International Taxation No. 1*] and P. Roper & J. Ware, *Offshore Pitfalls* p. 5 (Butterworth 2000).

120. M. Hampton, *The Offshore Interface: Tax Havens in the Global Economy* p.10 (St. Martin’s Press 1996).

121. Doggart, *supra* n. 24, at p. 1.

122. Hampton, *supra* n. 120, at p. 17.

123. UN Ad Hoc Group of Experts on International Co-operation in Tax Matters, *Guidelines for International Cooperation Against the Evasion and Avoidance of Taxes (With Special References to Taxes on Income, Profits, Capital, and Capital Gains)* p.30 (Dept Intl. Econ. & Soc. Affairs, UN 1984).

124. Ginsberg, *supra* n. 7, at pp. 51-60; Rappako, *supra* n. 69, at pp. 193 -197; and J. Alm, J.M. Vazquez & M. Rider, *The Challenges of Tax Reform in a Global Economy* p. 208 (Springer 2006).

125. A.W. Oguttu, *Ensuring a Right Balance in Applying the Residence and Source Bases of Taxation in Order to Protect South Africa’s Tax Base*, in *Income Tax in South Africa: The First 100 Years 1914 - 2014* pp. 245-275 (J. Hattingh, J. Roeleveld & C. West eds., Juta & Co 2016).

126. *Id.*

challenge, though, was that in most countries' tax systems, the foreign-source income of foreign subsidiary companies could not be subject to tax in the jurisdiction of its parent company, since the subsidiary was incorporated and recognized as a separate juridical entity in foreign jurisdiction.¹²⁷ This implied that the country where the parent company was registered could not apply its "residence basis" of taxation to tax the worldwide income of its foreign subsidiary until such income was distributed to the domestic shareholders as dividends.¹²⁸ This, in turn, meant that the profits of the MNE could be tied up in the foreign subsidiary where they could be accumulated for further foreign investment instead of being repatriated to the parent company to be taxed.¹²⁹ As long as the income was sheltered in the foreign subsidiary and not distributed, it was deferred or postponed, implying that the taxes due were postponed to future years.¹³⁰ In order to prevent tax deferral, some countries introduced "controlled foreign company" (CFC) legislation,¹³¹ which ensures that the undistributed income of a CFC is not deferred, but it is taxed in the hands of the domestic shareholders of the MNE on a current basis.¹³² CFC legislation is essentially an extension of countries' worldwide basis of taxation, and has been mainly introduced by countries that have the administrative ability to extend their tax net very wide.¹³³ Countries that have CFC legislation generally define a CFC as foreign company more than 50% of whose shares, voting power or value is owned by domestic shareholders.¹³⁴ The United States was the first to enact CFC legislation under the Revenue Act of 1962.¹³⁵ This was followed by the United Kingdom, which enacted CFC legislation in the FA 1984.¹³⁶ Other countries like Germany, Japan, Australia, New Zealand, Brazil and Russia followed suit.¹³⁷

Towards the end of the 20th century, countries realized that their domestic anti-avoidance provisions could only go so far in curtailing tax avoidance that was encouraged by the very existence of tax haven jurisdictions.¹³⁸ These are sovereign jurisdictions that have a right to determine their own tax policy (including making their country a tax haven). Other countries cannot enact legislation to remove the very existence of tax haven countries.¹³⁹ Thus, countries embarked on international efforts to crack down on tax havens.¹⁴⁰ A particular onslaught on tax havens was propelled by the OECD when, in 1998, it issued a report on harmful tax competition.¹⁴¹ This report recommended that countries needed to intensify international cooperation in tax matters, and affirmed that, in order to prevent the harmful tax practices of tax havens, countries needed to adopt tax avoidance measures such as CFC and transfer pricing legislation.¹⁴²

While countries embarked on enacting this anti-avoidance legislation, MNE business models changed in the late 20th century. They became increasingly integrated, whereby control was centralized in one location¹⁴³ and intra-group trade grew steadily.¹⁴⁴ Integration meant that MNEs' internal businesses were no longer structured as before, where subsidiaries operated as separate enterprises, with each entity carrying out distinct functions, like production, marketing or distribution.¹⁴⁵ They increasingly operated as a single unified enterprise managed from a central location by managers who were responsible for the enterprise as a whole.¹⁴⁶ It is through integration that 20th century MNEs achieved economies of scale in aspects such as transaction costs, risk management, brand development and logistics.¹⁴⁷ Integration meant that capital, technology, central services and risk management were treated as overhead costs to be shared in all business activities.¹⁴⁸ This increased integration meant that the ALP, which had been developed in the 19th century to prevent transfer pricing based on the separate entity approach, could not hold. The ALP was developed in a context where the basic structure of MNEs constituted subsidiaries in a few countries and each subsidiary carried out a range of functional activities that reflected

127. Arnold & McIntyre, *supra* n. 44, at p. 87.
 128. OECD, *Studies in Taxation of Foreign Source Income: Controlled Foreign Company Legislation* p. 10 (OECD 2000).
 129. W.H. Diamond & D.B. Diamond, *Tax Havens of the World*, Release No. 108, vol. 1 at INTRO/1 (Mathew Bender & Co. 2002); E. Tomsett, *Tax Planning for Multinational Companies* p. 11 (Woodhead-Faulkner 1989); and A. Jones, *Tax Havens and Measures Against Tax Evasion and Avoidance in the EEC* p. 7 (Associated Bus. Programmes 1974).
 130. Arnold & McIntyre, *supra* n. 44, at p. 87.
 131. This legislation generally defines a CFC in the same way; as being a foreign company in which more than 50% of the shares, voting power or value is owned by domestic shareholders. See Arnold & McIntyre, *supra* n. 44, at p. 91.
 132. L. Olivier & M. Honiball, *International Tax: A South African Perspective* p. 559 (Syber Ink, 2011) and B. Arnold, *The Taxation of Foreign Controlled Corporations: An International Comparison* p. 131 (Canadian Tax Fond. 1986).
 133. D. Sandler, *Case Notes: Tax Treaties and Controlled Foreign Company Legislation*, Brit. Tax Rev. 1, p. 14 (1998).
 134. R.L. Doernberg et al., *Electronic Commerce and Multi-jurisdictional Taxation* p. 323 (Kluwer L. Intl. 2001).
 135. US: Revenue Act of 1962. The US's CFC rules are referred to as Subpart F provisions which are now set out in sections 957(a) and (b) of the IRC. See Rotterdam Institute for Fiscal Studies, *International Tax Avoidance* vol. A, p. 272 (Kluwer 1979) and Arnold, *supra* n. 132, at p. 131.
 136. UK: FA 1984. The United Kingdom's CFC provisions were later consolidated in UK: Income and Corporations Taxes Act (ICTA) 1988, secs. 747-756 and schs. 24-26, now in UK: *Taxation (International and Other Provisions) Act 2010*. See M. Lang et al., *CFC Legislation Tax Treaties and EC Law* p. 609 (Kluwer L. Intl. 2004) and J.S. Schwarz, *Controlled Foreign Companies and Tax Treaties*, 51 Bull. Intl. Fiscal Docn. 12, sec. 1., p. 554 (1997).
 137. B.J. Arnold, *International Tax Primer* 4th edn., ch. 7 (Kluwer L. Intl. 2019).

138. OECD, *Issues in International Taxation No. 1*, *supra* n. 119, at p. 20 and Ginsberg, *supra* n. 7, at pp. 5-6.
 139. Ogutttu, *supra* n. 3, at p. 13.
 140. In 1997, the European Council came up with a "Code of Conduct" on business taxation. See W. Bratton & J. McCahery, *Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation*, 28 Com. Mkt. L. Rev., p. 677 (2001). In 1998, the United Kingdom issued the Edwards Report entitled "Review of Financial Regulations in the Crown Dependencies". In 1999, the UK government released a White Paper outlining the terms and conditions expected of the British Overseas Territories. See T. Bennet, *International Initiatives Affecting Financial Havens* p. 37 (LexisNexis 2001).
 141. OECD, *Harmful Tax Competition*, *supra* n. 4, at pp. 13-14.
 142. *Id.*, at pp. 67-75.
 143. UN, *Practical Manual*, *supra* n. 73, at para. A.2.8.
 144. *Id.*, at para. B.1.1.3.
 145. Hay, Horner & Owens, *supra* n. 2.
 146. R.S. Avi-Yonah & K.A. Clausing, *Business Profits (Article 7 OECD MTC), in Source versus Residence: Problems Arising from the Allocation of Taxing Rights in Tax Treaty Law and Possible Alternatives* p. 75 (M. Lang et al. eds., Kluwer L. Intl. 2008).
 147. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* para. 1.9 (OECD 2022), Primary Sources IBFD.
 148. Avi-Yonah & Clausing, *supra* n. 146.

the group's business structure.¹⁴⁹ In that context, the ALP was fairly helpful in preventing transfer pricing as the prevailing circumstances were characterized by slow communications, currency exchange rules, customs duties, and relatively high transportation costs that made integrated global supply chains difficult to operate.¹⁵⁰

With the rise in information and communications technology (ICT), reductions in currency and custom barriers and the move to digital products and a service based economy, MNEs became more integrated and they began to operate much more as single global firms.¹⁵¹ The developments in ICT changed the spread of MNE value chains such that individual legal entities became less important and MNEs came to be viewed as single firms operating in a coordinated fashion to maximize opportunities in a global economy.¹⁵² With increased integration, applying the comparability analysis between controlled and uncontrolled entities in order to determine an arm's-length price became unrealistic as core MNE functions were centralized.¹⁵³ Increased integration made it difficult to find duplicate independent transactions conducted by two non-integrated businesses performing the same or similar functions and selling the same or similar products.¹⁵⁴ Thus, MNEs began to manipulate the transfer pricing provisions,¹⁵⁵ which were grounded in an economic environment characterized by a lower degree of economic integration across borders.¹⁵⁶

6. Twenty-First Century MNEs: The Digital Era, Addressing BEPS and A New International Tax Regime

The 21st century has been characterized by the rise of the digital economy, which has brought about an exponential advance in ICT in many realms of business and commerce.¹⁵⁷ In this environment, MNEs have blossomed and dominated global investment. Since the foundations of the international tax laws are still based on principles developed in the 19th century that do not suit modern business environment, MNEs have succeeded in most cases in unshackling themselves from state fetters by utilizing sophisticated mechanisms to avoid taxes and reap the gains of the digital era despite the plethora of regulations. The last decade of the 20th century into the 21st century saw an exponential rise of cutting edge giant digital MNEs like Amazon.com founded in 1994 (although it is not fully

web based and does operate in some physical goods);¹⁵⁸ Google founded in 1998;¹⁵⁹ Facebook founded in 2004;¹⁶⁰ and Twitter founded in 2006.¹⁶¹ These giant digital MNEs took business integration to an all-time new level. They managed to maximize production by using technology to ease market access, and by shifting their business models from country-specific to global models with integrated value chains and functions that are centralized at a regional or global level.¹⁶² Basically, a value chain¹⁶³ is the full range of a company's activities, from the conception of a product or service to its end use and beyond. It includes activities such as design, production, marketing, distribution and supply to the final consumer.¹⁶⁴ Modern value chains are characterized by the fragmentation of production across borders.¹⁶⁵ This has changed the notion of what economies do and what they produce. Unlike in the past centuries when businesses placed much value on the final products (goods and services), in the 21st century greater value is being placed on where tasks and stages of production take place.¹⁶⁶ For digital companies, business value is placed where upstream activities like product design, research and development (R&D) or where production of core components occur, as well as in the downstream activities where marketing or branding occurs.¹⁶⁷ This means that knowledge-based intangible assets, such as, software, organizational skills and intellectual property (IP - which includes patents, trademarks, copyrights, brand names and know-how¹⁶⁸) have become increasingly important for competitiveness.¹⁶⁹ Thus, some digital companies have grown exponentially by placing value on "data and user participation".¹⁷⁰ They collect data about their customers, users, suppliers, and operations to leverage and monetize such data. For social network business models (such as Facebook, Instagram and Twitter), the active collaboration of their users is a key value-driver of the business.¹⁷¹ Other digital companies place value on "network effects", whereby they take advantage of the fact that decisions of users have a direct impact on the benefit received by other users. This is especially so with the "internet of things", in which companies deploy

149. A.J. Cockfield, *Formulary Taxation Versus the Arm's Length Principle: The Battle Among Doubting Thomases, Purists, and Pragmatists*, 52 *Canadian Tax J.* 1, p. 116 (2004).
 150. J. Pleune, *The Desirability of the Arm's Length Principle in the 21st Century*, Master's Thesis, International Business Tax Economics, Tilburg School of Economics and Management, Tilburg University p.17 (2017).
 151. Oguttu, *supra* n. 68, at pp. 138-158 and OECD, *Action 1 Final Report* (2015), *supra* n. 10, at para. 232.
 152. OECD, *Action 1 Final Report* (2015), *supra* n. 10, at para. 232.
 153. R. Collier & J.L. Andrus, *Transfer Pricing and the Arm's Length Principle After BEPS* ch. 6 (Oxford U. Press 2017).
 154. *Id.*
 155. Miesel, Higinbotham & Yi, *supra* n. 70, at p. 2.
 156. OECD, *Action Plan on BEPS*, *supra* n. 9, at p. 47.
 157. OECD, *Digital Economy Outlook* p. 47 (OECD 2017).

158. Encyclopedia Britannica, *Amazon.com*, available at www.britannica.com/topic/Amazoncom (accessed 20 Dec. 2019).
 159. Google, *From the Garage to the Googleplex*, available at https://about.google/intl/ALL_us/our-story/ (accessed 20 Dec. 2019).
 160. The Guardian, *A Brief History of Facebook* (2017), available at www.theguardian.com/technology/2007/jul/25/media.newmedia (accessed 20 Dec. 2019).
 161. J. Meyer, *History of Twitter: Jack Dorsey and The Social Media Giant*, available at www.thestreet.com/technology/history-of-twitter-facts-what-s-happening-in-2019-14995056 (accessed 24 Sept. 2022).
 162. OECD, *Action Plan on BEPS*, *supra* n. 9, at p. 25.
 163. OECD, *Interconnected Economies Benefiting from Global Value Chains* pp. 5-6 (OECD 2013).
 164. OECD, *Public Discussion Draft – BEPS Action 10: Discussion Draft on the Use of Profit Splits in the Context of Global Value Chains* para. 5 (OECD 2014), Primary Sources IBFD.
 165. OECD, *Action Plan on BEPS*, *supra* n. 9, at p. 26.
 166. *Id.*, at p. 27.
 167. United Nations Conference on Trade and Development (UNCTAD), *Creative Economy Report* p. 7 (UN 2013).
 168. World Intellectual Property Organization (WIPO), *World Intellectual Property Report the Changing Face of Innovation* p. 5 (WIPO 2011).
 169. OECD, *Action Plan on BEPS*, *supra* n. 9, at p. 27.
 170. OECD, *Action 1 Final Report* (2015), *supra* n. 10, at para. 164.
 171. *Id.*

software in many devices and leverage off this infrastructure to sell goods or services to the owners of those devices or to advertisers. In advertising business models, hardware and software infrastructure are a channel to get in touch with end users and to create value by monetizing the data that flows from end users or the externalities generated through network effects and then selling goods or services to them.¹⁷² Digitization has also seen the rise of “multi-sided business models” that capture value from externalities generated by free products. Essentially, in these models, multiple distinct groups of persons interact through an intermediary or platform, and the decisions of each group of persons affects the outcome for the other groups of persons through a positive or negative externality. An example of a multi-sided business model with positive externalities is the payment card system, which is more valuable to merchants if more consumers use the card, and more valuable to consumers if more merchants accept the card.¹⁷³

The ever-increasing value that is placed on developing and exploiting intangible assets, like IP, means that giant digital companies have to expend substantial resources on R&D to upgrade their software or to develop new software.¹⁷⁴ This has impacted on the way MNEs are structured and managed, which impacts on their tax liabilities.¹⁷⁵ Giant digital companies normally ensure that a subsidiary company in a low-tax jurisdiction has the legal ownership of their intangible assets so that it is entitled to large portions of the MNE group’s income, which would be subject to low or no taxes,¹⁷⁶ thus reducing the MNE’s global tax exposure.¹⁷⁷ The mobile nature of the digital economy has been a major catalyst in this regard as it makes it easy to transfer intangible assets at minimal cost.¹⁷⁸ The mobility of digitalization also allows MNEs to easily move the location of where their functions and operations are carried out, which permits them to conduct substantial sales (for example, through online advertisements) in market jurisdictions from remote locations.¹⁷⁹ This has increased their ability to provide goods and services across borders¹⁸⁰ with minimal need for personnel to be present (the so-called “scale without mass” phenomenon).¹⁸¹

Countries tend to rely on their transfer pricing provisions to ensure that the transfer of intangible assets among the entities in a MNE is at arm’s length.¹⁸² However, countries

find it particularly hard to apply the ALP to intangibles due to their unique nature which makes it difficult to find comparable intangibles.¹⁸³ Countries also find it hard to analyse mixed contracts involving intangibles and other elements such as goods and services. This is because it is difficult to ascertain the true nature of the transactions, to determine the value of the other elements to the contract as well as to identify and value the intangibles component.¹⁸⁴

Where MNEs transfer intangible assets to subsidiary companies in low-tax jurisdictions, residence based countries can also apply their CFC legislation to prevent tax deferral by taxing the undistributed income of the CFC in the hands of its domestic shareholders on a current basis.¹⁸⁵ However, where a country’s CFC rules exempt the application of the rules to a CFC that carries out substantive economic activities in the jurisdiction it is based in, such exemption does not normally apply if the CFC does not directly and regularly create, develop or substantially upgrade the intangible assets that gives rise to that income.¹⁸⁶

Source-based countries often apply withholding taxes on royalties paid by entities in their jurisdictions for the use of the intangible assets that are owned by an entity in another jurisdiction. Normally, an obligation is imposed on the entity in the source country to withhold a certain percentage of tax from the royalties paid to the non-resident and pay it over to the revenue.¹⁸⁷ However, in a double tax treaty context, article 12(1) of tax *treaties based on the OECD Model provides* that “royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State”. This implies that it is only the resident state of the beneficial owner of the royalties that may tax the royalties. The Commentary on Article 10 of the OECD Model¹⁸⁸ explains that the term “beneficial owner” does not cover a nominee or agent who is a treaty country resident if the person who has all the economic interest in, and all the control over, the property (the beneficial owner) is not also a resident. Furthermore, a conduit company cannot be regarded as a beneficial owner if, through the formal owner, it has, as a practical matter, very narrow powers, which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties (such as the shareholders of the conduit

172. Id., at paras. 169-172.

173. Id., at paras. 173-174.

174. Id., at paras. 152-153.

175. OECD, *Action Plan on BEPS*, *supra* n. 9, at p. 25.

176. E.L. Guruli, *International Taxation: Application of Source Rules to Income from Intangible Property*, 5 *Houston Bus. & Tax L. J.*, p. 206 (2005), available at <http://hbtj.org/wp-content/uploads/2021/10/Guruli.pdf>.

177. OECD, *Action 1 Final Report* (2015), *supra* n. 10, at para. 187.

178. European Commission, *Expert Group on Taxation of the Digital Economy* p. 3 (2014).

179. OECD, *Action 1 Final Report* (2015), *supra* n. 10, at paras. 159-160.

180. Id., at paras. 155-156.

181. Id., at para. 158.

182. Article 9(1) of the *OECD Model* (2017) and OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2022), para 6.1, Primary Sources IBFD [hereinafter the *Transfer Pricing Guidelines 2022*]. Chapter VI of OECD, *Transfer Pricing Guide-*

lines 2022, *supra* deals with intangibles. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2017), Primary Sources IBFD included revisions in light of the recommendations contained in OECD, *Action 8-10 Final Report* (2015), *supra* n. 13.

183. M. Markham, *Tax in a Changing World: The Transfer Pricing of Intangible Assets*, 40 *Tax Notes Intl.* 10, pp. 895-906 (2005).

184. UN, *Taxation of Intellectual Property Rights Taxation of Intellectual Property Rights and Other Intangibles: Issues for Developing Countries* p. 54 (UN 2015).

185. Olivier & Honiball, *supra* n. 132 and Arnold, *supra* n. 132, at p. 131.

186. Markham, *supra* n. 183, at p. 899 and Olivier & Honiball, *supra* n. 132, at p. 559.

187. Olivier & Honiball, *supra* n. 132, at pp. 362-363.

188. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 10* para. 12.1 (21 Nov. 2017), *Treaties & Models IBFD*.

company).¹⁸⁹ The OECD further explains that “beneficial ownership” means “the right to use and enjoy” the amount “unconstrained by a contractual or legal obligation to pass on the payment received to another person”.¹⁹⁰ Under article 12(3) of the OECD Model, the source state may tax the royalties if the beneficial owner of the royalties carries on business in that state through a PE situated therein and the right or property in respect of which the royalties are paid is effectively connected with such PE. Thus, for a source state to tax royalties in a treaty context, it must first of all be proved that the beneficial owner of the royalties carries on business in that country. However, proving beneficial ownership is very difficult in light of international cases such as *Velcro Canada Inc. v. The Queen* (2012)¹⁹¹ and *Prevost Car Inc. v. Her Majesty the Queen* (2008 and 2009).¹⁹² Even if the source state could prove that the beneficial owner is carrying on business in the state, article 12(3) of the OECD Model requires that the beneficial owner must have carried on business in the source through a PE situated therein and the right or property in respect of which the royalties are paid is effectively connected with such a PE. The PE concept as defined in article 5 of the OECD Model is designed to ensure that the business activities of a foreign enterprise are not taxed by a source state, unless that enterprise creates significant and substantial economic presence in that state.¹⁹³

Beyond these measures, countries have also enacted other specific anti-avoidance provisions to address the sophisticated tax avoidance schemes of MNEs. These include measures to prevent the abuse of tax treaties through treaty shopping,¹⁹⁴ measures to prevent excessive deductions of interest¹⁹⁵ and measures to prevent tax avoidance resulting from hybrid financial instruments.¹⁹⁶ However, as more

measures were adopted to curtail the new tax avoidance schemes, countries’ corporate tax systems became more complicated and uncoordinated, which opened up more loopholes for sophisticated tax avoidance schemes; and the cycle went on.

An example of a sophisticated MNE tax avoidance scheme that brought countries’ domestic anti-avoidance provisions and tax treaty provisions to no effect is the much publicized and notorious “double Irish Dutch sandwich” structure.¹⁹⁷ Highly digitized MNEs, like Google, Facebook, Microsoft Corp and Apple, used this structure to shift profits to low-tax jurisdictions, thereby keeping their global effective tax rates (ETRs) low.¹⁹⁸ As its name implies, the “double Irish Dutch sandwich” structure involves two companies incorporated in Ireland; the one an IP-Holding Company and the other an Operating Company. Sandwiched between them is a conduit company¹⁹⁹ incorporated in the Netherlands.²⁰⁰ The following is how the convoluted structure has been utilized to minimize the global tax exposure of giant digital MNEs based in the United States which operate in various countries.²⁰¹

To avoid high taxes in the United States, the first step in the structure is to ensure that the rights to exploit the parent company’s IP are held outside the United States. The US parent company would enter into a cost sharing agreement with an Irish IP-Holding Company for the future enhancement of the IP so that it would receive all the profits for the exploitation of the IP outside the United States. To ensure that the buy-in payment from the Irish IP-Holding Company does not trigger US transfer pricing rules,²⁰² the parent company makes sure that the IP is only partially developed at the time of transfer and that the risk associated with future earnings is very low. In this way, it becomes difficult to determine an arm’s-length price for the buy-in payment and the company was also able to avoid high US exit taxes.²⁰³ Google, for instance, set up a subsidiary in Ireland called Google Ireland Holdings which owns its search engine, advertising technology and

189. OECD, *Report on the Use of Base Companies* para. 14(b) (OECD 1987).

190. OECD, *Revised Proposals concerning the Meaning of “Beneficial Owner” in Articles 10, 11, and 12* (OECD 2012). See also paragraph 12.1 of the *OECD Model: Commentary on Article 10* (2017); paragraph 9.1 of the *OECD Model: Commentary on Article 11* (2017); and paragraph 4 of the *OECD Model: Commentary on Article 12* (2017).

191. See the decision of the Tax Court of Canada (TCC) in CA: TCC, 24 Feb. 2012, *Velcro Canada Inc. v. The Queen*, 2012 TCC 57, Case Law IBFD. The TCC considered the issue of beneficial ownership by reference to four elements that must be considered in determining whether the recipient is the beneficial owner: (i) possession (ii) use; (iii) risk and (iv) control.

192. See CA: TCC, 22 Apr. 2008, *Prevost Car Inc. v. Her Majesty the Queen*, 2004-2006(IT)G and 2004-4226(IT)G, 2008 TCC 231, Case Law IBFD, together with the subsequent decision of the Canadian Federal Court of Appeal (CFCA) in CA: CFCA, 26 Feb. 2009, *Prevost Car Inc. v. Her Majesty the Queen*, A-252-08, Case Law IBFD.

193. Vogel, *supra* n. 87, at p. 280, para. 4.

194. “Treaty shopping” refers to use of double tax treaties by the residents of a non-treaty country to obtain treaty benefits that are not supposed to be available to them. This is mainly done by interposing a “conduit company” in one of the contracting states so as to shift profits out of those states. See H. Becker & F.J. Wurm, *Treaty Shopping: An Emerging Tax Issue and its Present Status in Various Countries* p. 1 (Kluwer L. & Taxn. Publishers 1988) and R.L. Reinhold, *What is Tax Treaty Abuse? (Is Treaty Shopping an Outdated Concept?)*, 53 *Taxpayer*, 3, p. 673 (2000).

195. For example, thin capitalization schemes which entail the use of unusual proportions of loan to equity capital in order to gain tax advantages. See B. Lawrence, *Government Restrictions on International Corporate Finance (Thin Capitalization)*, 44 *Bull. Intl. Fiscal Docn.* 3, sec. 1, p. 118 (1990) and G. Richardson, D. Hanlon & L. Nethercott, *Thin Capitalization: An Anglo-American Comparison*, 24 *Intl. Tax J.*, 2, p. 36 (Spring 1998).

196. Hybrid financial instruments possess characteristics that are neither debt nor equity. This means that they may be classified differently

for tax purposes in different countries. This produces mismatches in tax outcomes that result in lower tax burdens for the parties involved, such as double non-taxation or long-term tax deferral. See J.A. Duncan, *General Report*, in *Tax treatment of hybrid financial instruments in cross border transactions*, International Fiscal Association (IFA), *Cahiers de droit fiscal international* vol. 85a, sec. 2. (IFA 2000), Books IBFD and G. Michiels et al., *Tax Treatment of Financial Instruments* p. 310 (Kluwer L. Intl. 1996).

197. J.R. Hines & E.M. Rice, *Fiscal Paradise: Foreign Tax Havens and American Business*, Q. J. Econ. (Feb. 1994)

198. UK: House of Lords Select Committee on Fiscal Affairs, *Tackling corporate tax avoidance in a global economy: is a new approach needed?*, HL Paper 48, p. 5 (31 July 2013), available at <https://publications.parliament.uk/pa/ld201314/ldselect/ldeconaf/48/48.pdf>.

199. A “conduit company” is an intermediary company with very narrow powers, which is used for holding assets or rights as an agent or nominee on behalf of another company. See Oguttu, *supra* n. 3, at p. 549.

200. E.D. Kleinbard, *Stateless Income*, 11 *Fla. Tax Rev.* 9, pp. 707-714 (2011) and J. Sandell, *The Double Irish and the Dutch Sandwich: How Some U.S. Companies Are Flummoxing the Tax Code*, 67 *Tax Notes Intl.* 9, pp. 867-878 (2012).

201. C. Fuest et al., *Profit Shifting and “Aggressive” Tax Planning by Multinational Firms: Issues and Options for Reform* ZEW, Centre for European Economic Research, Discussion Paper No. 13-078, p. 4 (2013), available at <http://ftp.zew.de/pub/zew-docs/dp/dp13078.pdf>.

202. Sec. 482 IRC.

203. Fuest et al., *supra* n. 201, at p. 5.

other intangible property. When a company in Europe, the Middle East or Africa purchases a search advert through Google, the money is sent to Google Ireland Holdings.²⁰⁴ Although the Irish IP-Holding Company is incorporated in Ireland, the structure ensures that it is managed and controlled in Bermuda (a tax haven) and, therefore, is tax resident there. This ensures that its earnings do not stay in Ireland.²⁰⁵ In terms of Irish tax law, a company is tax resident where its central management and control is located, not where it is incorporated. In Bermuda, this company is not subject to tax.²⁰⁶

The second step in the structure is to ensure that the rights to the IP of the Bermuda company are in turn licensed to a second Irish company (thus, the “double Irish”) – the Operating Company which is tax resident in Ireland. In the case of Google, its Dublin subsidiary (the operating company) is a fully owned subsidiary of the Google Ireland Holdings. The Irish Operating Company is used to provide advertising services and acts as the contractual partner of all non-US customers. Functions in the customers’ residence states, like the delivery of products or marketing activities are usually assigned to low-risk group companies. These group service providers work on a cost-plus basis, thus keeping the tax base in the country of final consumption low.²⁰⁷ For the profits derived from exploiting the IP licence; the second Irish Operating Company would have to pay royalties to the first Irish IP-Holding Company. This royalty income would be taxed at the Irish Corporate tax rate of 12.5%. However, since the first Irish IP-Holding company is tax resident in Bermuda, Irish tax on royalties derived is avoided.²⁰⁸ Although the profits from customer sales earned by the second Irish Operating Company would be subject to tax in Ireland, the tax base of the Operating Company is close to zero because it has to claim a tax deduction on royalties paid for the use of the IP held by and sub-licensed from the Irish IP-Holding Company. As Ireland only introduced transfer pricing rules in 2010, these rules did not apply to contracts and terms agreed on before 2010, so the second Irish Operating Company was able to erode the tax base in Ireland by claiming deductions for high royalty payments made to the Irish IP Holding Company.²⁰⁹

To avoid Irish withholding tax that would result if payments are made directly from the second Irish Operating Company (Google’s Dublin subsidiary) to the first Irish IP-Holding Company (tax resident in Bermuda), the third part of the scheme is effected – the Dutch sandwich. In this part of the scheme, a Dutch conduit company (for example, Google Netherlands Holdings BV) is inter-

posed between the two Irish companies.²¹⁰ This ensures that the royalties do not go directly to Bermuda, but they are routed through Netherlands because Irish tax law exempts certain royalties to companies in other EU Member States under the EU Interest and Royalties Directive (2003/49).²¹¹ The payments are, thus, sheltered in the Netherlands conduit company – a shell company which has no employees, in order to take advantage of generous tax laws there. Since the Netherlands does not impose withholding tax on any royalty payments, the tax liability of the conduit company in the Netherlands would consist only of a small fee payable for the use of the Dutch tax system.²¹² This set up ensures that the profits earned in the European Union can leave the European Union virtually untaxed. The Dutch Conduit company (Google Netherlands Holdings BV) then passes on the profits to the first Irish IP-Holding Company – tax resident in Bermuda.²¹³ Since in Bermuda the profits are not liable to corporate tax,²¹⁴ the profits can be kept there until they are repatriated to the US shareholders as dividends. This results in the circumvention of the US CFC legislation (Subpart F rules - which prevent tax deferral)²¹⁵ as the second Irish Operating Company (Google Dublin) is a fully owned subsidiary of the first Irish IP Holding Company (tax resident in Bermuda), which enables the company to make use of the US entity classification election (the “check-the-box rules”) to avoid the Subpart F rules.²¹⁶ The check-the-box rules ensure that the second Irish Operating Company (Google Dublin) is disregarded as a separate entity from its owner - the first Irish IP Holding Company (tax resident in Bermuda), and so the payments between the two Irish companies are ignored for US tax purposes.²¹⁷

This structure is the largest tax avoidance tool that has been used in history by US MNEs to build up untaxed offshore reserves of USD 1 trillion from 2004 to 2018.²¹⁸ Google avoided about USD 2 billion in worldwide income taxes in 2011 by shifting USD 9.8 billion in revenues into the Bermuda shell company using this structure.²¹⁹ Microsoft Corp used the same structure and saved at least USD 500 million in taxes each year by licensing its software in Europe, Middle East and Africa through its Irish subsidiary.²²⁰ In the aftermath of the 2007/08 global financial

204. J. Drucker, ‘Dutch Sandwich’ saves Google Billions in taxes, Bloomberg Businessweek (22 Oct. 2010), available at www.nbcnews.com/id/39784907/ns/business-us_business/t/dutch-sandwich-saves-google-billions-taxes/#.Xjih9C2B10s (accessed 24 June 2020).

205. Y. Wang, *Does a More Transparent International Tax Environment Provide the Same Outcomes as Transfer Pricing Would but in a Less Arbitrary Way?*, 30 *Austral. Tax Forum*, p. 272 (2015).

206. Pleune, *supra* n. 150, at p. 31.

207. Drucker, *supra* n. 204.

208. *Id.*

209. Fuest et al., *supra* n. 201, at p. 6.

210. J. Drucker, *Google 2.4% Rate Shows How \$60 Billion Is Lost to Tax Loopholes*, Bloomberg UK (21 Oct. 2010), available at www.bloomberg.com/news/2010-10-21/google-2-4-rate-shows-how-60-billion-u-s-revenue-lost-to-tax-loopholes.html/ (accessed 23 June 2020).

211. Council Directive 2003/49/EC of 3 June 2003 on a Common System of Taxation Applicable to Interest and Royalty Payments Made between Associated Companies of Different Member States, OJ L49 (2007), Primary Sources IBFD.

212. Drucker, *supra* n. 210.

213. Drucker, *supra* n. 204.

214. *Id.*

215. US: Tax Reform Act of 1986, sec. 956.

216. P.R. West, *Rethink Check the Box Subpart F*, *Taxes* pp. 36-37 (Mar. 2005).

217. Drucker, *supra* n. 204.

218. J.R Hines, *Treasure Islands*, 24 *J. Econ. Perspectives* 4, pp. 103-125 (2010).

219. Bloomberg, *How Google saved \$2 Billion income tax*, The Times of India (11 Dec. 2012), available at <http://timesofindia.indiatimes.com/tech/enterprise-it/strategy/How-Google-saved-2-billion-in-income-tax/articleshow/17567959.cms?referral=PM> (accessed 13 June 2020).

220. J. Mutti & H. Grubert, National Bureau of Economic Research, *International Trade in Services and Intangibles in the Era of Globalization*, in

crisis,²²¹ outrage spread across Europe and in the United States over corporate tax dodging using this structure. Governments in France, the United Kingdom, Italy and Australia embarked on probing the tax affairs of MNEs like Google so as to boost their revenue and budgetary deficits. In 2014, the European Commission (the “Commission”) embarked on an investigation of the use of this structure from 2004 to 2014, which forced Ireland to issue legislation in 2015 that led to the closure of the structure.²²² The legislation, which provides that a company incorporated in Ireland is to be treated as resident in Ireland for tax purposes, implied that MNEs would no longer be able to incorporate in Ireland without also being tax resident there.²²³ However, the Commission’s investigations in August 2016 showed that Apple, Google, Facebook and Pfizer still applied this structure; so the European Union gave these companies until January 2020 to close down the structures.²²⁴

The tax avoidance that resulted from these structures cannot be blamed on MNEs alone. Countries’ tax authorities knew about these structures but for decades there was no political will to address the problem as each country wanted to protect its own interests. It is only in the aftermath of the 2007/08 global financial crisis that the political will to address the matter was developed, propelled by increasing public outcry engineered by non-governmental organizations²²⁵ about MNEs paying little or no corporation tax in the countries in which they do business. Consequently, at the 2012 G20²²⁶ summit in Mexico, the national leaders explicitly referred to the need to prevent BEPS.²²⁷

This ushered in the so called BEPS 1.0 initiative whereby, at the behest of the G20, in February 2013, the OECD released an Action Plan to address BEPS.²²⁸ The OECD

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The Effect of Taxes on Royalties and the Migration of Intangible Assets Abroad pp. 111-137 (U. Chicago Press 2009).

- 221. Bloomberg, *supra* n. 219.
- 222. A. Barker, V. Boland & V. Houlder, *Brussels in Crackdown on Double Irish Tax Loophole*, Fin. Times (Oct. 2014).
- 223. The Irish Times, ‘Double Irish’ and ‘Dutch Sandwich’ saved Google \$3.7Bn in tax in 2016 (2 Jan. 2018), available at www.irishtimes.com/business/economy/double-irish-and-dutch-sandwich-saved-google-3-7bn-in-tax-in-2016-1.3343205 (accessed 23 June 2020).
- 224. European Commission, Commission Decision of 30.8.2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple (30 Aug. 2016), available at https://ec.europa.eu/competition/state_aid/cases/253200/253200_1851004_674_2.pdf.
- 225. Christian Aid, *Death and Taxes: The True Toll of Tax Dodging* pp. 21-23 (May 2008), available at www.christianaid.org.uk/images/deathandtaxes.pdf and Tax Justice Network (TJN), *Economic Crisis + Offshore*, available at www.taxjustice.net/cms/front_content.php?idcat=136 (accessed 6 June 2020).
- 226. The G20 is an international forum for the governments and central bank governors from 20 major economies. The members consist of European Union and 19 countries: Argentina, Australia, Brazil, Canada, China (People’s Rep.), France, Germany, India, Indonesia, Italy, Japan, Korea (Rep.), Mexico, Russia, Saudi Arabia, South Africa, Türkiye, the United Kingdom and the United States. The G20 was founded in 1999 with the aim of studying, reviewing, and promoting high-level discussion of policy issues pertaining to the promotion of international financial stability. For details, see Wikipedia, *G-20 Major Economies*, available at http://en.wikipedia.org/wiki/G-20_major_economies (accessed 8 Aug. 2019).
- 227. G20 Leaders, *Declaration Los Cabos Mexico* (2012), available at <http://www.g20.utoronto.ca/2012/2012-0619-loscabos.html> (accessed 24 Sept. 2022).
- 228. OECD, *Addressing BEPS*, *supra* n. 16, at p. 7.

acknowledged that BEPS has been enabled by the fact that the current international corporate taxation framework has not kept pace with the changing business environment.²²⁹ Thus, MNEs have been able to come up with structures which are technically legal but which take advantage of asymmetries in domestic and international tax rules.²³⁰ In 2015, the OECD issued 15 Reports with Action measures to address BEPS, which ensure that profits are taxed where economic activities generating the profits are performed and where value is created.²³¹ The OECD noted that most of the Action measures could be applied to address BEPS in the digital economy.²³² However, the OECD’s 2018 Interim Report on the Tax Challenges of the Digital Economy²³³ noted that although some MNEs had, in response to the BEPS measures, realigned their transactions with real economic activity, risks still remained.²³⁴ Highly digitalized MNEs can still have the legal ownership of their intangible assets held in low-tax jurisdictions where such legal ownership is subject to no or limited taxation.²³⁵ In addition, highly digitalized MNEs are still able to contractually allocate business risk to entities in low-tax jurisdictions in a way that does not reflect the actual conduct of the entities in the group. Although the intra-group contracts may reflect that the entity in the low-tax jurisdiction provides the capital for the development of the IP and that it contractually bears the financial risks associated with the activities carried out by the other entities²³⁶ in reality, there could be limited physical activity in the low-tax jurisdiction.²³⁷ In terms of the contract, the entity in the low-tax jurisdiction would be entitled to substantial amounts of income, while the other entities that actually carry out the activities would be awarded less than an arm’s-length compensation for their supposedly low risk functions.²³⁸ Because of these BEPS risks that still remain, the OECD realized that merely strengthening anti-avoidance provisions to address BEPS matters is not enough to address the tax challenges of the digital economy. Indeed, in Action 1 of the BEPS Report, the OECD noted that the digital economy poses broader tax challenges that go beyond BEPS matters, and that this would require the international community to come up with new rules for taxing the digital economy.²³⁹

This ushered in the so-called BEPS 2.0 initiative whereby, in January 2019, the OECD issued a Policy Note²⁴⁰ in which

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- 229. Id.
- 230. OECD, *Action Plan on BEPS*, *supra* n. 9, at p. 49.
- 231. OECD, *Addressing BEPS*, *supra* n. 16, at pp. 7-8.
- 232. OECD, *Action 1 Final Report* (2015), *supra* n. 10, at para. 208.
- 233. OECD, *2018 Interim Report*, *supra* n. 17, at p. 3.
- 234. Id.
- 235. OECD, *Action 1 Final Report* (2015), *supra* n. 10, at para. 187.
- 236. Id., at para. 192.
- 237. OECD, *Public Consultation Document Addressing the Tax Challenges of the Digitalisation of the Economy*, OECD/G20 Base Erosion and Profit Shifting Project para. 3 (OECD 2019), Primary Sources IBFD [hereinafter *Addressing the Tax Challenges of the Digitalisation of the Economy*].
- 238. OECD, *Action 1 Final Report* (2015), *supra* n. 10, at para. 230 and OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy*, *supra* n. 237, at para. 13.
- 239. OECD, *Action 1 Final Report* (2015), *supra* n. 10, at para. 248.
- 240. OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note* (OECD 2019).

it set out its Two-Pillar solution to resolve the challenges of the digital economy. A Public Consultation document on the Two Pillars was released in February 2019²⁴¹ and, on 12 October 2020, the Blueprints for Pillar One²⁴² and Pillar Two²⁴³ were issued. On 8 October 2021, 136 members of the OECD Inclusive Framework entered a political agreement on the Two-Pillar solution to address the tax challenges arising from the digitalization of the economy.²⁴⁴ A detailed explanation of the operation of the Pillar One and Pillar Two (which can be consulted in other articles²⁴⁵) is beyond the scope of this article. It suffices to point out briefly the following in order to reinforce the focus of this article.

Pillar One aimed to ensure a fairer distribution of profits and taxing rights among countries with regard to large MNEs.²⁴⁶ It introduced a new nexus rule that gives jurisdictions in which goods or services are supplied or where consumers are located (market jurisdictions) the right to tax a portion of the profits (dubbed Amount A) of large and highly profitable enterprises (covered groups), whether or not such enterprises have a physical presence in that market jurisdiction.²⁴⁷ In terms of the draft Pillar One Model rules which were issued on 4 February 2022,²⁴⁸ the nexus threshold for covered groups will be EUR 1 million for jurisdictions with an annual gross domestic product (GDP) equal to or greater than EUR 40 billion and EUR 250 thousand for jurisdictions with an annual GDP of less than EUR 40 billion.²⁴⁹ Revenue sourcing rules are used to determine where revenue arises for purposes of Amount A. The draft Model rules set out categories of revenue, which must be sourced on a transaction-by-transaction basis. A fixed return for routine baseline marketing and distribution activities taking place in a market jurisdiction (dubbed Amount B) would continue to be allocated to market jurisdictions using the ALP where it works relatively well.²⁵⁰ Retaining the ALP in the rules is, however, concerning, since it has been a major contributor to BEPS by MNEs and would continue perpetuating the status

quo.²⁵¹ In Action 1 of the BEPS Report, the OECD indicated that the international community was to come up with new rules for taxing the digital economy.²⁵² Nevertheless, in the guise of limiting administrative complexity, the new rules that have been developed only apply to the largest of MNEs, and yet, in a globalized economy, there are very few businesses that are not operating digitally. This means that for the small to medium enterprises that do not fall in the scope of the new nexus rules, the current rules which have been historically circumvented by MNEs (albeit patched up by the 15 Action BEPS measures) will continue to operate. For all the time that resources and unprecedented political will among countries to change the current century-old international tax rules have existed in the hope that new rules fit for the 21st century would be developed, the BEPS 2.0 initiative has been largely a lost opportunity.

Pillar Two is intended to address the remaining BEPS issues by setting out measures to prevent harmful tax competition and the “race to the bottom”²⁵³ of offering the lowest corporate tax rates by offering tax incentives to lure investors.²⁵⁴ On 20 December 2021, the OECD published the Pillar Two Model rules, which set a global minimum corporate tax rate of 15% to assist countries in the implementation of the new international tax rules to put a floor on tax competition on corporate income tax.²⁵⁵ The Pillar Two Model rules provide countries a right to “tax back” by imposing a top-up tax on profits arising in a jurisdiction where the ETR is below the minimum rate.²⁵⁶ The rules apply to MNE groups that have annual revenue of EUR 750 million or more in the consolidated financial statements of the ultimate parent entity in at least two of the four fiscal years immediately preceding the tested fiscal year.²⁵⁷ The implementing date of the Pillar Two Model rules was initially set for 2023²⁵⁸ and then was extended to start from 2024 onwards.²⁵⁹ The top-up

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241. OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy*, *supra* n. 237, at para. 3.
242. OECD/G20 BEPS Project, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint* para. 24 (OECD Oct. 2020) [hereinafter the *Pillar One Blueprint*].
243. OECD/G20 BEPS Project, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint* (OECD Oct. 2020).
244. OECD/G20 BEPS Project, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* p. 3 (OECD Oct. 2021), available at www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf [hereinafter the *Two-Pillar Solution*].
245. A.W. Oguttu, *A Critique from a Developing Country Perspective of the Proposals to Tax the Digital Economy*, 12 *World Tax J.* (2020), *Journal Articles & Opinion Pieces* IBFD.
246. OECD/G20 BEPS Project, *Two-Pillar Solution*, *supra* n. 244, at p. 4.
247. OECD, *Public Consultation Document, Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Source* p. 2 (OECD 4 Feb. 2022) at 2, available at www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-nexus-revenue-sourcing.pdf.
248. *Id.*
249. *Id.*, at p. 5.
250. OECD/G20 BEPS Project, *Pillar One Blueprint*, *supra* n. 242, at para. 24.

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251. The BEPS Monitoring Group, *International Corporate Tax Reform and the ‘New Taxing Right’* p. 6 (11 Sept. 2019), available at www.bepsmonitoringgroup.org/news/2019/9/10/international-corporate-tax-reform-and-the-new-taxing-right-b4ajr (accessed 25 Apr. 2022).
252. OECD, *Action 1 Final Report* (2015), *supra* n. 10, at para. 248.
253. OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy* para. 53 (OECD 31 May 2019), available at www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.htm (accessed 8 Sept. 2022).
254. P Biggs, *Tax Incentives to Attract FDI*, Meeting of Experts on “FDI, Technology and Competitiveness”: A conference convened in honour of Sanjaya Lall, UNCTAD, Palais des Nations, Geneva (8-9 Mar. 2007), available at <https://vi.unctad.org/fdiCD/sessions/Session3/Biggs.pdf>.
255. OECD, *OECD Releases Pillar Two model rules for domestic implementation of 15% global minimum tax* (OECD 20 Dec. 2021), available at www.oecd.org/tax/beps/oecd-releases-pillar-two-model-rules-for-domestic-implementation-of-15-percent-global-minimum-tax.htm (accessed 4 Feb. 2022) [hereinafter *OECD Releases Pillar Two Model rules*].
256. *Id.*
257. OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, art. 1.1. (OECD 2012), *Primary Sources* IBFD.
258. OECD, *OECD Releases Pillar Two Model rules*, *supra* n. 255.
259. D. Burns, *OECD chief sees global digital tax deal pushed back to 2024*, Reuters (24 May 2022), available at www.reuters.com/markets/oecd-chief-quietly-optimistic-about-eu-global-minimum-tax-deal-approval-2022-05-24/ (accessed 31 May 2022) and The Guardian, *Historic OECD*

tax for the Pillar Two Model rules will have an impact on business investment decisions, especially for in scope MNEs that benefit from tax incentives where their ETR is below 15%. Although not all investment decisions are tax motivated, some MNEs may still find ways to restructure by coming up with new strategies to avoid paying the top-up tax. There are, however, some aspects of the Pillar Two Model rules that may make it practically difficult for MNEs to circumvent. For example, the “substance-based income exclusion” to the Model rules²⁶⁰ may be difficult to manipulate as sending employees to low-tax jurisdictions to meet the substance requirements may become cumbersome for employees of MNEs to comply with due to the travelling constraints. Indeed, some argue that the global minimum tax may, in the future, make establishing entities in low-tax jurisdictions to be for other reasons and not necessarily tax, as many MNEs have come to realize that the days of moving to a jurisdiction for tax reasons are long gone.

MNEs and their tax advisers have been at the forefront of responding to calls for comments on the Public Consultation Documents that are regularly tabled by the OECD on the development of the new rules (which they are by all means entitled to as stakeholders in the international tax community).²⁶¹ However, it is anticipated that many of them (as they have done historically) are already a step ahead in finding ways to circumvent the rules.²⁶² The Business and Industry Advisory Committee to the OECD which comprises of tax professionals who are employed by MNEs has been heavily involved in the developments of the rules and have expressed concerns about the complexity of the rules and the adminis-

trative problems they would pose.²⁶³ This concern is quite ironic as MNE BEPS schemes have historically thrived on exploiting the loopholes in the complexity in tax legislation to reduce their tax liabilities.²⁶⁴ MNEs have been quick to raise concerns about the technical aspects of the Model rules, which could result in double taxation and reduced global income.²⁶⁵ Particular concern was raised about the possibility of double taxation in cases in which the Pillar Two Model rules apply a top-up tax in circumstances where there is no net income for a jurisdiction to apply the rules to.²⁶⁶

Countries should take note that even though the comments of the tax advisers of MNEs may provide valuable input due to their expert tax knowledge and practical experience, the views they express are largely directed to a preferred position that protects the interests of MNEs.²⁶⁷ It should also be kept in mind that it is the tax advisers of the MNEs that engineered the sophisticated tax avoidance schemes that took advantage of the current international tax rules.²⁶⁸ It is common knowledge that the “revolving door” of tax experts employed by governments moving to the private sector (and back) means that tax experts working for MNEs often have insider knowledge of the loopholes in the laws, which enables them to keep a step ahead in coming up with schemes that beat the system. It is, therefore, important that the comments provided by the MNEs and their advisers on the structure of the new tax system should be cautiously considered. Care should be taken to ensure that the unbiased views tabled by other stakeholders, such as academics, non-governmental organizations and civil society are given due attention in the development of the new rules and that a full consensus of all stakeholders is reached on all aspects of the new rules.²⁶⁹

It is also common knowledge that MNEs (most of which are based in developed countries) have historically lobbied their countries to push for international tax laws that favour them.²⁷⁰ These countries have benefited from the

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international tax deal pushed back to 2024 (24 May 2022), available at www.theguardian.com/business/live/2022/may/24/davos-day-2-world-food-crisis-imf-ec-nato-ukraine-pandemic-live-update?filterKeyEvents=false&page=with:block-628cbe7f8f08e646defacd81#block-628cbe7f8f08e646defacd81 (accesses 31 May 2022).
260. OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD/G20 Base Erosion and Profit Shifting Project, art. 5.3.2. (OECD 14 March 2022), Primary Sources IBFD.
261. International Chamber of Commerce, *Comments on OECD Public Consultation Document on The Global Anti-Base Erosion (Globe) Proposal Under Pillar Two: Addressing The Tax Challenges of The Digitalisation of The Economy* (Nov. 2019), available at <https://iccwbo.org/content/uploads/sites/3/2020/12/icc-comments-on-oecd-public-consultation-document.pdf> (accessed 25 Sept. 2022); KPMG, *Comments on OECD’s Global Anti-Base Erosion (GloBE) Proposal under Pillar Two* (4 Dec. 2019), available at <https://tax.kpmg.us/taxnewsflash/taxnewsflash-transfer-pricing/tnf-kpmg-report-comments-oecd-globe-proposal-pillar-two.html> (accessed 25 Sept. 2022); PwC, *Comment Letter in Response to OECD Consultation Paper on the Unified Approach under Pillar 1* (12 Nov. 2019) 11, available at www.pwc.com/us/en/tax-services/publications/insights/assets/OECD-Pillar-1-Paper-PwC-Response-Final.pdf; Deloitte, *OECD Pillar Two – Global Minimum Tax* (2022), available at www2.deloitte.com/global/en/pages/tax/articles/oecd-pillar-two.html (accessed 1 Aug. 2022); and EY, *OECD Releases Commentary and illustrative examples on Pillar Two Model Rules* (21 Mar. 2022), available at www.ey.com/en_gl/tax-alerts/oecd-releases-commentary-and-illustrative-examples-on-pillar-two-model-rules (accessed 22 Mar. 2022).
262. Deloitte, *Your Move in the right direction: Investing in Ireland* (2017), available at www2.deloitte.com/content/dam/Deloitte/ie/Documents/Tax/IE_T_invest_in_ireland_0517.pdf.

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263. The Business and Industry Advisory Committee (BIAC), *Letter to OECD Working Part II Regarding the 20th December 2021 Pillar Two Model Rules*, of 6 January 2022; Danish Mehboob *BIAC slams OECD model rules on pillar two for several issues* (14 Jan. 2022), available at <https://www.internationaltaxreview.com/article/2a6aafin5m44msd7au2v4/biac-slams-oecd-model-rules-on-pillar-two-for-several-issues> (accessed 25 Sept. 2022).
264. Binh Tran-Nam, A.W. Oguttu & K. Mandy, *Overview of tax complexity and tax simplification: A critical review of concepts and issues*, in *Tax Simplification an African Perspective* p. 26 (C. Evans, R. Franzsen & E. Stack eds., Pulp 2019).
265. BIAC, *supra* n. 263.
266. In this regard, BIAC, *supra* n. 263 refers to article 4.1.5 of the Pillar Two Model rules.
267. A. Christians, *OECD Secretariat’s Unified Approach: How to get things on a truly Equal Footing*, International Centre for Tax and Development (5 Nov. 2019), available at www.ictd.ac/blog/oecd-secretariat-unified-approach-equal-footing/ (accessed 28 Aug. 2022).
268. A.W. Oguttu, *Exposing and Curtailing Secret Offshore Tax Shelters: The Tools and the Enablers: A Call for Vigilance in South Africa*, 54 *Comp. & Intl. L. J. S. Afr.* 1, pp. 30-58 (2011).
269. PwC, *Comment Letter in Response to OECD Consultation Paper on the Unified Approach under Pillar 1*, *supra* n. 261.
270. UNCTAD, *Transnational Corporations: Investment and Development*, 25 Special Issue on Investment and International Taxation 3, p. 5 (UN 2018)

practices of their MNEs at the expense of other countries.²⁷¹ As the new international tax rules are being deliberated upon, it is clear that the key point of contention in the taxation of the digital economy is mainly about the United States trying to protect its digital companies²⁷² and Europe's desire to tax the United State's digital companies more than is permitted under the current rules.²⁷³ These dynamics may derail the process and inadvertently benefit MNEs. It is, therefore, important that the broader international tax community takes a stand not to encourage an international tax system that protects only a few countries' interests.²⁷⁴

7. Conclusions and Recommendations

This article has traced the development of MNEs through the centuries and it has shown that MNEs have been the drivers of international trade that has fostered the interconnectedness of world economies. The article shows that through the decades countries have enacted domestic and international tax laws to ensure that MNEs contribute to the economic development of the countries they transact in. However, MNEs kept devising tax avoidance schemes that took advantage of the loopholes in the tax laws. This cycle has been going on with MNEs always a step ahead. Such a trend has been enabled by the fact that the international tax laws have not kept pace with new business models.

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271. E. Stikeman, *Towards a Level Playing Field: Regulating Corporate Vehicles in Cross Border Transactions: A Review Commissioned by the International Tax and Investment Organisation and the Society of Trust and Estate Practitioners* pp. 15-16 (Stikeman Elliot 2002) and R.S. Avi-Yohan, *Prepared Testimony of Reuven S. Avi-Yohan, Irwin I Cohn Professor of Law, University of Michigan Law School before the US Senate Permanent Subcommittee on Investigations, Hearing on Offshore Transactions* para. E (1 Aug. 2006), available at <https://www.hsgac.senate.gov/imo/media/doc/STMTAviYonahUofMI.pdf> (accessed 25 Sept. 2022).
272. US: Office of the US Trade Representative (USTR), Section 301 Investigation Report on France's Digital Services Tax pp. 76-77 (2 Dec. 2019) and USTR Press Notice, Conclusion of USTR's Investigation Under Section 301 into France's Digital Services Tax (2 Dec. 2019).
273. Christians, *supra* n. 267.
274. T. Dagan, *The Costs of International Tax Cooperation*, Bar Ilan University Law School, Working Paper No. 1-03 (2003) 8, available at <https://silo.tips/download/the-costs-of-international-tax-cooperation> (accessed 25 Sept. 2022).

Developing new international tax rules that are in tune with the digital economy is a step in the right direction to prevent modern tax avoidance schemes. However, for the new international tax rules to be effective in preventing tax avoidance, a complete overhaul of the current system should have been undertaken. Leaving the physical presence tests and the ALP (the two main aspects of the current international tax system which have been the main causes of tax avoidance schemes) to keep applying to the majority of MNEs (which are out of scope of the new rules – that only apply to a very small number of the largest MNEs) is not helpful.²⁷⁵ MNEs stand to benefit more if the current tax system continues to apply at large as they would maintain their tax advantaged positions and save them the costs of having to roll back the structures already in place. This would also reduce the compliance burdens of having to comply with a whole new set of rules.

It is, therefore, important that the process of changing the century old international tax rules should not be rushed. If the rules developed are not well thought through, this will create uncoordinated provisions that will open up loopholes for further tax arbitrage by MNEs. It would be absurd if, after a few years, countries realize that the new rules did little to change the status quo and that they “ultimately represent a little more than an incremental improvement (if at all) of the current international tax order”.²⁷⁶ Even though the new international tax rules may not eradicate all MNE BEPS schemes, effort should be taken to ensure that they are not given the latitude to maintain the existing state of affairs. This requires that the rules should not be set in stone, but that they should be reviewed and modified regularly to address unforeseen loopholes that could be manipulated by MNEs.²⁷⁷

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275. The BEPS Monitoring Group, *International Corporate Tax Reform and the New Taxing Right* p. 6 (11 Sept. 2019), available at www.bepsmonitoringgroup.org/news/2019/9/10/international-corporate-tax-reform-and-the-new-taxing-right-b4ajr (accessed 30 Dec. 2019).
276. Christians, *supra* n. 267.
277. African Tax Administration Forum (ATAF), *A new era of international taxation rules – What does this mean for Africa?* (8 Oct. 2021), available at www.ataftax.org/a-new-era-of-international-taxation-rules-what-does-this-mean-for-africa (accessed 18 Aug. 2022).