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by Hugh J. Ault

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VIEWPOINTS

Some Reflections on the OECD and the Sources of International Tax Principles

by Hugh J. Ault

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As we all know, the basic architecture of the existing international systems goes back to the work of the League of Nations in the 1920s and I don't need to repeat that familiar history here. From that seminal work grew the structure of the tax principles that we know today: residence taxation, permanent establishments, reduced source taxation, credit and exemption methods for relief of still existing double taxation, and the like. But to some extent, these developments have been one-sided. I think there is one important aspect of the early work that has been neglected. I quote a key part from the 1927 report:

> From the very outset, [the drafters of the model convention] realized the necessity of dealing with the questions of tax evasion and double taxation in co-ordination with each other. It is highly desirable that States should come to an agreement with a view to ensuring that a taxpayer shall not be taxed on the same income by a number of different countries, and it seems equally desirable that such international cooperation should prevent certain incomes from escaping taxation altogether. *The most elementary and undisputed principles of fiscal justice, therefore, required that the experts should devise a scheme whereby all incomes would be taxed once and only once.*[1] [Emphasis added.]

It is fair to say that most of the effort in the ensuing years has been focused more on ensuring the relief of double taxation than making sure that double nontaxation does not take place. There are many reasons why things have developed this way, not the least of which is that for tax competition reasons some countries were happy to see structures that reduced the tax burden on their multinational enterprises in their activities abroad, and facilitating double nontaxation was part of that effort.

In 1998 the OECD released a report on harmful tax competition that signaled an important change of focus in international cooperation efforts.[2] The report directly or indirectly raised three distinct problems related to double nontaxation or reduced or nominal taxation on international income:

- tax evasion;
- tax avoidance; and
- tax subsidies and ''substantive'' tax competition.

A description of the history of the 1998 report would be a separate story in itself, full of political intrigue, broken promises, and the like. I will simply say that the most concrete results of that work have been in the area of tax evasion. Events, political pressure, people such as Heinrich Kieber and Bradley Birkenfeld, and the recent International Consortium of Investigative Journalists (ICIJ) data dump have now made the cross-border exchange of tax information increasingly a reality. After the Foreign Account Tax Compliance Act developments in the U.S. and the recent statements by the G-20 and the EU, it is only a question of time — and not much time in my view — before automatic exchange of information becomes the international

[1]Report prepared by the Committee of Experts on Double Taxation and Tax Evasion (League of Nations Publications, 1927), p. 23.

[2]*See* http://www.oecd.org/tax/transparency/44430243.pdf.

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norm. The technical work to implement such automatic exchange has been developed by the OECD and now the political will to put it into effect seems to be here as well.

On the second strand of the 1998 report, it now seems that the time has come for greater international cooperation in the area of tax avoidance in the form of the OECD's base erosion and profit shifting (BEPS) project and that is what I would like to focus on today. I will also touch on possible work concerning some forms of tax subsidies and tax competition, although I am more skeptical that quick progress can be made in that area.

If you have been reading the papers or watching TV in the last few months, you have undoubtedly seen reports about MNEs paying little or no effective taxes on their worldwide profits. Starbucks, Amazon, Google, GE, and other, non-U.S.-based companies have been identified as having very low effective tax rates. And this is happening at a time when countries are enacting austerity programs, facing budget deficits, and raising VAT rates on ordinary consumers. Not surprisingly, this has caught the attention of politicians. At the G-20 finance ministers meeting in Los Cabos, Mexico, in June 2012, the final G-20 communiqué, after discussing the OECD work on exchange of information, stated:

> We reiterate the need to prevent base erosion and profit shifting and we will follow with attention the ongoing work of the OECD in this area.

This was taken as a clear political mandate for the OECD to analyze the issues raised by BEPS, and after some urgent effort, the OECD published in January a note titled ''Addressing Base Erosion and Profit Shifting.'' Recall that it took the OECD 10 years to develop some changes in article 7 of the model convention dealing with the allocation of profits between a head office and a PE, so this BEPS work is really going at a rapid pace. The BEPS report was presented to the G-20 finance ministers meeting in Moscow in February of this year and was noted in the communiqué as follows:

> In the tax area, we welcome the OECD report on addressing base erosion and profit shifting and acknowledge that an important part of fiscal sustainability is securing our revenue bases. We are determined to develop measures to address base erosion and profit shifting, take necessary collective actions and look forward to the comprehensive action plan the OECD will present to us in July.

This was followed by a statement in the *Financial Times* by the Conservative U.K. chancellor of the Exchequer, the Socialist finance minister of France, and the center-right German finance minister, which said:

> Some multinationals are exploiting the transfer pricing or treaty rules to shift profits to places with no or low taxation, allowing them to pay as little as 5 percent in corporate taxes while smaller businesses are paying up to 30 percent. This distorts competition, giving larger companies an advantage over smaller, more domestic companies. In this difficult economic climate, it cannot be right that larger companies can avoid paying tax, with families and small businesses ending up paying more.

Note several things here:

- While concerns about BEPS appeared in the European and OECD political discourse increasingly in 2012, these concerns have been discussed for some time in the U.S. The main focus of BEPS concerns in the U.S. has been the problem of U.S.-developed intangibles that are transferred to tax haven holding companies, which is only part of the much wider range of BEPS issues identified by the OECD in its report.
- Also, the OECD had a mandate from the G-20, whose members include the BRICS countries (Brazil, Russia, India, China, and South Africa), which often disagree with OECD tax policies; the United States, which often goes its own way; and from European finance ministers from across the political spectrum, who generally don't agree on anything but agree on the need for change and giving a timetable to the OECD to produce this work. So what is going to happen?

Key Pressure Points

The BEPS report presented to the G-20 identifies six ''key pressure points'' that are involved in corporations reducing their tax rates.

Hybrid Mismatch Arrangements and Tax Arbitrage

First are hybrid mismatch arrangements and tax arbitrage. A classic example of tax arbitrage involves creating instruments that generate deductible payments in one jurisdiction but are treated as nontaxable receipts in the other jurisdiction. This technique involves structuring an instrument that would be classified as debt in one country and generate deductible interest payments, but the payment would be treated as an exempt participation dividend in the other country and could be received tax free. Another example would be a repo agreement in which the two countries treat different taxpayers as the owner of the underlying obligation with correspondingly different tax treatment.

A possible solution to some of these problems would be to develop further some of the ideas in the OECD partnership report[3] dealing with qualification, conflicts. You will recall that in the partnership report, the basic approach to deal with mismatches in the

[3]''The Application of the OECD Model Tax Convention to Partnerships'' (OECD, 1999).

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treatment of partnerships was for the source country, from which the partnership derived income, to look at the treatment in the residence country of the partnership (where it can claim to be a treaty resident) or of the partners. If the partnership was treated as transparent by the country in which it was established and the partners were not themselves treaty residents, then treaty benefits would not be granted, even if under the laws of the source country the foreign partnership would constitute the relevant taxpayer. The partnership report also proposed the converse principle to deal with conflicts of qualification: In that case, it would be the country of residence that would look at the treaty characterization of income in the source country in order to determine whether and how it should provide relief of double taxation on that income. Similar principles could be developed and applied to arbitrage situations. For example, the country of source would not give a deduction if the payment were not taxed in the country of residence. A similar approach could be applied to the granting of treaty benefits. Or, to ensure taxation from the perspective of the residence country in which income was not subject to tax in the source country, something like the so-called switchover clauses (found in some tax treaties and in article 23A(4), which the partnership report added to the OECD model) could be applied; these move from the exemption method to the credit method in the recipient country and thus ensure one level of tax.

Such anti-arbitrage principles would also deal with the use of entity classification differences; in particular, the U.S. check-the-box rules, which allow an organization that is treated as an entity under the laws of a foreign jurisdiction to be transparent under U.S. rules, thus providing a vehicle for earnings stripping that does not involve U.S. CFC rules since from the U.S. point of view the payments that reduce the foreign base are simply tax-neutral intracompany transfers.

Digital Goods and Services

The report also focuses on the application of treaty concepts to profits derived from the delivery of digital goods and services. Amazon and other Internet sellers have been in the spotlight, and I recommend that you look on YouTube for the U.K. Public Accounts Committee hearings in which the Amazon representative tried in vain to explain to the parliamentarians why Amazon had millions of sales in the U.K. but paid no tax.[4] The technical answer is quite clear: Amazon did not have a PE under current principles since there was no fixed base or dependent agent in the article 5 sense and hence the U.K. as simply the country of final sale had no right to tax. But of course the spotlight on Internet sellers raises the question of whether the traditional PE threshold is still appropriate. For example, one could imagine a solution in which for Internet sales, the existence of a warehouse or stock of goods could be enough to constitute a PE. While for a ''normal'' seller a warehouse is only ''ancillary or preparatory'' to its activities in the country, for an Internet seller the local activities perform a different function, which could justify taxation. Similar issues are raised by the use of so-called *commissionaire* arrangements, in which under civil law the agent does not technically bind the principal and thus avoids dependent agent status. This allows significant sales in a jurisdiction with no taxable presence under current rules.

Intragroup Financial Transactions

The third pressure point is the tax treatment of intragroup financial transactions — generating interest deductions in a high-tax jurisdiction with corresponding receipts by a related party in a low-tax jurisdiction. Some possible solutions would be for the source country to limit the interest deduction generally, as in the limitation on interest deductions (*zinsschranke*) you have in Germany, or to deny deductions for payments going to no-tax or low-tax jurisdictions. An ingenious proposal had been made in this context to switch from the deduction of related-party interest payments to a credit in the paying country at the rate of tax paid on the interest by the interest recipient. Thus, a payment to a fully taxed domestic related party would get a full credit, which is the economic equivalent of a full deduction, but for a payment to a related company in a tax haven, where no tax is paid, there would be no credit — the equivalent of a denial of the deduction. There are other possibilities. Some have made proposals for the worldwide allocation of intragroup interest expenses, based on a key of assets in each jurisdiction. This would prevent ''loading'' interest expense in high-tax jurisdictions and transferring interest income to low-tax jurisdictions. More far-reaching proposals involve rethinking the corporate tax structure to eliminate the difference between the treatment of interest and dividend payments. These broader ACE and CBIT proposals may also be involved in the BEPS project or in possible future work.

Transfer Pricing

Transfer pricing is of course recognized as a pressure point. The OECD is working on modifications of the transfer pricing guidelines to develop rules on the treatment of intangibles. A discussion draft was issued recently that tries to put returns from intangibles into the jurisdictions where the real economic activities are occurring and prevent the shifting of profits to offshore companies where no real activity is undertaken. But of course drawing the lines in this area is easier said than done. Is an intellectual property (IP) holding company that is used to centralize IP operations for a group but that has few employees and no role in the development of the intangibles or their later expansion entitled to a share of the intangible related return? Does a low-risk distributor that develops the local market create marketing intangibles that entitles it to more than a resale

[4] *See* http://www.youtube.com/watch?v=3TeZlt3dRig.

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minus return? How should location-related savings generated by lower wage and cost saving because of lax regulations be allocated? Are they simply market conditions, like sunshine in a tropical island, or do they represent an element of value for which the local company should be compensated? The work on the discussion draft is quite advanced but the BEPS project may give it a different focus and perhaps a mandate to make more fundamental modifications in existing principles. For example, contractual shifting of risk within a group is generally respected in determining the appropriate transfer price, but from a broader perspective, the group as a whole in the form of its shareholders bears the actual economic risk and not any individual company. Should risk be such an important factor in determining the appropriate transfer price? There are many other similar questions that the BEPS report highlights.

Antiavoidance Measures

The report also identifies the effectiveness (or ineffectiveness) of antiavoidance measures to prevent base erosion and profit shifting. Here there are a number of different structures. Some countries have a general antiavoidance rule, which allows the tax authorities to ignore or restructure a transaction that can't be justified economically. How successful these rules are depends in large part on how receptive the domestic courts are to teleologically based methods of interpretation. There are also more narrowly focused antiavoidance rules like the limitation on benefits rules in some treaties, which try to prevent treaty shopping, or the beneficial ownership provisions of many treaties, which may limit the right to claim treaty benefits.

But the most important antiavoidance rules in this area are the controlled foreign corporation rules, which tax the income of some foreign corporations to the domestic shareholders directly when earned, thus eliminating the ability to defer or exempt from tax the profits of the offshore company. These rules can prevent the shifting of profits by bringing the profits back into the domestic system of the residence country — or by taxing directly base eroding payments that the foreign company has received from a related party.

Here, however, there is a certain irony, since many countries have intentionally weakened their CFC rules to improve the alleged competitiveness of their MNEs in foreign markets or to attract companies' headquarters to their jurisdictions, as has been the case in the U.K., despite Prime Minister David Cameron's complaints in Davos, Switzerland, about low-taxed MNEs. Also, some countries like the U.S. have been complicit in structuring their own CFC rules to keep the domestic tax base but in effect encouraging base erosion by U.S. companies operating in other jurisdictions, thus lowering the U.S. companies' overall effective tax rate and strengthening their competitive position in foreign markets. If the BEPS project is to achieve some kind of agreement on the appropriate reach of CFC rules, these basic tax competition questions must be faced.

Preferential Regimes

Finally (and I am now getting back to the issue of tax subsidies), the report focuses on the availability of preferential regimes for some activities to attract investment. One would think that the previous work on harmful tax competition by both the OECD and the EU would have made this less of an issue. The current debate on patent box regimes, however, shows that the issue is still very much present, even in the EU, and I will return to this question later.

Looked at somewhat differently, companies have four basic strategies to reduce the tax burden on international income:

- minimizing profits taxation in the source country by avoiding source country taxing jurisdiction or through generating deductible payments to related parties;
- reducing or eliminating withholding tax in the source country by taking advantage of treaty rules and treaty shopping;
- ensuring low or no taxation in the recipient jurisdiction by shifting profits to subsidiaries in tax havens or low-tax jurisdictions; and
- finally, ensuring that there is no current taxation in the parent country jurisdiction through avoiding the application of CFC rules.

One important thing to keep in mind is that most of these techniques and structures for reducing or eliminating corporate tax involve not direct bilateral relations between two countries but generally the use of an intermediary or third-country company interposed in between the residence company and the source country, typically located in a tax haven or a low-tax jurisdiction. One of the challenges in BEPS is to try to extend principles that have been developed in bilateral relationships to deal adequately with situations that are trilateral.

So consider the following case.

R Co., resident in state R, transfers intangibles that it has developed, often with the use of subsidies for research and development in state R, to an intermediary company, I Co., based in a tax haven. I Co. then licenses the intangibles to related company S, which uses the intangibles to earn profits in state S, and deducts the payments to I Co. Thus, the profits are shifted from R Co. to I Co. through the manipulation of the transfer pricing rules, and the tax base of state S is eroded by the deductible payments to I Co., resulting in income that is not taxed anywhere, which some have begun to refer to as ''stateless'' income. What to do? A number of the techniques described above could be applied to this situation. State R could prevent the shifting by applying its CFC rules to I Co. and tax directly the income of I Co. to R Co. Or state R could

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ignore the transaction under its domestic GAAR and also tax the income directly to R Co. and not I Co. Or state S could deny a deduction for the license payments under its domestic rules which might limit the deductibility of payments to low-tax jurisdictions.

Now suppose state R is the U.S., I Co. is located in Ireland or the Netherlands, and state S is Germany. Treaty rules may restrict the ability of state S to deny deductions under nondiscrimination principles in article 24. Under at least some interpretations of the treaty, there may also be a limit on the ability of state R in some circumstances to apply its CFC rules, and if state R and the state in which I Co. is located are EU countries, the European Court of Justice decisions limiting CFC application to wholly artificial transactions may also limit CFC application. Similarly, some courts do not adopt the OECD position that domestic anti-avoidance rules like GAAR apply to treaty situations and these courts would not allow the tax authorities to ignore the existence of I Co. as long as it technically meets the definition of a treaty resident. So there is much work to be done in evaluating the extent to which treaty rules need to be modified to deal effectively with the problems identified in the BEPS project.

Now in a third case, assume state R is the U.S., I Co. is located in a tax haven, and state S is India. There is no treaty between the U.S. and the state in which I Co. is located, so the U.S. can apply its CFC rules without limitation to tax the royalty payments received by I Co. And similarly there is no treaty between India and the state in which I Co. is located so India can deny deductions for the royalty payments to I Co. without any concern about nondiscrimination complaints. But now, rather than there being double nontaxation of I Co.'s profits, there is double taxation by both the real residence country and the real source country. So there would presumably be a better place if both the U.S. and India could agree on who should now tax this income that was previously not subject to tax anywhere.

But this in turn raises some fundamental issues about the allocation of taxing rights between source and residence countries. In the bilateral relations between India and the U.S., as is well known, there are important differences between the approaches of the two countries as to the appropriate allocation of income principles. While they both purport to apply the arm's-length principle, they give the principle very different interpretations. Take a look at chapter 10 of the U.N. transfer pricing manual, in which India sets out its position, and compare that with the OECD transfer pricing guidelines to see the extent of these differences.

Thus, in my view, the basic question is whether BEPS problems can be solved without getting into the more fundamental question of the appropriate allocation of tax base between residence country and source country. And if that is true, is the OECD the appropriate forum to have the discussions about those basic principles? Is it enough that the nonmember countries are at the table as observers, fully participating in the dialogue and expressing their views, but not in the end having a vote or the ability to block the changes?

But if not the OECD, then what? The U.N. has the political breadth the OECD lacks but doesn't have the technical know-how or experience to really carry out the difficult technical analysis that these issues demand. And if countries don't participate in some kind of coordinated exercise in dealing with BEPS issues, there will be a proliferation of individual, uncoordinated measures that will lead to issues of double taxation. As shown in the India-U.S. example above, if the source country denies deductions to payments to intermediary companies and the resident country taxes the companies on that income under its CFC rules, there will be unrelieved double taxation of the intermediary companies, which in turn affects both India and the U.S. Now, one might respond to this result by saying "so what?" or even by saying "wonderful." We don't want companies to be wasting time and resources setting up these tax avoidance structures anyway, so the fact that because of the changed rules they must now bear a double tax burden will mean that they won't be used, and that is a desirable result. However, it is unlikely that the rules dealing with the BEPS issues can be structured so accurately that they hit only the desired targets and there will inevitably be situations when undesirable double taxation could arise from uncoordinated responses to the issues raised by asserting taxing jurisdiction over previously untaxed income.

There is again a certain irony here. The OECD has concentrated in the past on developing solutions to the problems of double taxation — this is the principal purpose of tax treaties and of the transfer pricing guidelines. But arguably at the same time, too little attention has been paid to the problems of double nontaxation or inappropriate low taxation on MNEs, which can be just as distortive to international trade and investment as double taxation. But now, finally awakening to the problems of double nontaxation, in creating solutions to these problems, we run back into issues of potential double taxation. And to deal with these questions, it seems necessary to go back to some fundamental and unresolved questions of the basis on which taxing rights are allocated to prevent double taxation, this development itself being caused by an exercise aimed at avoiding double nontaxation.

In trying to figure out how things might work out in the resolution of these questions, it is useful to look at some of the other recent developments in international tax to see if we can identify where things might be going. I think it is clear that there has been a general move in the direction of recognizing more taxing rights in the source jurisdiction. I will look later more exactly at what "source" really means. These developments involve reducing the role of a fixed base and physical presence in the taxing jurisdiction as a prerequisite for claiming taxing rights. Thus, the commentary to the

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OECD model treaty now contains an alternative provision for a personal services PE that does not require a fixed base in the taxing jurisdiction but does require physical presence. Further, various proposals regarding the U.N. treaty dealing with technical services go beyond this and do not require either a fixed base or physical presence but merely the utilization of the services in the jurisdiction. Regarding digitally provided services and Internet sales of goods, the only real connection with the source jurisdiction is that the ultimate product is being consumed there, and as indicated above, some countries are claiming taxing rights here as well. In the transfer pricing area, taxing rights are being claimed in market jurisdictions based on the presence of marketing intangibles, which give rise to intangible related returns beyond the simple low-risk/low-reward of cost-plus or resale-minus. And taken to its extreme, some economists — notably Michael Devereux at Oxford and Alan Auerbach at Berkeley — have proposed that the whole corporate income tax should be based on looking only at the destination market of the final goods, a kind of subtraction method VAT with a deduction for wages. And against this background, there is a chorus of nongovernmental organizations pressing for global unitary formulary taxation and of course the EU with its common consolidated corporate tax base. So where do we go from here? And what role can the OECD play?

The OECD was very successful in the last few years in developing a globally accepted set of principles dealing with exchange of information and, therefore, in addressing the question of cross-border tax evasion. The Global Forum on Transparency and Exchange, which grew out of the pioneering work of the OECD in the late 1990s, now has more than 100 members and an active listing and monitoring program, and is taking work further in the direction of global automatic information exchange as well as more coordinated efforts of tax collection and administration. But here in the beginning there was generally agreement, with the exception of very few countries, on the desirability and direction of the change, and since then economic events and political pressures have gradually reduced the number of opponents. As I have already said, I can now see automatic exchange of information as a realistic short-term goal.

But regarding the kinds of issues raised in the BEPS exercise, things are much more complicated. It might be possible to get general agreement that double non-taxation is a bad thing and coordinated measures should be used to combat it. But as I hope my analysis has shown, solutions to that relatively limited problem quickly blend into more basic questions of international taxing rights.

So here the OECD is swimming in much rougher water. The basic problem is that there is no real economic content to the notion of source of income; it is just a taxing claim that isn't based on the personal characteristics of the recipient of the income but some activity or transaction that has some connection with the jurisdiction. As I wrote once a long time ago: ''The idea that income has a locatable source seems to be taken for granted, but the source of income is not a well-defined economic idea.''[5] From a theoretical point of view, income is a characteristic of persons; in the classical Schanz-Haig-Simons definition, it is the sum of consumption plus increases in the value of assets of an individual in a given period. Of course, to adapt that concept to the real world of taxation, we need to focus on transactions and activities as well as persons. And for transactions, one can indeed recognize some ''locatable sources'' and exclude some others. For example, if a company produces all of its goods in country A and sells all of its goods to consumers in country B, one could say that some allocation of the overall profit between country A and country B but not to country C would be appropriate. But exactly *what* allocation is far from clear, and there is little theoretical guidance on what the appropriate economic result should be. In fact, one could well argue that the existing international rules applicable in that area are more the result of concerns related to administration and enforceability than of any economic principles.

In this regard, technological improvements have greatly improved the general ability of governments to administer, enforce, and collect taxes. As a result, it has become increasingly possible to separate the country that *collects* the tax and the country that is *entitled to the tax revenue*. But this in turn underlines the basic question of what principles should be used to determine where the revenue ends up.

To the lack of a clear economic idea of source, I think one could add that the idea of source of income is not a well-defined legal concept either. As Wolfgang Schoen said at an Oxford Centre for Business Taxation conference on taxing multinationals in January, ''There is no natural law of income allocation.'' Decisions about the assignment of taxing jurisdiction in terms of source rules and the corresponding obligation to give double tax relief are essentially political, with countries assessing their interests as residence countries and as source countries, since typically jurisdictions have both interests, and at the same time recognizing that if their choices take them too far out of the generally agreed framework of principles, they will hurt their own interests. For example, if a country adopts destination-based income tax or formulary apportionment and others keep the old system, double taxation and damage to the competitive position of its own corporations could result, which is obviously not a desirable outcome.

Also, even once some basic principles of tax jurisdiction have been agreed on, there remains the question of working out in concrete situations exactly how

[5]Hugh J. Ault and David F. Bradford, ''Taxing International Income: An Analysis of the U.S. System and its Economic Premises'' (NBER Working Paper No. 3056 (1990)), at 26.

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these rules should be applied. This is clear in the current work on intangibles; there is general agreement that the country of the market should be entitled to some return, but how much? Is a simple cost-plus arrangement adequate, or should some portion of the overall rent that the MNE's synergies allow it to generate be allocated to the market jurisdiction as well? And if so, on what basis? Assets, and if so, based on fair market value or tax value, or wages paid in each jurisdiction, and if wages, should some adjustment be made based on relative overall wage levels? Answering some questions then leads to others and in turn to others that need to be answered for the international tax systems to function properly. Some of these questions raise basic policy issues and some others simply require the working out of an agreed set of logical, coherent, and administrable rules from common basic starting points.

So what can the OECD do? It can provide a forum in which those issues can be discussed, common interests can be identified, and political compromises aimed at establishing a compatible set of practices can be established. In many situations, the countries are in a kind of prisoner's dilemma: They recognize that all are better off if they can cooperate in certain areas but there has to be some way to define those areas and also to prevent defections. Here the OECD has the potential to play a key role. Take the case of patent boxes, reducing the rate of tax on intangible income to attract headquarters companies to the domestic jurisdiction or to prevent domestic activities from leaving. If one country introduces a patent box and successfully gets or keeps investment, it wins. But if everyone starts doing this, in the end the only result will be that all countries have less revenue, and all are worse off unless somehow the existence of a patent box increased the overall level of economic activity. On this latter point, there is no convincing economic evidence. We are already seeing this sort of development taking place regarding patent boxes in the U.K., the Netherlands, Ireland, France, Spain, and the U.S., where such a step has been proposed.

There is a historical precedent here in the case of international shipping; as more and more countries introduced special regimes for international shipping, the result was a race to the bottom so that shipping didn't pay tax anywhere and countries had to respond by introducing tonnage taxes. If — and that is a big if — countries can agree within the framework of the OECD on what kinds of tax provisions are the legitimate exercise of tax sovereignty and which are ones that all would benefit from avoiding, the world would be a better place.

The expansion of the OECD membership and the inclusion of nonmember countries in the discussions of these issues increase the potential scope for constructive dialogue while enhancing, not sacrificing, the OECD's hard-won legitimacy as an objective arbiter of international issues. It may be possible to agree on what can be agreed on and also to agree on the differences. This can provide the basis for working out in a logical, coherent, and uniform manner the implications of those principles in concrete situations and help to ensure that the basic principles can be consistently applied. Not everything is politics, but not everything is logical deduction from agreed starting points and purely conceptual reasoning (*Begriffsjurisprudence*) either. Rather, what is needed is a complex mix of policy decisions and then the logical working out of those principles in concrete situations.

One could be tempted to suggest that what we really should have is an updated set of the ''Four Wise Men'' who are credited with the development of the basic pattern of rules that we have been operating under since the League of Nations work in the 1920s. It remains to be seen if we can find such people and, even more, if they work at the OECD. If they exist, to what extent will they be open to new approaches or influenced by what is already in place?

The BEPS political discourse shows that something is in motion, but do not underestimate the inertia effect resulting from the existing domestic tax rules and treaties. ◆

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