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Full circle? The Single Tax Principle, BEPS, and the New US Model

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Full Circle?

The Single Tax Principle, BEPS, and The New US Model

1. Introduction

On October 5, 2015, the OECD and G20 released the final BEPS package. It included the following new preamble to the OECD model tax treaty:

(State A) and (State B)...Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital **without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance**...(emphasis added)



*Reuven S. Avi-Yonah**

This language embodies the OECD and G20's official commitment to preventing both double taxation and double non-taxation, i.e., to the single tax principle.

The official press release that accompanied the final package quoted OECD Secretary General Angel Gurría as stating that “[t]he measures we are presenting today represent the most fundamental changes to international tax rules in almost a century”. How innovative is the final BEPS package?

This paper will argue that while there is some innovation in BEPS, it is in fact more of a continuation than a sharp break with the past. Like Alexis de Tocqueville's French Revolution, BEPS represents both continuity and change.¹ In particular, the single tax principle has formed the theoretical basis of much of the international tax regime from the beginning. And it is in fact this continuity rather than any sharp change that gives the final BEPS package its promise to, as Secretary General Gurría also promised, “**put an end to double non-taxation.**”

2. The Single Tax Principle

Since 1997, I have argued that a coherent international tax regime exists that is embodied in both tax treaties and the domestic laws of most countries, including the United States, and that limits the practical ability of countries to adopt any international tax rules they choose. I further argued that the core of the international tax regime is two principles, which I call the benefits principle (active income should be taxed primarily at source and passive income primarily at residence) and the single tax principle (all income should be subject to tax once at the rate derived

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from the benefits principle, i.e., active income at the consensus corporate rate and passive income at the residence rate for individuals).²

This formulation has been highly controversial. While most commentators would agree that the benefits principle has been the core of the international tax regime since 1923, many deny the validity of the single tax principle and some doubt its coherence.³ In particular, the single tax principle suggests that whenever the country that has primary jurisdiction under the benefits principle refrains from taxing cross-border income, the other country (residence for active income, source for passive) should tax it instead. This seemed to fly in the face of observed reality because residence countries typically exempt or defer active income, and source countries refrain from taxing many forms of passive income unilaterally without regard to whether it is taxed at residence.

There are, however, elements of US international tax that seem consistent with the single tax principle. The decision in 1918 to prevent double taxation by granting a foreign tax credit rather than an exemption was justified by Thomas Adams in terms of the single tax principle.⁴ The adoption of the foreign passive holding company rule in 1935, followed by the PFIC rule in 1986, seems intended to ensure effective residence based taxation of passive income that is unlikely to be taxed at source. The adoption of Subpart F in 1962 was premised on the assumption that the type of income that can be deferred (active income) is likely to be taxed at source at rates comparable to the US rate, and that other types of income (passive and base company income) for which this assumption does not hold should be taxed on a residence basis regardless of the benefits principle (since some of them, especially base company income, are active income that should generally be taxed primarily at source).⁵

These examples all relate to the US as a residence country. As a source country the first U.S. income tax treaty was concluded with France in 1932, and it reduced U.S. withholding taxes (e.g., on royalties to zero) at a time when France was purely territorial, i.e., did not tax foreign source income. Thus, at approximately the same time that the U.S. was enacting the foreign personal holding corporation provisions to ensure that its residents pay tax on income that was unlikely to be taxed at source, it was tolerating double non-taxation of U.S. source income earned by non-residents. The same tolerance

applied to U.S. tax treaties, which were commonly extended to tax havens.

This began to change in the 1960s under the guidance of Stanley Surrey, the author of Subpart F and a major architect of the international tax regime.⁶ The first U.S. treaty that indicated that double non-taxation of U.S. source income was inappropriate was the treaty with Luxembourg, which precluded the application of reduced U.S. withholding rates to certain Luxembourgian holding corporations that were not subject to tax on a residence basis.⁷ Similar language appears in the 1963 protocol to the Antilles Treaty, in the 1970 U.S. treaty with Finland and the 1975 U.S. treaty with Iceland.⁸ The U.K. treaty of 1975 imposed limitations on the benefits of corporate residents if the tax imposed by the residence country was “substantially less” than the general corporate tax and twenty-five percent or more of the company was held by third-country residents.⁹ However, the limitation did not apply to U.K. close companies or to companies held by U.K. individuals, giving rise to Rosenbloom’s comment that “it is difficult to discern a coherent U.K. treaty policy in the article.”¹⁰ The 1978 protocol to the treaty with France likewise contained only narrow limitations.

In general, therefore, U.S. policy before 1979 did not significantly restrict double non-taxation in regard to U.S. source income, despite placing significant unilateral limits on double non-taxation when the United States was the country of residence. However, in 1979, following congressional hearings that revealed the extensive use of the Antilles Treaty by third-country residents, the U.S. Treasury announced its intention to reexamine the Antilles Treaty and a series of treaty extensions to U.K. colonies and former colonies. In 1981, the U.S. Treasury published the new U.S. Model Tax Treaty, which for the first time included a broad LOB provision applicable to both corporations and individuals.¹¹ This provision provided that the benefits of reduced withholding under the treaty will not apply to nonpublicly-traded corporations residing in the treaty partner, unless over seventy-five percent of such corporations are owned by individual residents and their income is not paid out to residents of third countries. Additionally, the LOB provided that treaty benefits will not be available to corporations entitled to a significantly lower tax rate in their country of residence.¹²

Subsequent to the 1981 U.S. Model Tax Treaty, the LOB provision became a standard part of all

U.S. treaties. It was next included in the treaties with Cyprus (1981), Jamaica (1981), New Zealand (1982), Australia (1982), Denmark (1983), France (1983)—and every U.S. treaty since. Indeed, ever since the Senate in 1981 refused to ratify the treaty with Argentina unless it included a LOB, it has been clear that no U.S. treaty will be ratified without a LOB. And in 1986, Congress created a treaty override by adopting a “qualified resident” test (a simple LOB) in the context of the branch profits tax, which made it applicable to all U.S. treaties, including the majority that did not yet have an LOB provision.¹³

Some argue that the creation of the LOB provision had nothing to do with double taxation, but was meant to prevent the United States from having a “treaty with the world.” (i.e., allowing any non-resident to achieve treaty benefits without residing in a treaty jurisdiction) by restricting treaty benefits to residents of that state and not allowing the extension of benefits to residents of other states, regardless of whether they were subject to tax at the residence. This, it can be argued, was also the purpose of the termination of the treaties with the Antilles and other tax havens in 1987.¹⁴

But, this limited view of the purpose of the LOB provision is inconsistent with the last paragraph of the 1981 model LOB, which explicitly makes the reduction of source-based taxation contingent on taxation at residence without regard to the ownership of the recipient of the income. It is also inconsistent with the contemporaneous views held by Rosenbloom who, as International Tax Counsel from 1977 to 1981, was responsible for the inclusion of the LOB provision in the 1981 U.S. Model Tax Treaty and other treaties of that period. In an article published in 1983, Rosenbloom explained the policy behind the LOB provision:

Many commentators believe that existing international commerce is, to a considerable extent, structured on the assumption that liberal use of treaties will be tolerated. . . .The fundamental goal of tax treaties is removal of the negative effects of double taxation...Since treaties are intended to eliminate double taxation, their benefits should flow to persons who, in the absence of the treaty, might be subject to double taxation. These are persons who, while potentially subject to tax in one country on either a source or a personal basis, are also subject to tax in the other country on

a personal basis. A principal task of treaty drafters, then, should be to identify those persons in each country who are subject to that country’s personal taxing jurisdiction. . . . It may prove necessary in some cases to adopt special rules to ensure that taxation on a personal basis is not avoided altogether.¹⁵

While Rosenbloom later mentioned the “treaty with the world” problem and the revenue impact of allowing third-country investors to benefit from a treaty, the principal thrust of these observations is that the United States (as a source jurisdiction) should not reduce its withholding tax, unless it has some reasonable assurance that the income will be subject to tax on a residence basis.¹⁶

By 1981, the single tax principle had become a foundation block of U.S. international tax policy. As Rosenbloom stated, “One possible course would be for Country X not to enter into a treaty relationship unless it is satisfied that State Y will be likely to impose a full tax on all persons falling within the personal jurisdiction of State Y. **In theory, then, at least a single, substantial tax will be collected.**”¹⁷ In 1984, the US adopted the dual consolidated loss rule, which (as Rosenbloom acknowledged in his later critique of the single tax principle) was the high point of commitment because it incorporated the principle into domestic US law.¹⁸

However, subsequent developments have led to significant erosion in the US commitment to the single tax principle. This began in 1984 with the adoption of the portfolio interest exemption, which relieves US source interest from taxation at source without regard to whether it was taxed at residence. The portfolio interest exemption has been followed by the rest of the world because no country can afford to tax interest if the largest economy does not do so.¹⁹

The decline in the US commitment to the single tax principle continued with a series of enactment that created new exceptions to Subpart F: The repeal of section 956A (1994), the banking and insurance exceptions (1997), and the adoption of check the box (1997). The broad use of check the box to change pre-existing international tax rules like Subpart F was unintended, and was followed immediately by Notice 98-11 that represented an attempt to undo the damage, but the genie was out of the bottle: Congress blocked the Notice from going into effect and subsequently enacted section 954(c)(6) to codify the harmful international effect of check the box. The effect of these provisions was

to enable US-based multinationals to defer tax on the Subpart F (passive and base company) income of their CFCs without triggering deemed dividends, resulting in a massive \$2.1 trillion that are currently “trapped” in CFCs located in low tax jurisdictions and that cannot be repatriated because of the 35% tax on actual dividends.

Nevertheless, despite these unfortunate developments, in other areas the US did maintain its commitment to the single tax principle. This can be seen especially in the treaty context by the insistence on LOB rules, by the conduit financing regulations under Code 7701(l), and by the enactment of anti-arbitrage provisions like Code 894(c). Even outside the treaty context the IRS challenged a variety of tax arbitrage schemes that result in double non-taxation, like the STARS transactions and other “foreign tax credit generators.” And Congress enacted sections 871(m) (to crack down on the use of derivatives to avoid withholding on dividends) and 901(k) and 7701(o)(2) (to address foreign tax credit tax arbitrage transactions, like the Compaq transaction). It can therefore be argued that the fundamental commitment of the US to the single tax principle remained unchanged despite the portfolio interest exemption and “check the box.”

The financial crisis of 2008 and the UBS scandal led to increased US concern about both tax evasion (US citizens pretending to be foreigners and abusing the portfolio interest exemption) and tax avoidance (the increased attention to what Ed Kleinbard has dubbed “stateless income” and the realization that “base erosion and profit shifting” (BEPS) does not just harm other countries but the US as well).²⁰ The result has been an increased commitment to the single tax principle in both the US and overseas. This can be seen in FATCA and its progeny, in the G20/OECD BEPS project, and in the new US model treaty.

3. FATCA and MAATM

FATCA was initially adopted in 2010 in response to the UBS case, and on the face of it FATCA is just about requiring foreign financial institutions to report accounts controlled by US citizens or residents directly to the IRS. Because FATCA has real teeth (non-complying FFIs that derive US source income are subject to 30% withholding) and because it violates local privacy laws, it initially met with huge resistance. But the US Treasury was able to negotiate Intergovernmental Agreements with over 100 countries to permit FFIs to transfer the information to their own governments, which would

then share it under treaties. That, in turn, led to the development of standard information exchange rules that culminated in the Multilateral Agreement on Administrative Assistance in Tax Matters (MAATM), which has now been signed by over 80 countries (including the US) and which provides for automatic exchange of information with no bank secrecy or dual criminality exceptions. At the same time, the US has now finalized regulations first proposed in 2000 to require US financial institutions to collect data on payments that qualify for the portfolio interest exemption.

These developments promise to deal a significant blow to tax evasion and consequent double non-taxation. In fact, Gabriel Zucman has recently estimated that total global tax evasion is only \$200 billion annually, which may seem like a big number but is actually very small in comparison to overall financial income.²¹ His estimate of US tax evasion and avoidance is only \$36 billion, which is much smaller than some previous estimates (e.g., a commonly used number of \$100 billion which conflates tax evasion and avoidance, or my 2005 estimate of \$50 billion for tax evasion).²² It may be that Zucman is under-estimating, but it is also possible that the deterrence effect of FATCA and MAATM has worked and that the scope of the problem is indeed smaller now than it was before 2010.

In any case, these developments indicate a global commitment to enforce taxation of passive income at residence and to limit the scope of the portfolio interest exemption by subjecting payments to potential automatic exchange of information. It should be remembered that even the original portfolio interest exemption has a provision (Code 871(h)(6)) that authorizes the Treasury to suspend the exemption for countries that do not cooperate with exchange of information. This provision has much more bite in the age of MAATM.

4. BEPS

In introducing the final BEPS package on October 5, 2015, OECD Secretary General Angel Gurría stated that:

“Base erosion and profit shifting affects all countries, not only economically, but also as a matter of trust. BEPS is depriving countries of precious resources to jump-start growth, tackle the effects of the global economic crisis and create more and better opportunities for all. But beyond this, BEPS has been also eroding the trust of citizens in the fairness of tax systems worldwide. The measures we are presenting today represent the most fundamental changes to

international tax rules in almost a century: they will **put an end to double non-taxation**, facilitate a better alignment of taxation with economic activity and value creation, and when fully implemented, these measures will render BEPS-inspired tax planning structures ineffective”.²³

While this is no doubt over optimistic, there is no questioning the new found resolve of the G20 and OECD to uphold the single tax principle. This goal can be seen in all of the BEPS action steps:

Action 1: Addressing the Tax Challenges of the Digital Economy

This step is designed to address the ability of multinationals to avoid taxation of active income at source by selling goods and services into an economy without having a PE. In a world in which most residence jurisdictions exempt or defer taxation of active income changing the PE physical presence standard is essential to prevent double non-taxation.

Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements

This step is obviously designed to address double non-taxation by limiting tax arbitrage transactions designed to utilize hybrid mismatches to create double non-taxation. Check the box is a target.

Action 3: Designing Effective Controlled Foreign Company Rules

This step is intended to enforce effective residence-based taxation of income that is not taxed at source by limiting the scope of exemption and deferral to income that is subject to source based taxation.

Action 4: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments

This step is designed to enforce source based taxation of active income by limiting interest and related deductions that erode the corporate tax base without corresponding inclusions at residence.

Action 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

This step is intended to reinforce source based taxation of active income by putting

limits on harmful tax competition involving special regimes like patent boxes and cashboxes, and by requiring real investment that raises the transaction costs.

Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

This action adopts the US LOB position that treaty benefits should not result in reduction of tax at source unless there is effective taxation at residence, including a “main purpose test” that states that the purpose of treaties is to prevent both double taxation and double non-taxation.

Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status

This action reinforces source based taxation of active income and prevents the Shifting of such income into low tax jurisdictions through commissionaire and similar arrangements.

Actions 8-10: Aligning Transfer Pricing Outcomes with Value Creation

These actions build on earlier OECD work by limiting the ability to shift income to low tax jurisdictions by transfer pricing.

Action 11: Measuring and Monitoring BEPS

This action attempts to incentivize governments to act on BEPS by measuring its Magnitude (between \$100 and \$240 billion reach year in tax avoided).

Action 12: Mandatory Disclosure Rules

This action seeks to prevent secret rulings that enable multinationals to pay very low effective tax rate in countries that appear to have high corporate tax rates.

Action 13: Guidance on Transfer Pricing Documentation and Country-by-Country Reporting

This action seems to bolster transfer pricing by requiring country by country reporting by multinationals, so that tax avoidance can be measured and source taxation of active income upheld.

Action 14: Making Dispute Resolution Mechanisms More Effective

This action builds on previous OECD work on mandatory arbitration in tax treaties to prevent double taxation. It is a necessary

corollary to the steps that limit double non-taxation.

Action 15: Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

This action is intended to improve coordination of the previous steps.

Overall this is a very impressive achievement in a very short span of time. While BEPS will not eliminate double non-taxation any time soon, it demonstrates significant political commitment by the G20 and OECD to the single tax principle. It builds on earlier OECD actions like the commentary on article 1 that incorporates LOB principles, and that according to OECD applies to all treaties that include article 1, which is every tax treaty.

Whatever we think about the efficacy of BEPS (and I have some doubts in this regard and in regard to the actual outcomes incorporated in the final package, which Inevitably reflect political compromises as well as MNE push-back),²⁴ I think the OECD CTPA did an amazing job in a very short time frame. BEPS represents a commitment to the single tax principle more than anything that has happened since 1927, and that by itself is a major achievement.

5. The New US Model

Anticipating the outcome of BEPS, the US in May 2015 released several proposed amendments to its model tax treaty, all of which are consistent with the single tax principle. These changes were all incorporated in the US Model released in February 2016.

a. Treaty Exempt PEs

New Article 1 Section 7 excludes from the withholding tax reductions of the treaty payments to a permanent establishment of a company of the treaty partner in a third state if-

the profits of that permanent establishment are subject to a combined aggregate effective rate of tax in the [treaty partner state] and the state in which the permanent establishment is situated of less than 60 percent of the general rate of company tax applicable in the [treaty partner state]

or if the PE is situated in a third state that does not have a tax treaty with the US and the PE is not subject to tax in the treaty partner.

This provision is intended to prevent treaty benefits to accruing to a company resident in a treaty party

that applies territoriality so as to exclude the profits of branches in low-tax jurisdiction. The effect of the provision would be to impose full 30% withholding on payments to such branches, consistently with the single tax principle and with the branch rule of Subpart F.

b. Expanded LOB

The new LOB article is a significant tightening of existing LOB rules. For example, the requirement that if a company is traded on a stock exchange, that stock exchange must be in the same country that the company is in, is intended to address “inversion” transactions in which US companies inverted to Bermuda, had the board meet in Barbados to qualify under the US-Barbados treaty, and claimed exemption from LOB because they were publicly traded on the NYSE.

In addition, similarly to the 1981 LOB, treaty benefits are denied to a company unless—

ii) with respect to benefits under this Convention other than under Article 10 (Dividends), less than 50 percent of the company’s gross income, and less than 50 percent of the tested group’s gross income, is paid or accrued, directly or indirectly, in the form of payments that are deductible for purposes of the taxes covered by this Convention in the company’s Contracting State of residence (but not including arm’s length payments in the ordinary course of business for services or tangible property), either to persons that are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph (a), (b), (c) or (e) of this paragraph **or to persons that meet this requirement but that benefit from a special tax regime in their Contracting State of residence with respect to the deductible payment.** (emphasis added).

“Special tax regime” is a newly defined term:

1) the term “special tax regime” with respect to an item of income or profit means any legislation, regulation or administrative practice that provides a **preferential effective rate of taxation** to such income or profit, **including through reductions in the tax rate or the tax base.** With regard to interest, the term special tax regime includes notional deductions that are allowed with

respect to equity. However, the term shall not include any legislation, regulation or administrative practice:

- i) the application of which does not disproportionately benefit interest, royalties or other income, or any combination thereof;
- ii) that, with regard to royalties, satisfies a substantial activity requirement;
- iii) that implements the principles of Article 7 (Business Profits) or Article 9 (Associated Enterprises);
- iv) that applies principally to persons that exclusively promote religious, charitable, scientific, artistic, cultural or educational activities;
- v) that applies principally to persons substantially all of the activity of which is to provide or administer pension or retirement benefits;
- vi) that facilitates investment in entities that are marketed primarily to retail investors, are widely-held, that hold real property (immovable property), a diversified portfolio of securities, or any combination thereof, and that are subject to investor-protection regulation in the Contracting State in which the investment entity is established; or
- vii) that the Contracting States have agreed shall not constitute a special tax regime because it does not result in a low effective rate of taxation (emphasis added).

This means that the withholding tax reductions of the treaty will not apply to a company 50% or more of its income (or of the income of its consolidated group) is paid in deductible payments either to residents of third countries or to a company in the treaty partner country that is subject to a low effective tax rate because of a “special tax regime.” As in the 1981 LOB, this provision makes it clear that the purpose of the LOB is to enforce the single tax principle, not just to prevent a treaty with the world.

c. Anti-Inversion Rules

New language is added to articles 10, 11, 12 and 21 to the effect that dividends, interest, royalties and other income paid by an “expatriated entity” can be subject to 30% withholding tax for a period of ten years after the inversion that created it. Since most

“second wave” inversions are to treaty jurisdictions and the treaty is essential to the purpose of the inversion, which is to generate double non-taxation by stripping earnings out of the US into low tax jurisdictions (e.g., through the Netherlands or Ireland, as in the infamous double Irish Dutch sandwich), this will be a significant blow to inversions when it is included in actual treaties.

d. Special Tax Regimes

The newly defined “special tax regime” will, in accordance with the Technical Explanation, also prevent reduction of withholding taxes under articles 11, 12 and 21.

The Technical Explanation provides that:

Subparagraph 1(l) defines the term “special tax regime” with respect to an item of income. The term is used in Articles 11 (Interest), 12 (Royalties), and 21 (Other Income), each of which denies treaty benefits to items of income if the resident of the other Contracting State (the residence State) beneficially owning the interest, royalties, or other income, is related to the payor of such income, and benefits from a special tax regime in its residence State with respect to the particular category of income. This rule allows the Contracting State in which the item of income arises to retain its right to tax the income under its domestic law if the resident benefits from a regime in the residence State with respect to a category of income that includes the item of income that results in low or no taxation. The term “special tax regime” also is used in Article 22 (Limitation on Benefits) for the purposes of the so-called “derivative benefits” rule in paragraph 4 of that Article.

The application of the term “special tax regime” in Articles 11, 12 and 21 is consistent with the tax policy considerations that are relevant to the decision to enter into a tax treaty, or to amend an existing tax treaty, as articulated by the Commentary to the OECD Model, as amended by the Base Erosion and Profits Shifting initiative. In particular, paragraph 15.2 of the introduction of the OECD Model now provides:

“Since a main objective of tax treaties is the avoidance of double taxation in order to reduce tax obstacles to cross-border

services, trade and investment, the existence of risks of double taxation resulting from the interaction of the tax systems of the two States involved will be the primary tax policy concern. Such risks of double taxation will generally be more important where there is a significant level of existing or projected cross-border trade and investment between two States. Most of the provisions of tax treaties seek to alleviate double taxation by allocating taxing rights between two States and it is assumed that where a State accepts treaty provisions that restrict its right to tax elements of income, it generally does so on the understanding that these elements of income are taxable in the other State. Where a State levies no or low income taxes, other States should consider whether there are risks of double taxation that would justify, by themselves, a tax treaty. States should also consider whether there are elements of another State's tax system that could increase the risk of non-taxation, which may include tax advantages that are ring-fenced from the domestic economy."

The term "special tax regime" means any legislation, regulation, or administrative practice that provides a preferential effective rate of taxation to interest, royalties or other income, including through reductions in the tax rate or tax base. In the case of interest, the term includes any legislation, regulation, or administrative practice, whether or not generally available, that provides notional deductions with respect to equity. For purposes of this definition, an administrative practice includes a ruling practice.

For example, if a taxpayer obtains a ruling providing that its foreign source interest income will be subject to a low rate of taxation in the residence State, and that rate is lower than the rate that generally would apply to foreign source interest income received by residents of that State, the administrative practice under which the ruling is obtained is a special tax regime.

Paragraph 2 of the Protocol provides a list of the legislation, regulations, and administrative practices existing in the other Contracting State at the time of the signature of the Convention that the

Contracting States agree are "special tax regimes" within the meaning of paragraph 1(l) of Article 3.

This is clearly consistent with the single tax principle and with the original US LOB of 1981, which has been eroded in subsequent versions but is now returning with full force to deny treaty benefits (reductions in source taxation) in cases that the effective tax rate at residence is too low.

e. Subsequent Changes

A new article 28 provides that-

1. If at any time after the signing of this Convention, the general rate of company tax applicable in either Contracting State falls below 15 percent with respect to substantially all of the income of resident companies, or either Contracting State provides an exemption from taxation to resident companies for substantially all foreign source income (including interest and royalties), the provisions of Articles 10 (Dividends), 11 (Interest), 12 (Royalties) and 21 (Other Income) may cease to have effect pursuant to paragraph 4 of this Article for payments to companies resident in both Contracting States.
2. If at any time after the signing of this Convention, the highest marginal rate of individual tax applicable in either Contracting State falls below 15 percent with respect to substantially all income of resident individuals, or either Contracting State provides an exemption from taxation to resident individuals for substantially all foreign source income (including interest and royalties), the provisions of Articles 10, 11, 12 and 21 may cease to have effect pursuant to paragraph 4 of this Article for payments to individuals resident in either Contracting State.
3. For purposes of this Article:
 - a) the allowance of generally available deductions based on a percentage of what otherwise would be taxable income, or other similar mechanisms to achieve a reduction in the overall rate of tax, shall be taken into account for purposes of determining the general rate of company tax or the highest marginal rate of individual tax, as appropriate; and
 - b) a tax that applies to a company only upon a distribution by such company, or that applies to shareholders, shall not be taken into account in determining the general rate of company tax.

4. If the provisions of either paragraph 1 or paragraph 2 of this Article are satisfied by changes in law in one of the Contracting States, the other Contracting State may notify the first-mentioned Contracting State through diplomatic channels that it will cease to apply the provisions of Articles 10, 11, 12 and 21. In such case, the provisions of such Articles shall cease to have effect in both Contracting States with respect to payments to resident individuals or companies, as appropriate, six months after the date of such written notification, and the Contracting States shall consult with a view to concluding amendments to this Convention to restore an appropriate allocation of taxing rights.

The Technical Explanation provides that-

The negotiation of the Convention took into account the desire of the two Contracting States to allocate taxing rights between them in a manner that would alleviate double taxation that could otherwise result if cross-border income, profit or gain were taxed under the domestic laws of the two Contracting States. The Contracting States recognize that certain subsequent changes to the domestic laws of one or both of the Contracting States that lower taxation could reduce the risk of double taxation but in addition increase the risk that the Convention would give rise to unwanted instances of low or no taxation. In addition, such subsequent changes in law could draw into question the continued appropriateness of the allocation of taxing rights that was originally negotiated in the Convention.

Article 28 addresses this possibility by providing that if, at any time after the signing of the Convention, either Contracting State enacts certain changes to domestic law that could implicate the terms of the Convention, certain benefits of the Convention may cease to have effect, and if so the Contracting States shall consult with a view to amending the Convention in a way that would restore an appropriate allocation of taxing rights.

Article 28 is consistent with the tax policy considerations that are relevant to the decision to enter into a tax treaty, or to amend an existing tax treaty, as articulated by the Commentary to the OECD Model,

as amended by the Base Erosion and Profits Shifting initiative.

Once again the consistency of this provision with the single tax principle is explicit. The goal is to address subsequent harmful tax competition provisions that erode residence-based taxation in the treaty partner.

Overall these provisions show that in the BEPS context the US delegation pushed consistently for the implementation of the single tax principle, while resisting efforts to upset the existing balance between residence and source countries by adopting more radical changes such as formulary apportionment (although country by country reporting may lead in this direction; this provision was not favored by the US).

6. Conclusion

The first model treaty, drafted by the League of Nations Committee of Technical Experts in 1927,²⁵ explicitly acknowledged the single tax principle in its commentary. The commentary states:

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.*²⁶

This language was implemented, for example, in the interest article by providing for a provisional withholding tax that would be refunded upon showing that the interest was declared in the country of residence.

We have now come full circle, in that the US, the OECD and the G20 clearly have adopted the single tax principle as their goal. The specific measures in the final BEPS package fall short of this goal, and the US model treaty provisions have not been incorporated into any treaty. But there is light at the end of the tunnel. With further political pressure, double non-taxation may in fact be on its way to

extinction, as Secretary General Gurria has said. The vision of Adams and Surrey (the principal US architects of the international tax regime) is closer to fruition now than at any time since the foreign tax

credit was enacted in 1918. The US should not let temporary pressures in the opposite direction, like the current legislative push for a patent box or for territoriality, stand in the way.

1. Alexis de Tocqueville, *L'Ancien Regime et la Revolution* (1856) argued that the major changes of the French Revolution represent more continuity than change with the Old Regime. See also Jacques Le Goff, *Must We Divide History Into Periods?* (2015).
2. Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 *Tax L. Rev.* 507 (1997).
3. See, e.g., H. David Rosenbloom, *International Tax Arbitrage and the "International Tax System"*, 53 *Tax L. Rev.* 137 (2000); Michael J. Graetz, *Taxing International Income - Inadequate Principles, Outdated Concepts, and Unsatisfactory Policy*, 54 *Tax Law Review* 261 (2001); Julie Roin, *Taxation Without Coordination* (2002), http://papers.ssrn.com/paper.taf?abstract_id=302141; Mitchell A. Kane, *STRATEGY AND COOPERATION IN NATIONAL RESPONSES TO INTERNATIONAL TAX ARBITRAGE*, 53 *Emory L.J.* 89; Adam H. Rosenzweig, *HARNESSING THE COSTS OF INTERNATIONAL TAX ARBITRAGE*, 26 *Va. Tax Rev.* 555. For the contrary position see, e.g., Reuven S. Avi-Yonah, *Commentary on Rosenbloom*, 53 *Tax L. Rev.* 167 (2000); Yariv Brauner, *An International Tax Regime in Crystallization*, 56 *Tax L. Rev.* 259; Fred B. Brown, *An Equity-Based, Multilateral Approach for Sourcing Income Among Nations*, 11 *Fla. Tax Rev.* 565; Ehab Farah, *Mandatory Arbitration of International Tax Disputes: A Solution in Search of a Problem*, 9 *Fla. Tax Rev.* 703; Victor Thuronyi, *INTERNATIONAL TAX COOPERATION AND A MULTILATERAL TREATY*, 26 *Brooklyn J. Int'l L.* 1641.
4. Thomas S. Adams, *Interstate and International Double Taxation*, in *Lectures on Taxation* 101, 112-13 (Roswell Magill ed., 1932) ("[t]he state which with a fine regard for the rights of the taxpayer takes pains to relieve double taxation, may fairly take measures to ensure that the person or property pays at least one tax.")
5. See Avi-Yonah, *U.S. Notice 98-11 and the Logic of Subpart F: A Comparative Perspective*, *Tax Notes Int'l* (June 8, 1998).
6. Surrey was largely responsible for the US position rejecting tax sparing, since his testimony against the US-Pakistan treaty (1957) led to the rejection of that treaty and to a consistent position against tax sparing since then. While this position is usually justified as a defense of US taxing rights on US source income, the sourcing of income is an uncertain business and a better argument is that tax sparing is a paradigmatic instance of double non-taxation. Given Surrey's subsequent actions I suspect that this is what he had in mind in 1957, but we cannot know for sure until someone investigates the Surrey papers at Harvard.
7. The following discussion is based on the excellent historical overview by H. David Rosenbloom. *Tax Treaty Abuse: Policies and Issues*, 15 *Law & Pol'y Int'l Bus.* 763 (1983).
8. *Finland Income Tax Treaty*, Mar. 6, 1970, art. XXVII, CCH TAX TREATIES ¶ 2678, P-H TAX TREATIES ¶37,057; *Iceland Income Tax Treaty*, May 7, 1975, art. XXVII, CCH TAX TREATIES ¶3730, P-H TAX TREATIES ¶46,127; see Richard L. Doernberg, *Legislative Override of Income Tax Treaties*, 42 *Tax Law.* 173, 188-89 (1989).
9. *United Kingdom Income Tax Treaty*, Dec. 31, 1975, art. XVI, CCH TAX TREATIES ¶8103P, P-H TAX TREATIES ¶89,046.
10. Rosenbloom, 790.
11. *United States Dept. of Treasury Model Income Tax Treaty*, June 16, 1981, CCH TAX TREATIES ¶158, P-H TAX TREATIES ¶1022.
12. The provision states:
 1. A person (other than an individual) which is a resident of a Contracting State shall not be entitled under this Convention to relief from taxation in the other Contracting State unless
 - (a) more than 75 percent of the beneficial interest in such person is owned, directly or indirectly, by one or more individual residents of the first-mentioned Contracting State; and
 - (b) the income of such person is not used in substantial part, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons who are residents of a State other than a Contracting State and who are not citizens of the United States.
 For the purposes of subparagraph (a), a company that has substantial trading in its stock on a recognized exchange in a Contracting State is presumed to be owned by individual residents of that Contracting State.
 2. Paragraph 1 shall not apply if it is determined that the acquisition or maintenance of such person and the conduct of its operations did not have as a principal purpose obtaining benefits under the Convention.
 3. Any relief from tax provided by a Contracting State to a resident of the other Contracting State under the Convention shall be inapplicable to the extent that, under the law in force in that other State, the income to which the relief relates bears significantly lower tax than similar income arising within that other State derived by residents of that other State.
13. See also IRC section 7701(l) and the regulations thereunder, which override all US treaties to impose a conduit financing test inspired by Aiken Industries.

14. The United States terminated its income tax treaties with Aden and a group of other UK colonies: Aruba, Netherlands Antilles, Belgian Congo, Honduras, Malawi, and Nicaragua.
15. Rosenbloom, 764-773.
16. Rosenbloom, 774-775.
17. Rosenbloom, 776 (emphasis added).
18. Rosenbloom (2000), *supra*.
19. For example, the EU Savings Directive (2003) does not apply to interest paid to non-EU persons.
20. Edward Kleinbard, *Stateless Income*, 11 Fla. Tax Rev. 699 (2011); Edward Kleinbard, *The Lessons of Stateless Income*, 65 Tax L Rev 99 (2011).
21. Gabriel Zucman, *The Hidden Wealth of Nations* (2015).
22. Guttentag and Avi-Yonah, *Closing the International Tax Gap*, in Max B. Sawicky (ed.), *Bridging the Tax Gap: Addressing the Crisis in Federal Tax Administration*, 99 (2005).
23. OECD press release, October 5, 2015 (emphasis added).
24. For an alternative to the BEPS approach see Avi-Yonah, *Hanging Together* (2015), available on SSRN.
25. T.S. Adams was one of the drafters of the first model treaty.
26. Report prepared by the Committee of Experts on Double Taxation and Tax Evasion (League of Nations Publications, 1927), p. 23 (emphasis added).

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