The "Upgraded" Strategy Against Harmful Tax Practices Under the BEPS Action Plan

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Abstract

The Action Plan on Base Erosion and Profit Shifting *(Action Plan) intends to "revamp" the work on harmful tax practices that has been undertaken by the Organisation for Economic Co-operation and Development (OECD) since the late 1990s. Further enhancement of the OECD's transparency standards, the reinforcement of the requirement of a "substantial activity" for any "acceptable" preferential tax regime and an ambition to ensure a closer engagement of non-OECD economies re-open the debate on "harmful tax competition" that sparked in the academic literature and political arenas following the first attempt of international co-ordination. This article discusses the priority measures that are envisaged by Action 5 of the Action Plan and their foreseeable prospects. It demonstrates that the OECD is merely seeking to upgrade its existing mandate and exploit the political momentum that has been created by the BEPS campaign. The proposed strategy aims to adjust the current methods and structures rather than offer a conceptual rethinking.*

The existence of harmful preferential tax regimes is considered by the OECD as one of the key "pressure points" in its campaign against base erosion and profit shifting (BEPS).[1] The BEPS Report and its follow-up Action Plan called for a new, more effective, strategy to tackle harmful tax practices,[2] which could accommodate "so-called 'international competitiveness' concerns and pressures".[3] It should build upon and further advance the goals that were initially acknowledged in the 1998 OECD Report, *Harmful Tax Competition: An Emerging Global Issue* (1998 OECD Report).[4] The underlying concerns with the "race to the bottom" of corporate tax on mobile income and the need to protect a global welfare are recognised as being "as relevant today as they were 15 years ago".[5] However, since the forms of tax competition have evolved, the OECD strategy needs to be adjusted.

Action 5 envisages two substantive priorities. The OECD will further build up its work on enhancing the transparency of states' tax affairs, including the "compulsory spontaneous exchange

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[1] OECD, *Addressing Base Erosion and Profit Shifting* (BEPS Report) (OECD Publishing, 2013); OECD, *Action Plan on Base Erosion and Profit Shifting* (Action Plan) (OECD Publishing, 2013).

[2] BEPS Report, above fn.1; Action Plan, above fn.1.

[3] BEPS Report, above fn.1, 28.

[4] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998).

[5] Action Plan, above fn.1, 17.

on rulings related to preferential tax regimes".[6] It will also focus on requiring "substantial activity for any preferential tax regime", which should reduce the incentives for foreign investment flows without economic substance.[7] The implementation plan contains the following three stages.[8] By September 2014, the Forum on Harmful Tax Practices should complete a review of all member country tax regimes. Next, the OECD will develop a strategy for closer engagement with non-members, either through the existing, or through potentially reorganised, institutional structures. The vision for an institutional framework should be presented by September 2015. And finally, the substantive criteria for defining "harmful tax practices" will be revised, offering a more "holistic" approach in the BEPS context.[9] The substantive revision should be finalised by December 2015.

This article analyses the prospects of these actions. To start with, it discusses the ambiguity of the concept of "harmful tax competition" and the difficulties with distinguishing "harmful" and "fair" tax practices. It focuses on fundamental concerns and controversies explored in the public finance literature. Then, it looks back at the objectives of the 1998 OECD's campaign and the key steps that have been undertaken in their pursuit. Finally, it turns to the changes in the OECD strategy envisaged by Action 5 of the Action Plan and explores some of the open questions in relation to the priority measures. Although this contribution focuses on the OECD's actions, it will draw some parallels with the actions undertaken by the EU, since the overlap between the two campaigns against harmful tax practices has increased due to the EU's intention to promote "minimum standards of good governance in tax matters" beyond the borders of the Single Market.

1. The notion of "harmful" tax practices

It is essential for the evaluation of the effectiveness of any countermeasure to have a clear understanding of what it is exactly that it should be directed against. The concept of "tax competition" can broadly be described as a process of uncooperative but interdependent setting of tax rates between jurisdictions that enjoy tax autonomy,[10] in a bid for investments, other economically relevant activities or resources, or mere profits.[11] International tax competition occurs between sovereign nations or territories. Although acknowledging the existence of other

[6] Action Plan, above fn.1, 18.
[7] Action Plan, above fn.1, 18.
[8] Action Plan, above fn.1, 31.
[9] Action Plan, above fn.1, 18.
[10] See, in this regard, M. Devereux and S. Loretz, "What Do We Know about Corporate Tax Competition?" (Oxford University Centre for Business Taxation, WP 2012/29).
[11] D. Wilson and D.E. Wildasin, "Capital Tax Competition: Bane or Boon" (2004) 88 *Journal of Public Economics* 1065, offer a narrower definition that excludes competition over taxable profits; however, since this kind of competition is the main driver (as compared to competition over firms or investments) for lowering statutory rather than effective rates, and it is moreover the foremost concern of the BEPS initiative, the authors have included it in their definition. It is also noteworthy that regarding personal capital income taxation in particular, which is often still based on the residence principle, the setting of low or no tax rates in source countries will have to be flanked by secrecy provisions, etc., i.e. the respective countries simultaneously facilitate tax evasion in the home country. See M. Littlewood, "Tax Competition: Harmful to Whom?" (2004) 26 *Michigan Journal of International Law* 411, 439 and following; G.R. Zodrow, "Capital Mobility and Capital Tax Competition" (2010) 63 *National Tax Journal* 865, 888 and following; P. Genschel and P. Schwarz, "Tax Competition: A Literature Review" (2011) 9 *Socio-Economic Review* 339, 352; all with further references.

potential contributing factors,[12] the economic literature provides strong empirical evidence for the existence of international tax competition as a main driver for lowering corporate income tax rates that has occurred from the early 1980s.[13] The identification of the problem, followed by the acknowledgement that a supranational solution may generate "added value", serves as an important legitimising factor for regulatory intervention. The fundamental task of defining "harmful" practices in this context is complicated by the fact that there is no general agreement, neither academically nor in global politics, on the extent to which this phenomenon should be viewed as harmful or, to the contrary, beneficial. Several arguments have been advanced in order to justify, or to advise against, international co-operation in order to reduce tax competition.[14]

In classical public finance models, national tax policymakers have usually been presumed to be impartial, disinterested and rational decision-makers who seek to enhance the well-being of a society as a whole. From such a perspective, each sovereign jurisdiction strives to implement a tax structure that reflects its citizens' preferred balance between the conflicting objectives of economic efficiency (that is, maximising the overall utility derived from public and private goods available to members of the society) on the one hand, and of realising a particular concept of social equity (that is, achieving a fair distribution of public and private goods among members of the society) and social insurance on the other hand.[15] In their pursuit of an optimal trade-off, national policymakers are expected to take into account the higher deadweight losses[16] and distortions associated with a higher level of taxation. It is assumed that the tax policy debate within a jurisdiction primarily focuses on the level and structure of taxation that is efficient in order to provide the optimal level of public goods, social insurance and redistribution, and also on how the relevant concept of optimality is influenced by diverging ideals of social equity.

Under these premises, tax competition between sovereign states is inherently "harmful" because it restricts the capacity of each state to pursue social welfare policies through its tax system: if tax jurisdictions compete for relatively mobile sources of income[17] by lowering the

[12] Other possible explanations are discussed by Devereux and Loretz, above fn.10; Devereux, et al., "Do Countries Compete Over Corporate Tax Rates?" (2008) 92 *Journal of Public Economics* 1210; M. Leibrecht and C. Hochgatterer, "Tax Competition as a Cause of Falling Corporate Income Tax Rates: A Survey of Empirical Literature" (2012) 26 *Journal of Economic Survey* 616.

[13] See, e.g. J. Slemrod, "Are Corporate Tax Rates, or Countries, Converging?" (2004) 88 *Journal of Public Economics* 1169; S. Loretz, "Corporate Taxation in the OECD in a Wider Context" (2008) 24 *Oxford Review of Economic Policy* 639; M. Overesch and J. Rincke, "What Drives Corporate Tax Rates Down? A Reassessment of Globalization, Tax Competition, and Dynamic Adjustment to Shocks" (2011) 113 *Scandinavian Journal of Economics* 579; Zodrow, above fn.11, 888 and following.

[14] For a comprehensive analysis, see also J. Edwards and M. Keen, "Tax Competition and Leviathan" (1996) 40 *European Economic Review* 113; W. Schön, "Tax Competition in Europe: The Legal Perspective" (2000) 2 *EC Tax Review* 90, 93 and following; J.C. Sharman, *Havens in a Storm: The Struggle for Global Tax Regulation* (Ithaca and London: Cornell University Press, 2006), 20 and following; A.P. Morriss and L. Moberg, "Cartelizing Taxes: Understanding the OECD's Campaign Against 'Harmful Tax Competition'" (2013) *Columbia Journal of Tax Law* 1, 4 and following. See also C.M. Boise, "Regulating Tax Competition in Offshore Financial Centers" (Case Legal Studies Research Paper No.08-26, 2008), 50, 57 and following.

[15] Possibly also other, non-material, values and preferences might play a role in the balancing exercise.

[16] i.e. welfare losses which result from the welfare-decreasing substitution effects that taxation has on the behaviour of economic agents and consumers; see Joseph E. Stiglitz, *Economics of the Public Sector*, 3rd edn (Norton, 2000), 518 and following.

[17] Even capital, which is commonly considered to be the most mobile source of income, is not fully mobile as between different open economy jurisdictions, especially due to decreasing marginal returns to capital in each jurisdiction, location-specific agglomeration rents (see Devereux and Loretz, above fn.10) and country-specific endowments,

tax burdens imposed on the corresponding activities, they might eventually end up in a position where they cannot impose tax burdens in excess of the value of public services received by a mobile taxpayer. A tax burden on mobile sources of income is then based on the benefit principle rather than on the ability to pay principle.[18] The burden of financing social insurance programmes[19] and redistributive policies is shifted to relatively immobile sources, in particular labour, increasing the distortions that taxing these factors implies.[20] Several empirical studies indeed suggest that international tax competition has resulted in a higher burden on labour, albeit mainly in the form of increases in social security contributions rather than increased income taxation.[21] Since mobile sources of income, and capital investments in particular, are typically owned by economically more potent taxpayers, this could moreover seriously undermine redistributive taxation.[22] To the extent that a higher taxation of immobile factors (including higher social security contributions) does not fully compensate the loss of revenue from taxing mobile sources of income, or that it is politically unfeasible, public goods or social insurance would have to be supplied at a less-than-optimal level,[23] and supply might be biased towards investment-relevant public goods (such as infrastructure).[24] The "race to the bottom" might even go further, with higher taxes on less mobile sources of income cross-subsidising public goods for the benefit of under- or zero-taxed mobile ones,[25] thus further compromising individual tax equity and permitting "free rider" behaviour. Ultimately, the tax system as a whole might then be endangered because it is perceived as unfair, and therefore public acceptance and tax compliance might deteriorate.

The idealistic presumption of the benevolent role of government and democratic decision-making processes in the field of tax policy has been challenged, however, especially by representatives of the public choice school of public finance theory.[26] They argue that politicians and governments will often (ab)use their power to tax in order to promote clientele and populist

which all imply that a given amount of capital will not necessarily yield the same pre-tax return in each competing jurisdiction.

[18] H.-W. Sinn, "Tax Harmonization and Tax Competition in Europe" (1990) 34 *European Economic Review* 489, 501.

[19] There is conclusive evidence that in most jurisdictions individual preferences for social insurance schemes have increased due to the greater personal risks associated with globalisation, D. Rodrik, "Do More Open Economies Have Bigger Governments?" (1998) *The Journal of Political Economy* 997; A. Adam and P. Kammas, "Tax Policies in a Globalized World: Is It Politics After All?" (2007) 133 *Public Choice* 321, 322 and following.

[20] See also Wilson and Wildasin, above fn.11, 1073: the shift results in inefficient redistributive policies.

[21] D. Swank and D. Steinmo, "The New Political Economy of Taxation in Advanced Capitalist Democracies" (2002) 46 *American Journal of Political Science* 642; H. Winner, "Has Tax Competition Emerged in OECD Countries? Evidence from Panel Data" (2005) 12 *International Tax and Public Finance* 667; Adam and Kammas, above fn.19.

[22] R.S. Avi-Yonah, "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State" (2000) *Harvard Law Review* 1573, 1578 and 1624 and following; D. Ring, "Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation" (2009) 9 *Florida Tax Review* 555, 576; see also S. Cnossen, "The Case for Tax Diversity in the European Community" (1990) 34 *European Economic Review* 471, 477.

[23] See W.E. Oates, *Fiscal Federalism* (Harcout Brace Jovanovich, 1972), 143; G.R. Zodrow, et al., "Property Taxation, and the Underprovision of Local Public Goods" (1986) 19 *Journal of Urban Economics* 356; D. Rodrik, "Has Globalization Gone Too Far?" (Washington, DC: Institute for International Economics, 1997), 73; C. Fuest and B. Huber, "Tax Competition and Tax Coordination in a Median Voter Model" (2001) 107 *Public Choice* 97, 102 and following; Avi-Yonah, above fn.22, 1612.

[24] See M. Keen and M. Marchand, "Fiscal Competition and the Pattern of Public Spending" (1996) 66 *Journal of Public Economics* 33.

[25] Avi-Yonah, above fn.22, 1592.

[26] See, in particular, G. Brennan and J.M. Buchanan, *The Power to Tax: Analytic Foundations of a Fiscal Constitution* (Cambridge: CUP, 1980 and 2006).

politics, and that they will therefore tend to overburden less vocal groups within the electorate or economically potent minorities (the "rich") to finance privileges for their constituents or to appeal to mainstream voter sentiment. Furthermore, the politicians' and, possibly, the bureaucrats'[27] appetite for power and influence may lead to an overproduction of public goods and to an oversized public sector, beyond the level that could be justified by social welfare considerations. Similar results have been estimated as likely outcomes in democratic societies if median voter preferences determine the supply of public goods and the level and mix of taxes.[28] Even to the extent that desirable public goods and transfer payments are financed by tax revenues, this has been assumed to often be done inefficiently due to waste and corruption.[29] Finally, deadweight losses due to the behavioural effects of taxation are often ignored or underestimated in politics, especially since they are frequently not fully appreciated by ordinary voters either. Against this background, international tax competition has been regarded by some as a much-needed instrument to "tame the Leviathan" by imposing budgetary restraints on excessive or wasteful spending.[30] In more recent studies, the welfare-reducing effects of political decision-making processes and the corresponding benefits of tax competition are also frequently taken into account, albeit in a more nuanced fashion, balancing them against the downsides of this development.[31]

Beyond the "Leviathan" line of reasoning, several other positive aspects of tax competition have also been put forward in the literature: it has been argued that countries with specific structural disadvantages such as small economies or peripheral regions might have to rely on competitive tax regimes in order to compensate for their natural disadvantages and the associated higher transaction costs or other additional costs of being located in such areas.[32] Moreover, taxes are only one factor in the international competition for capital and investment: to take away these instruments from sovereign nation states (or from regions enjoying a certain tax autonomy) would mean to reward those that have relied on other incentives such as lax regulatory standards. Some scholars are pointing out that the existence of preferential tax regimes and tax havens may improve the allocation of capital: for instance, the availability of tax havens for the purpose of business structuring makes the location of real investment *less* responsive to a pure difference in tax rates between two countries.[33] Furthermore, several studies emphasise that the current

[27] Regarding the possibly negative role of bureaucrats, see C. Fuest, "The Political Economy of Tax Coordination as a Bargaining Game between Bureaucrats and Politicians" (2000) 103 *Public Choice* 357.

[28] See Fuest and Huber, above fn.23. For a general overview and further references, see also Stiglitz, above fn.16, 169 and following; B. Le Maux, "Governmental Behavior in Representative Democracy: A Synthesis of the Theoretical Literature" (2009) 141 *Public Choice* 447.

[29] See Morriss and Moberg, above fn.14, 6.

[30] Prominent defenders of this stance include, e.g. Brennan and Buchanan, above fn.26; C.E. McLure, "Tax Competition: Is What's Good for the Private Goose Also Good for the Public Gander?" (1986) 39 *National Tax Journal* 341. For a more nuanced opinion, see Edwards and Keen, above fn.14. But see also H. Cai and D. Treisman, "Does Competition for Capital Discipline Governments? Decentralization, Globalization, and Public Policy" (2005) 95 *The American Economic Review* 817, 822 and following, who argue that in some poorly endowed regions of the world, capital mobility and tax competition will not have a disciplining effect on governments.

[31] For a survey of this more recent trend, see, e.g. M. Keen and K.A. Konrad, "The Theory of International Tax Competition and Coordination" (Max Planck Institute for Tax Law and Public Finance, WP 06/2012), 56 and following.

[32] See Morriss and Moberg, above fn.14, 10.

[33] Q. Hong and M. Smart, "In Praise of Tax Havens: International Tax Planning and Foreign Direct Investment" (CESInfo Working Paper No.1942, 2007).

system of tax havens and preferential regimes allows multinational enterprises (MNEs) to decrease their effective tax rate, but this in turn permits governments to tax less mobile domestic firms at a higher rate.[34] This "regular" rate comes closer to the one that would have been chosen without the constraints imposed by international tax competition, thereby "increasing efficiency and even effectively mitigating tax competition".[35] If forced to eliminate a preferential tax regime, governments may need to lower their overall tax rates for both mobile and immobile businesses when competing for mobile capital. These findings are not undisputed, however.[36]

Current economic and political theory is thus ambivalent as to whether and under what conditions the efficiency and equity concerns outweigh the positive aspects of international tax competition,[37] especially since the underlying assumptions are hard to verify empirically.[38] Therefore, the question as to whether to take co-ordinated international action against low corporate tax burdens essentially requires a political appreciation of the available knowledge and data. If the answer is in the affirmative, a similar political choice has to be made as to whether to try to contain international tax competition generally or rather through a targeted approach. The latter, narrower, approach has its merits if it focuses on tax regimes featuring elements that imply that perceived disadvantages will *clearly* outweigh any eventual advantages with a view towards efficiency, equity and public choice. From a more pragmatic viewpoint, which was probably the guiding one in the deliberations of the OECD,[39] a narrow approach directed only against tax havens and preferential tax regimes also offers greater chances of political success: empirical research suggests that small economies will, under certain conditions, reap higher benefits from uncooperative behaviour if the alternative is an approximation of levels of taxation in general,[40] but this "advantage of smallness" is significantly reduced in the case of competition by way of special regimes. The willingness to co-operate will therefore tend to be greater regarding the abolition (only) of such preferential tax concessions.[41] However, if limited action is chosen,

[34] M. Keen, "Preferential Regimes Can Make Tax Competition Less Harmful" (2001) 54 *National Tax Journal* 757; M.A. Desai, et al., "The Demand for Tax Haven Operations" (2006) 90 *Journal of Public Economics* 513; M.A. Desai, et al., "Do Tax Havens Divert Economic Activity?" (2006) 90 *Economics Letters* 219; M.A. Desai, "Are We Racing to the Bottom? Evidence on the Dynamics of International Tax Competition" (1999) 96 *Proceedings of the National Tax Association Annual Conference* 176; J.R. Hines, "Will Social Welfare Expenditures Survive Tax Competition?" (2006) 22 *Oxford Review of Economic Policy* 330; J.R. Hines, "Corporate Taxation and International Competition" in A.J. Auerbach, et al. (eds), *Taxing Corporate Income in the 21st Century* (CUP, 2007); Hong and Smart, above fn.33; see also the survey made by D. Dharmapala, "What Problems and Opportunities are Created by Tax Havens?" (2008) 24(4) *Oxford Review of Economic Policy* 661, 677.

[35] M. Devereux, "Business Taxation in a Globalised World" (2008) 24(4) *Oxford Review of Economic Policy* 625, 633.

[36] See A. Haupt and W. Peters, "Restricting Preferential Tax Regimes to Avoid Harmful Tax Competition" (2005) 35 *Regional Science and Urban Economics* 93.

[37] See also the summary conclusion by Keen and Konrad, above fn.31, 59 and following.

[38] Some attempts to provide guidance in this regard for practical policy-making have nevertheless been made in literature; see, e.g. Edwards and Keen, above fn.14; Fuest and Huber, above fn.23.

[39] Likewise, K. Stewart and M. Webb, "International Competition in Corporate Taxation: Evidence from the OECD Time Series" (2006) 21(45) *Economic Policy* 153.

[40] See S. Bucovetsky, "Asymmetric Tax Competition" (1991) 30 *Journal of Urban Economics* 167; R. Kanbur and M. Keen, "Jeux Sans Frontiers: Tax Competition and tax Coordination When Countries Differ in Size" (1993) 83 *The American Economic Review* 877; J.D. Wilson, "Theories of Tax Competition" (1999) 52 *National Tax Journal* 269; Avi-Yonah, above fn.22, 1613.

[41] See A. Kemmerling and E. Seils, "The Regulation of Redistribution: Managing Conflict in Corporate Tax Competition" (2009) 32 *West European Politics* 756.

it is important to follow a *conceptually clear* dividing line between acceptable and unacceptable forms of tax competition, notwithstanding the need to apply a holistic approach in each individual case. Otherwise, the relevant criteria cannot be consistently applied, which risks disputes and "avoidance" on the side of interested governments, and may entail the dilution of criteria and, consequently, a lack of political support in implementation.[42]

2. OECD actions against "harmful tax competition" in retrospect

In 1998, the OECD's Committee on Fiscal Affairs prepared a report on harmful tax competition that aimed to address "the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases".[43] The Report did not address the debate on the pros and cons of taking measures against tax competition in a comprehensive fashion. Instead, it tried to chart a middle course in its evaluation of the phenomenon. Tax competition was supposed to be "harmful" only in case of "special" tax provisions or administrative practices with the "principal aim of bidding *aggressively* for the tax base of other countries" through the attraction of capital and financial flows and the corresponding revenue from the other jurisdictions.[44] This concept was substantiated further by a list of indicative factors that would have to be assessed in order to determine whether a tax regime was "poaching other countries' tax bases" by causing substantial spillover effects.[45] A zero or low tax rate provided an essential starting point for the assessment of "harmfulness", but the final judgement was made on the basis of three "key" and eight "other" factors, as well as after taking into consideration the economic effects of the regime in issue.[46] The "key" joint factors included: (i) the lack of transparency; and (ii) the absence of effective exchange of information. The third factor distinguishes between "tax havens" and "harmful preferential tax regimes": the 1998 Report pointed to (iii) the lack of a substantial activities requirement for the former and the "ring fencing" practices aimed at protecting the domestic economy for the latter. The "other factors" were provided specifically with a view towards identifying harmful preferential regimes, mostly depicting specific approaches for granting tax concessions for certain types of income, such as an "artificial" definition of the tax base or the fact that the tax rate or the tax base was negotiable under certain conditions. These factors were of an ancillary nature. For instance, the list included the existence of secrecy provisions, which one may consider as being already covered by the transparency requirement. The tax competition in the form of a mere difference in the effective tax rates, in so far as "the other factors are not present", was not regarded as "harmful".[47]

The OECD campaign had several limitations. It focused on geographically mobile activities, such as financial and other services, including intangibles, whereas manufacturing and similar "real" investments were (ambiguously) left for future consideration. Territorially, it targeted "tax havens" worldwide and "preferential tax regimes" primarily in the OECD member countries:

[42] See also, regarding the 1998 initiative, S. Jogarajan and M. Stewart, "Harmful Tax Competition: Defeat or Victory" (2007) 22 *Australian Tax Forum* 3, 9 and following.
[43] 1998 OECD Report, above fn.4, 3.
[44] 1998 OECD Report, above fn.4, 16 (emphasis added).
[45] 1998 OECD Report, above fn.4, 16.
[46] 1998 OECD Report, above fn.4, 21–25 (tax havens) and 25–35 (preferential regimes).
[47] 1998 OECD Report, above fn.4, 20.

although non-OECD economies were encouraged to associate themselves with the campaign directed against the latter,[48] the "soft" expansion of the OECD standards has not been proactively pursued beyond the exchange of information and transparency requirements. The implementation was channelled through non-binding mechanisms. The OECD published 19 recommendations that included measures for changes in national laws and double tax treaties, as well as multilateral responses, to tackle harmful tax practices. It relied upon reputational pressure against the countries maintaining the "harmful" regimes by adopting two lists: one of "tax havens" and one of "potentially harmful preferential tax regimes".[49] The OECD countries committed to co-ordinate their policy responses against the "tax haven" jurisdictions and to eliminate the "potentially harmful preferential tax regimes" in their own jurisdictions.

The OECD list of 35 "tax havens" was published in 2000.[50] Although the 1998 OECD Report distinguished a requirement for "substantial activity" as one of the "key" indicative factors for "tax heavens", the subsequent lack of political support narrowed the OECD actions to seeking the governments' commitment to the OECD's standard of transparency and an effective exchange of information.[51] This criterion was decisive for the formation of a follow-up blacklist of seven "uncooperative tax havens" (2002).[52] This blacklist was cleared by 2009, when Andorra, Liechtenstein and Monaco expressed their commitments.[53] The jurisdictions that committed to the OECD's standards of transparency and exchange of information were subsequently invited to join the Global Forum on Taxation to participate in their further development.[54] Following the financial crisis, tax evasion and avoidance, and in particular the lack of transparency, were put high on the political agenda of world leaders. As one of the consequences, the Global Forum on Taxation was reformed in 2009[55]; renamed into the Global Forum on Transparency and Exchange of Information for Tax Purposes, it currently includes 120 members. The Global Forum obtained a three year mandate to undertake a two-phase peer review, assessing the legal and regulatory framework (phase 1) and practical implementation of the OECD standards (phase 2).[56] In the realisation of its new mandate, over 110 peer reviews were completed and over 660 recommendations for improvement were issued by September 2013.[57]

[48] 1998 OECD Report, above fn.4, 58–59.
[49] 1998 OECD Report, above fn.4, 52–58.
[50] It did not include several jurisdictions that met the criteria, but had made "advanced commitment" to the OECD's standards of transparency and exchange of information, i.e. Bermuda, Cayman Islands, Cyprus, Malta, Mauritius and San Marino. OECD, *Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices* (2000).
[51] For the analysis of political debates see: Sharman, above fn.14.
[52] OECD, *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report* (2001).
[53] OECD, *Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices* (2000 OECD Report) (2000).
[54] Established in 2000.
[55] OECD Council Decision, "Establishing the Global Forum on Transparency and Exchange of Information for Tax Purposes" C(2009)122/Final of September 25, 2009.
[56] The terms of reference, methodology and assessment criteria can be consulted at: *http://www.oecd.org/tax/transparency/taxtransparency-globalforumlaunchescountry-by-countryreviews.htm* [Accessed November 5, 2013].
[57] Global Forum on Transparency and Exchange of Information for Tax Purposes (OECD), *Progress Report to the G20 Leaders: Global Forum Update on Effectiveness and On-going Monitoring* (September 2013).

A list of 47 "potentially harmful preferential regimes" in the OECD member countries was also published in 2000.[58] In 2006, the OECD reported that the project "has fully achieved its initial aims"[59]: 20 regimes had been abolished, 14 had been amended to remove their potentially harmful features and 13 were found not to be harmful.[60] The 2006 OECD Report envisioned an ongoing review of newly introduced regimes as well as of amendments to existing regimes.[61] However, the figures reported by the BEPS Report suggest that little progress has been made since then.[62] The Forum on Harmful Tax Practices, which is responsible for this work, has not been substantially reformed. The project largely remained within the borders of OECD membership; although non-OECD economies were encouraged to associate themselves with the 1998 campaign, their involvement was more evident in the context of the actions on transparency and the effective exchange of information, as described above.

Commentators agree that the 1998 campaign was a remarkable shift in the OECD's agenda, which had traditionally focused on double taxation matters.[63] The evident progress in promoting the international standards of transparency and the exchange of information is recognised as the key outcome of the 1998 campaign. However, the OECD has been criticised for departing from and failing to meet its wider initial objectives. The lack of attention paid to the "no real economic activity" requirement meant that the OECD's actions were oriented towards personal income tax evasion, which is more sensitive to "information sharing", rather than corporate tax avoidance.[64] Considering this, some studies argue that "the OECD initiative cannot be expected to have much impact on corporate uses of tax havens, even if (or when) the initiative is fully implemented".[65] Furthermore, the OECD has provided no evidence that the negative effects of "harmful tax competition" have de facto been moderated. Using the example of the Cayman Islands, Kudrle demonstrated that the reforms on information sharing, despite formally being successful, had no significant impact on tax evasion as measured by the volume of tax haven liabilities.[66] The Action Plan states that the underlying concerns of the 1998 OECD Report still hold, implicitly admitting some flaws in the initial strategy and its implementation. The next section analyses the alterations that have been proposed to address the remaining issues more effectively.

3. The "upgraded" strategy in the 2013 Action Plan

Although Action 5 of the Action Plan builds upon the previous campaign, it avoids giving any explicit retrospective evaluation of its lessons and provides little explanation for the choice of

[58] 2000 OECD Report, above fn.53.
[59] OECD, *The OECD's Project on Harmful Tax Practices: The 2006 Progress Report* (2006 OECD Report) (2006).
[60] 2006 OECD Report, above fn.59. See also: OECD press release, "Committee on Fiscal Affairs releases outcome of review of preferential tax regimes in OECD countries", available at: *http://www.oecd.org/ctp/harmful/committeeonfiscalaffairsreleasesoutcomeofreviewofpreferentialtaxregimesinoecdcountries.htm* [Accessed November 5, 2013].
[61] 2006 OECD Report, above fn.59, 6.
[62] It refers to the elimination of over 40 potentially harmful tax regimes. See BEPS Report, above fn.1, 83 and 85.
[63] See, among others, Jogarajan and Stewart, above fn.42, 4 and following.
[64] Dharmapala, above fn.34, 670.
[65] Dharmapala, above fn.34, 670.
[66] R.T. Kudrle, "The OECD's Harmful Tax Competition Initiative and the Tax Havens: From Bombshell to Damp Squib" (2008) 8 *Global Economy Journal* 1524.

priority measures. Functionally, Action 5 envisages: (i) a review of preferential tax regimes in the OECD countries; (ii) a potential modification in the existing institutional structures; and (iii) a revision of the substantive criteria for identifying harmful tax practices. Each of these steps may produce outcomes of different amplitude. Some noticeable vagueness in the formulations of the ultimate goals may partially be explained by the political sensitivity of this matter, especially in the context of global economic difficulties. It leaves the OECD with a much needed flexibility in the process of securing political support for implementation. The lack of more explicit commitments may also indicate that the drafters had no certainty in the scope of their political mandate. Without second-guessing the political intention behind these objectives, the following section focuses on the two substantive priorities: substance and transparency.

a. Substantial activity requirement

As mentioned above, the 1998 OECD Report considered "ring-fencing" to be a key factor for identifying "harmful" preferential regimes. Ring-fencing consists of insulating the preferential tax regime partially or fully from the domestic markets of the country providing the regime.[67] The most common forms of ring-fencing rely on conditions that exclude resident taxpayers from taking advantage of the regime's benefits, or that prohibit enterprises that benefit from the regime from operating in the domestic market. The limitations in the personal eligibility or geographical scope of this kind of preferential regime partially undermine any possible advantages of international tax competition. They can create internal distortions in the jurisdiction that offers the regime, and they may have a significant negative impact on other jurisdictions' ability to raise revenue in accordance with their tax and social equity preferences. Therefore, such practices have been characterised as "harmful".[68]

The Action Plan seeks to go beyond this well-established criterion, promoting a realignment whose precise scope is still not entirely clear, but is potentially far-reaching. The Action Plan notes that international tax competition for mobile sources of income—denominated as "the race to the bottom"—nowadays tends to take "less the form of traditional ring-fencing and more the form of across the board corporate tax rate reductions on particular types of income".[69] A first, explicit conclusion drawn from this insight in the Action Plan is that a substantial activity requirement should be established for the evaluation of preferential regimes.[70] A similar criterion could already be found as one of the "other factors" in the 1998 OECD Report, to be relied upon in assessing preferential regimes under the heading "purely tax-driven operations or arrangements that involve no substantial activities".[71] This criterion will now probably be elevated to the status of a new key factor, which reflects a cornerstone objective of the Action Plan to realign "taxation and relevant substance".[72]

At first sight, the practical implications of such a move seem to be limited in scope: different from tax havens, most preferential tax regimes seek to attract *genuine* economic activities by

[67] 1998 OECD Report, above fn.4, 26–27.
[68] Likewise Avi-Yonah, above fn.22, 1663.
[69] Action Plan, above fn.1, 17.
[70] Action Plan, above fn.1, 17–18.
[71] 1998 OECD Report, above fn.4, 26–27.
[72] Action Plan, above fn.1, 13.

offering attractive tax conditions. However, within the framework of the Action Plan, the emphasis on economic substance in Action 5 has to be read in the broader context of the intended fight against conduit companies, treaty shopping and abuse, and the shifting of profits through aggressive transfer pricing.[73] While these aspects are also addressed in a targeted manner in Actions 6 and 8 to 10 of the Action Plan, they are likely to play a role in the future assessment of preferential regimes, too: the degree to which such regimes facilitate or even encourage the aforementioned tax minimisation strategies, rather than ensuring that only the "real" value generated by genuine economic activities carried out in the respective jurisdiction benefits from a preferential treatment, will probably become an important factor in the new "holistic" review procedure.[74] Moreover, by focusing on economic substance, the Action Plan also makes an implicit commitment to tackle corporate tax avoidance through the use of tax havens.[75] Admittedly, the concept of a tax haven is not mentioned in Action 5. However, it would seem only natural for the OECD to capitalise on the political momentum behind the BEPS campaign in order to finally give some bite to the substantial activity criterion, which was stated in the 1998 OECD Report as being key for identifying tax havens, but which—as explained in Section 2 above—has not yet been fully followed through.

The crucial question in this context will, of course, be how to substantiate a rather abstract requirement of "economic substance". Quite probably, a "one size fits all" approach to this problem would be inappropriate. Instead, different assessment criteria will have to be developed for certain categories of beneficial tax rules. In the case of jurisdictions that are liable to attract conduit companies because they not only offer low or no tax burdens for business profits, but also an attractive tax treaty network (or access to protection under the framework of EU law) for inbound earnings, and a similarly attractive network or low withholding taxes for outbound payments, it will not be sufficient to require some commercial presence and activity beyond a mere letterbox. Considering the broader context of the BEPS initiative, such a regime should also be considered harmful if it does not take adequate precautions to exclude from its scope of application, or from the relevant treaty benefits, entities (conduits) that have not been set up for valid commercial reasons. This should be presumed, in particular, when the interposition of the company in the low-tax jurisdiction does not create any additional significant value beyond mere tax benefits.[76] By contrast, preferential regimes that privilege profits resulting from certain economic activities will have to be assessed in the light of their potential to attract "book profits" through transfer pricing. Certainly, an indicator for harmful "book profit" attraction would be a lack of relevant transfer pricing adjustments in the jurisdiction that offers the preferential regime. A significant and beneficial deviation, either in statutory law or in administrative practice, from established OECD transfer pricing standards, may also permit the characterisation of the regime

[73] There is considerable empirical evidence that multinational firms (mis-)use transfer pricing in order to shift profits between countries, taking advantage of differences in statutory tax rates. See the references cited by Devereux, et al. (2008), above fn.12, 1211.

[74] This is reasonable from the perspective of curbing negative effects of international tax competition, since a firm's decision on where to locate certain economic activities will not only depend on the effective average tax rate, but simultaneously on profit shifting opportunities, cf. Leibrecht and Hochgatterer, above fn.12, 617.

[75] Small tax havens typically rely on low or no statutory tax rates to attract book profits rather than genuine, profit-generating economic activities, see Devereux and Loretz, above fn.10; Keen and Konrad, above fn.31, 50.

[76] See also 1998 OECD Report, above fn.4, 22: a tax practice is harmful if it does not require "adding value".

as harmful. Profits should be benefiting from special treatment only to the extent that their allocation to the jurisdiction in issue can be justified by functions performed, assets used and risks assumed.[77] Regarding regimes aimed at profits derived from intangibles, the beneficial treatment should be primarily accorded to returns attributable to clearly identifiable core functional contributions to (added) value creation, such as the development, active management or protection of intangibles.[78] This will play an important role in the assessment of patent box regimes, in particular. Assets used and risks assumed should be permitted to be taken into consideration as relevant factors only to the extent that they go beyond mere ownership of the intangible.

But independent of whether or not the criteria suggested above will eventually be adopted in the course of the BEPS process, two challenges certainly lie ahead. First, the co-ordination of the relevant criteria with any approach adopted under the OECD Transfer Pricing Guidelines. Secondly, in the specific case of EU and EEA Member States, the reconciliation with the requirements of EU law of any eventual authorisation to take countermeasures against the tax regimes that will be deemed harmful due to their extension beyond substantial activities. While the Court of Justice of the EU has accepted violations of the arm's length standard as a form of abuse that Member States may combat,[79] the court is much more reluctant to admit measures that target conduit companies or base companies sheltering profits from taxation in the home country of the taxpayer.[80] This highlights the need, at least for EU Member States, to eliminate such potentially harmful practices at the root, that is in the jurisdiction that offers them, through a reliable and effective institutional framework.

The OECD and the national governments that are involved in the development of a new global standard against harmful tax competition should, however, be careful not to pursue a policy that risks effectively pillorying all preferential regimes. It would indeed go a step too far to categorise as potentially harmful practice *any* significant and targeted but comprehensive tax concession for specific types of mobile sources of income. No convincing explanation could then be given as to why tax systems that offer low corporate tax rates for all business activities, or that reduce tax burdens on capital investments in general, should be considered unobjectionable, whereas more targeted but non-discriminatory measures aimed at creating attractive tax conditions for selected business or investment activities should qualify as aggressive beggar-thy-neighbour politics. Regarding the merits and drawbacks of international tax competition discussed above, both strategies indeed seem comparable, the only difference being the magnitude of positive and negative "spillover effects". In particular, it cannot be convincingly argued that in the context of corporate income taxation, "general" reductions in the tax burden imply corresponding reductions in public expenditure, thus ensuring efficient taxation according to the benefit principle[81]: revenue losses could also be compensated by increasing the tax burden on other activities and factors, or by reducing the production of public goods and transfer payments that are not relevant for corporations. Besides, as has already been pointed out, several authors have

[77] See OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Publishing, 2010).

[78] See also the tendency reflected in OECD, *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles* (July 30, 2013), para.79.

[79] *Societe de Gestion Industrielle SA (SGI) v Belgium* (C-311/08) [2010] ECR 1-487.

[80] *Cadbury Schweppes plc v IRC* (C-196/04) [2006] ECR I-7995.

[81] For a possibly different position see Avi-Yonah, above fn.22, 1627 and following.

come to the conclusion that targeted but non-discriminatory preferential regimes may better reconcile efficiency and equity of taxation than across-the-board tax rate reductions.[82]

b. Transparency of tax regimes

Under the 1998 OECD Report any preferential tax regime should satisfy two conditions to be deemed "transparent": (i) it must be based on clear conditions of administration and apply consistently to similar taxpayers (internal context); and (ii) the details on its operation should be available to the tax authorities of other countries (external context).[83] The failure to meet these conditions "may suggest" that the preferential tax regime constitutes "harmful" tax practices.[84] Two reasons were given in defence of this position: the discrepancy in the treatment of similar taxpayers is "likely to increase harmful tax competition" and "the lack of transparency (…) will make it harder for the home country to take defensive measures."[85] A direct causality between the breach of these conditions and the qualification as harmful tax competition is not self-explanatory and requires further qualification. The true rationale underlying the transparency criterion seems to be a mere *presumption* that any non-transparency in the operation of tax provisions has harmful effects on the competitive position of other states similar to those attributed to formally ring-fenced regimes. This is demonstrated by repeated references in the explanatory notes to the likelihood that opaque regimes may lead to an inequality of treatment of taxpayers, sector-specific or individual privileges, and corruption.[86] However, the operational (or procedural) assessment should not substitute a more substance-focused analysis; otherwise, the heading of "harmful tax competition" is used as a political shelter for other, broader objectives of OECD member countries. Admittedly, the idea of transparency constitutes an attractive political target in its own right, which goes back to the basic virtues of the rule of law, such as openness and clearness of regulation.[87] Furthermore, these fundamental virtues can generate consensus exceeding the legitimising capacity of "harmful tax competition": this was implicitly acknowledged by OECD members when they increased their efforts to address this particular issue in isolation in 2001 (see section 2 above). Yet, the requirement of transparency in the context of eliminating harmful tax practices needed some qualification.

The OECD is now determined to focus on one aspect of transparency, which is the one most closely connected to the idea of "harmful" administration. Emphasising the need for a greater "transparency between governments", Action 5 of the Action Plan gives priority to "compulsory spontaneous exchange on rulings related to preferential regimes".[88] Conceptually, a compulsory exchange of rulings would not go beyond what was already required by the 1998 OECD Report, pursuant to which

[82] See above in fnn.30–33.
[83] 1998 OECD Report, above fn.4, 28.
[84] 1998 OECD Report, above fn.4, 30.
[85] 1998 OECD Report, above fn.4, 27.
[86] e.g. 1998 OECD Report, above fn.4, 28–29.
[87] See J. Raz, *The Authority of Law* (Oxford: OUP, 2009), 212–219.
[88] Action Plan, above fn.1, 18 and 31.

> "details of the regime, including any applications thereof in the case of a particular taxpayer, must be available to the tax authorities of other countries concerned".[89]

In practice, however, following the 1998 OECD Report, the OECD has been primarily focused on the exchange of information "upon request", that is, when the information is provided to the foreign tax authorities on the basis of a specific request with respect to a specific taxpayer. The spontaneous exchange of information is not present in the 2002 Model Agreement on Exchange of Information on Tax Matters,[90] and it is only briefly acknowledged in Article 26 of the OECD Model Convention on Income and on Capital and the OECD Commentary.[91] The most comprehensive coverage of the circumstances in which the contracting parties should provide information spontaneously is envisaged by Article 7 of the Convention on Mutual Administrative Assistance in Tax Matters.[92] Pursuant to this provision, certain information is exchanged unconditionally and without prior request if it is considered to be relevant to a foreign tax authority. The evaluation of relevance remains within the discretion of tax authorities; as a result, the effectiveness of implementation largely depends on the tax administrations' capacity to identify such information, and on their willingness to share it. The need to fully implement existing legal standards provides a strong rationale for more elaborate guidance. In practice, the requirement for spontaneous exchange on rulings could greatly facilitate the assessment of a preferential regime, especially with a view towards its *actual* attitude towards book profit shifting and economic substance requirements (see section 3a above), because the relevant information would be more readily available. Failure to comply with this new transparency standard would result (almost) automatically in a qualification as a "harmful" regime; that is the presumption mentioned above will be extended to a lack of spontaneous exchange of rulings.

Accepting the solution as such, one should, however, answer several questions regarding the best balance to be achieved between costs and benefits. One of the most obvious objections to the compulsory spontaneous exchange of rulings related to preferential regimes would be the administrative burden that it creates. Furthermore, there is little guarantee of reciprocity or even mere relevance of the information that is exchanged without request. To moderate these effects, the rulings that are subject to such an exchange should be defined in more specific terms. On the one hand, this delimitation exercise should exclude some rulings from consideration. Those rulings that are adopted on the basis of clear and consistent administrative practices, that do not depart from the statutory provisions and/or are reflected in publicly available guidelines, may be excluded (unless requested). On the other hand, there is a need to agree upon specific circumstances in which the exchange might be particularly relevant, and upon its essential components. A too broad definition in this case may defeat the purpose. Another inherent weakness of the proposed exchange on rulings is of the opposite nature: Action 5 narrows down the scope of exchange to regimes that have already been identified as preferential under statutory

[89] 1998 OECD Report, above fn.4, 28.

[90] 2002 Model Agreement on Exchange of Information on Tax Matters, Art.5 para.1 (see also the OECD Commentary).

[91] Model Tax Convention on Income and on Capital 2010 (OECD Publishing, 2012). Note also OECD, *Update to Article 26 of the OECD Model Tax Convention and its Commentary* (approved by the OECD Council on July 17, 2012).

[92] See, OECD, Convention on Mutual Administrative Assistance in Tax Matters, (as amended in 2010); the most recent developments, available at: *http://www.oecd.org/tax/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm* [Accessed November 5, 2013].

law provisions. A preferential treatment that is based exclusively on a system of rulings granting unlawful or discretionary concessions to individual taxpayers is not captured. *Any* rulings that relax the tax burden at an administrative level should be subject to exchange. This route has been taken by the EU Code of Conduct Group (Business Taxation) in developing a Model Instruction to improve the spontaneous exchange of information on cross-border rulings.[93]

The final comment concerns the lack of incentives for exchange. Obviously, the preferential tax regime may be administrated through rulings that are based on clear and consistent criteria, and are also available to all similar taxpayers. However, these types of practices are hardly of major concern in the international context when it comes to the assessment of taxpayers' liabilities. Much more problematic are those situations that depart from the OECD standard, such as where a favourable treatment is provided on a selective basis, or where administrative practices depart from the statutory provisions. In some cases these practices can be associated with corruption or simply an inefficiency of administration, which may be explained by the weak capacity of tax authorities. It is difficult to see what should incentivise (or even enable) such countries to disclose the information, and, furthermore, to make it subject to a compulsory spontaneous exchange. The progress with respect to these types of practices can hardly be reached without designing an incentivising and capacity-building strategy that promotes a wider transparency. It should also be mentioned that the implementation of Action 5 will benefit from close co-ordination with other actions in the Action Plan, in particular Section (iii), which explicitly deals with "ensuring transparency while promoting increased certainty and predictability" (Actions 11 to 14).[94]

4. Co-ordinating the OECD and EU campaigns towards non-member countries

The 1998 OECD Report acknowledged the importance of engaging the "non-member countries with its analytical and policy discussions on harmful tax competition".[95] A proactive dialogue with non-member countries was considered particularly essential in the context of harmful preferential tax regimes: the OECD's recommendations in relation to tax havens were expected to "reduce the amount of displacement", whereas the elimination of harmful tax regimes within the OECD countries was less effective due to the possible relocation to a non-member country that continues to operate a preferential regime.[96] The Forum on Harmful Tax Practices was limited to the OECD member countries, but had a political mandate to "engage in a dialogue with non-member countries using, where appropriate, the fora offered by other international tax

[93] *Code of Conduct Group (Business Taxation) Report* (No.11465/13 from June 21, 2013), points 17–19.

[94] Action Plan, above fn.1, 21–23. For instance, Action 13 aims to enhance transparency regarding transfer pricing documentation, including a requirement to provide all relevant governments with information on MNEs' global allocation of income, economic activities and paid taxes. Requiring MNEs to report on their economic activities worldwide should be directly linked with the obligations of governments to disclose any granted tax incentives. Otherwise, this "may also lead to a false presumption that the company involved has shifted profits out of the country when in fact it has received a tax incentive from the government" (see M. Devereux, et al., *Transparency in Reporting Financial Data by Multinational Corporations* (Oxford University Centre for Business Taxation Report, July 2011), 13).

[95] 1998 OECD Report, above fn.4, 10.

[96] 1998 OECD Report, above fn.4, 59.

organisations"[97] on the basis of "the well established procedures already available under OECD rules".[98] The Action Plan seems to go further and explicitly sanctions a more institutionalised form of involvement through "revisions or additions to the existing framework".[99] With no further guidance on the level of such involvement, one may only speculate as to whether the co-operation against harmful tax regimes will follow the approach that has been approbated in the context of transparency and the exchange of information,[100] or whether non-member countries will become engaged in a less institutionalised form. Action 5, however, implicitly suggests that the review of harmful tax regimes may be expanded to non-member countries.

The OECD is not the only platform for intergovernmental co-ordination of actions where national governments are pursuing their interest in the elimination of harmful tax practices. Back in 1997, the EU was one step ahead by adopting its own package of policy measures.[101] Subsequently, the European Commission articulated its interest in integrating the EU standards of good governance in tax matters into a political dialogue between the EU and third countries, as well as developing a more unified approach for EU Member States towards countries that do not adhere to it.[102] The strategy for implementing these priorities was substantiated in the 2012 Commission's Recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters.[103] The EU standard distinguished two components: (i) it refers to the OECD standards on transparency and the exchange of information; and (ii) it requires the elimination of "harmful tax measures" in the area of business taxation as defined by the EU Code of Conduct.[104] Despite the difference in the situations within and beyond the Single Market, the definition of harmful tax practices repeats the Code of Conduct and refers to the conclusions already reached by the Code of Conduct Group. The EU Member States were recommended to adopt "national blacklists" of countries that do not comply with the EU requirements. Where the standards are breached, a Member State is advised to either renegotiate the double tax convention with this country, or suspend or terminate it.[105] If a third country is committed to complying with the minimum standards, a Member State should consider offering "closer cooperation and assistance (…) in fighting effectively against tax evasion and aggressive tax planning", such as a secondment of experts.[106] The Member States should inform the Commission about the measures undertaken, and the Commission will publish a follow-up report by December 2015. In addition, the ECOFIN invited the EU Member States to consider

[97] 1998 OECD Report, above fn.4, 58.
[98] 1998 OECD Report, above fn.4, 54.
[99] Action Plan, above fn.1, 31.
[100] The Global Forum on Transparency and Exchange of Information for Tax Purposes operates on the basis of the equality of all participants, takes decisions by consensus and offers structured review process.
[101] The so-called "Monti Package" consisted of legislative proposals on the tax treatment of interest, royalties and savings in cross-border situations, as well as a non-binding instrument, the Code of Conduct for Business Taxation, which addressed the problem of harmful tax competition.
[102] Commission, *Promoting Good Governance in Tax Matters* ((Communication) COM(2009)), 201 final, see also Commission, *Tax and Development: Cooperating with Developing Countries on Promoting Good Governance in Tax Matters* ((Communication) COM (2010)), 163 final.
[103] Commission Recommendation C(2012) 8805 final of December 6, 2012 regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters.
[104] Commission Recommendation, above fn.103, point (9).
[105] Commission Recommendation, above fn.103, point 4.3.
[106] Commission Recommendation, above fn.103, point 6.1.

"whether developing a European list of third country non-cooperative jurisdictions is appropriate",[107] and this proposal was supported by the European Parliament.[108]

The 1997 EU policy package was regarded by the 1998 OECD Report as "broadly compatible" to OECD efforts and with "mutually reinforcing" impact, even though the two approaches were different in their institutional and procedural design, as well as in the scope of their actions.[109] The EU Code of Conduct covered a broader scope by addressing *any* tax measures that "affect, or may affect, in a significant way the location of business activities in the Community".[110] The OECD's campaign was, as explained in section 2, wider territorially. The 1998 OECD Report nevertheless reconciled the EU and OECD review procedures by referring to their "different institutional frameworks" and "geographical grouping", concluding that "each Organisation is responsible independently for the interpretation and application of its respective instruments".[111] Currently, however, since the EU and OECD are both proactively targeting non-members, the scope of overlap has increased, actualising the need for closer co-ordination. A political dialogue recognises this: in May 2013, the ECOFIN emphasised the importance of a joint work for the Code of Conduct Group on Business Taxation with the OECD to tackle harmful tax practices in third countries.[112] Indeed both, the OECD and the EU, would benefit from a more coordinated approach.

5. Conclusion

There is no agreement in public economics on whether and under what conditions negative implications of international tax competition outweigh its positive aspects. Neither the 1998 OECD Report, nor the BEPS campaign, attempts to address this fundamental question in a comprehensive manner. Instead, the OECD chose to find the middle ground by tackling those tax regimes that are deemed to "aggressively" attract capital flows and corresponding revenue from other jurisdictions. Under the 1998 OECD Report, a zero or low tax rate, the "ring-fencing" practices, the lack of transparency and the effective exchange of information were viewed as the "key" factors in evaluation of the "harmfulness" of preferential tax regimes. Following the 2013 Action Plan, this list will be supplemented with the requirement of "substantial activity" (a similar criterion was included already in the 1998 OECD Report as an "other", supplementing, factor) and with the incorporation of compulsory spontaneous exchange of rulings related to preferential tax regimes. Conceptually, the strategy proposed by Action 5 of the Action Plan remains within the original remit that was indicated by the 1998 OECD Report and it can be seen as a new attempt to reach the initial objectives. However, the vagueness in formulations of "expected output", as well as the absence of any measurable goals and explicit political commitments towards them, makes the outcomes of Action 5 highly dependent on political

[107] Conclusions of the 3238th Council Meeting "Economic and Financial Affairs" (May 14, 2013).
[108] *European Parliament resolution of July 4, 2013 on the European Parliament's priorities for the Commission Work Programme 2014* (2013/2679(RSP)), point 44.
[109] 1998 OECD Report, above fn.4, 11.
[110] *ECOFIN Council Meeting Conclusions of December 1, 1997 concerning taxation policy, Annex 1: Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of December 1, 1997 on a code of conduct for business taxation* [1998] OJ C2/1, point A.
[111] 1998 OECD Report, above fn.4, 11.
[112] Conclusions of the 3238th Council Meeting "Economic and Financial Affairs" (May 14, 2013).

support within and beyond the OECD member countries. Even though the endorsement of the Action Plan by G20 creates an expectation of a stronger political foundation, the success of this "reinforcement" is far from certain. The proportionality of the "substantial activity" test and its consistent application, as well as sustaining the balance between costs and benefits in setting transparency requirements will be among key issues to be addressed in this regard. ☞

☞ European Union; International taxation; OECD; Tax avoidance; Tax competition; Tax havens