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International Taxation and the Moral Debate

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BEPS' input to a fascinating discussion

Taxation is the unrivaled field of law where public interest (attending state goals towards the population's needs as a whole), in one hand, and private wealth protection, in the other, most apparently collide;[1] and the reason for that is quite simple: Public needs are financed out of private wealth through the tax system, by applying a wide variety of levies which, patterned after the mandates of the tax technique, are combined in a given manner to attend to certain preset tax policy goals.

Leaving the legal perspective aside for a moment, from the preceding paragraph's simple description one may easily conclude that taxation is a complex phenomenon which can be approached from a number of different angles, including but not limited to, a political, sociological, ethical, economic, fiscal, and behavioral perspective.

From a strictly legal perspective the public-private collision inherent to taxation is so significant to social equilibrium that states' permissible scope of action and private protection against state overflows in this field are usually set forth in the foundational documents of every organized society. And, thus, modern western constitutionalism adopts almost unanimously the principle of reserve or legality as the clear dividing line between the states' power to impose and the taxpayers' freedom to arrange their own private affairs from a tax angle. In accordance to this principle it is beyond all dispute that nobody is obliged to contribute to public needs beyond the scope of a legal mandate, so that there is nothing reproachable in arranging one's business affairs in an efficient tax manner as long as it is done in conformity with the text and within the spirit of the tax laws enacted by parliaments in the exercise of the state tax jurisdiction.[2]

Nowadays, however, the traditional legal borders between the states' power to impose and the taxpayers' behavior *vis-à-vis* the application of taxes are deeply shaken because of the increasing influence of somehow conflicting approaches to taxation coming from other disciplines, such as ethics and political science.

Moreover, for a variety of reasons, including (i) the industrialized countries' dissatisfaction with low revenue collection levels that started following the 2008-9 world financial crisis, (ii) the perceivably abusive arrangement of affairs within the global company, and the appearance of (still tax-uncaught) business manifestations such as the new digital-economy models, and (iii) the persistence of some tax-opaque offshore jurisdictions to remain impenetrable to the international exchange of information, politician and the press have lately fueled in practice the trend to analyze

the tax phenomenon (particularly in cross-border situations) and the taxpayers' conduct vis-à-vis taxation beyond a strictly-legal "lawful-unlawful" dual test. [3]

Under this approach, the well-settled distinction (and associated legal consequences) among legitimate tax planning, tax avoidance and tax evasion started to disappear in the political language. In other words, unable to fight the new realities efficiently with existing legal tools, political leaders jump over traditional legal concepts, and focus their speeches on more flexible, all-embracing ethical standards pursuant to which the taxpayers' behavior is judged as equally reproachable beyond legal standards. In this line, a new concept is coined into the law as a leading meta-legal interpretation tool (despite being alien to the law in Continental and Anglo-Saxon law systems), and taxpayers are deemed to be legally obliged by their fair share under the circumstances.[4] In this context the crucial question is whether the legal share and the fair share are antagonistic terms; or, in other words, whether demanding the payment of a tax obligation in fulfilment of one's fair share without a clear legal basis is lawfully demanded. Certainly it is not if, as it usually happened, fair share taxation is understood as the equivalent to the taxpayers' maximum possible tax burden under the circumstances.[5]

In the years following the last world financial crisis, public voices at both shores of the Atlantic started to speak out in term of immoral or unpatriotic taxpayers' conduct,[6] referring to actions that even though coming within the text and meaning of the law, actually or potentially erode the national tax basis and/or allow taxpayers to shift income to alien, more suitable jurisdictions.

At the basis of this development lies the ethically appealing but still mistaken "two-pockets theory": Money either goes as taxes to the government's coffer which applies it candidly to finance public needs, or to the taxpayers' pocket who greedily keep it for themselves even in violation of others' elementary human rights, including but not limited to the right of the poorest to be fed, sheltered, cured from diseases, and cared of in every possible way.[7]

Within this over simplistic view –the money that do not fall within the government's coffer directly make shareholders illegitimate richer–, back in 2012-13, the pendulum started to hit hard to the global company[8] which, allegedly, manages to pay taxes nowhere (i.e., neither at home nor at host countries), thus overcharging other less mobile activities and taxpayers (e.g., personal services rendered by resident individuals) who, as part of this *zero-sum game*, are consequently called to finance more heavily an ever-increasing public expenditure.

But the simplest observation shows that while in corporate solution, monetary resources circulate among a wide spectrum of *flesh-and-bone* persons, *i.e.*, they are, *inter alia*, (i) used to pay white- and blue-collar salaries, purveyors, and contractors, (ii) applied to finance R&D expenses aimed at creating IP registrable patents and copyrighted property, then embedded in marketable goods that some way or another improve people's lives, and (iii) utilized to acquire business assets used in manufacturing and sales activities. Even if, as expected, a business generates a distributable surplus, it is worth considering that most global companies' equity is floated, so that distributed profits mostly revert to the public at large rather than to a selected group of super-rich individual owners. But even if it were so (an unintended by-product of capitalism), some super rich individuals (but not all) are philanthropist persons who arrange their businesses as efficiently as possible, in accordance with the applicable tax laws at home and beyond, to be able to reach their personal philanthropic goals.[9]

Based on the foregoing, one may be tempted to reach the conclusion that, in practice, the principle

of reserve or legality functions as a legal obstacle against higher individual and social values which would mandate the wealthy to relieve the needs of those less protected persons through the tax system; or, in other words, against the redistributing social function of the tax system. In fact, however, from its very beginning, the reserve principle protects all inhabitants against the otherwise unlimited power of the sovereign and it means nothing as regards vertical and horizontal equity is concerned. Achieving vertical and horizontal equity is dependent upon other factors such as the tax policy and the social values embodied in its design, as well as the quality of the tax legislation.[10]

Although the discussion of the ethical approach to the construction of the tax obligation goes on nowadays, as from 2012 tax policy makers from industrialized countries started to realize that, beyond the issues posed by the global company taking advantage of existing opportunities to reduce its tax liabilities, the actual problem was in the loopholes and rule mismatches offered by domestic tax legislation and an outdated general and conventional international tax system, so that a consistent and systematic combined effort was required to overcome it, amending national as well as international conventional law rules. This was rightly perceived as an extremely ambitious goal far beyond the reach of individual nations, or even blocks of nations' unsystematic attempts.

The project of reshaping the international tax framework needed to be entrusted to a technically-competent multilateral body, which were also capable of summing up to the common endeavor as much participants as possible. In this context, and with a strong support from member states and G20 countries, OECD took the lead and a first diagnostic on the illness affecting international business taxation was offered to the tax community in October 2012.[11]

OECD's message sounded loud and clear: Let's recreate a level playing field for businesses by making the necessary changes to close existing loopholes through the amendment of domestic rules and bilateral conventions, as well as multilateral instruments, but without departing from elemental traditional paradigms ruling contemporaneous international taxation.[12] This was one of the BEPS Project's greatest achievements: To carry on a concrete effort to reshape international business taxation within its natural legal framework, and, thus, putting aside alternate perspectives that following the mood of the times would have implied a jump to the void with chaotic effects.

The BEPS project's kept the right path at every subsequent step, including (i) the release in June 2013 of a first document aimed at implementing a program to neutralize BEPS;[13] (ii) the drafting of the OECD/G20 BEPS Plan, a guiding document on key aspects to be addressed henceforth, submitted to the G20 Meeting held in Saint Petersburg in September 2013, and subsequently approved by the Leaders' Declaration at that meeting.;[14] and (iii) the release in October 2015 of the final Reports[15] concerning all but Action 15 (multilateral agreement) whose outcome is expected by the end of 2016.

OECD's effort has been gigantic and the goals achieved within the preset time framework: Final recommendations are aimed at making the global business tax environment fairer than ever by closing loopholes and adopting rules of international conventional law which would be adopted by all participating nations; all of that with the aim of making the global enterprise accountable for taxes at source (markets) and home, and without altering existent inter-nation equity. Beyond final successes and disappointments, the task was not an easy one considering the need to listen and coordinate many diverging voices, overcome different viewpoints, and still reach workable outcomes.[16]

There is still much to be done at the current implementation stage at national level and in connection with the still to be born catch-all multilateral agreement. Meanwhile, advances at the OECD level, the EU level (anti-tax avoidance proposed package), and in a number of countries compound a race against corporate abuses through the rule of law that has been widely welcome from the outset, but still needs to be counter-balanced by a reasonable defense of corporate taxpayers' rights and guarantees at the national level, as it appears to have been simultaneously learned by the international business community, scholars and practitioners.

All in all, a road ahead plenty of foreseen and unforeseen difficulties coming from a presumably fierce competition on the inter-jurisdictional allocation of a greater post-BEPS global tax basis, but yet a road that following the lead of the OECD's BEPS project and its outcomes, should be paved solely by the law and under the law.

[1] See *BEPS Project at half way – Entering the implementation stage,* Kluwer International Tax Blog, November 2015

[2] See, inter alia, *Gregory v. Helvering*, U.S. Supreme Court (1935); *SRL IKA Industrial Comercial Argentina*, Argentine Supreme Court (1958), and similar highest courts' cases elsewhere.

[3] The result is an idealistic view, or even worse, a sort of tax fundamentalism that having originated in the UK back in 2012, rapidly spread all over the EU and other regions.

[4] Please note that this approach goes far beyond the application of GAAR, since the latter as applied to the interpretation of the tax law and/or the taxpayers' behavior, depending on the national legal order, is always a legal concept which adopts different forms depending on the statutory language (e.g., economic reality, substance over form, business purpose or the like).

[5] It must be recognized, however, that this is a highly controversial open issue around which there is an unsettled discussion in academic and political *fora*, in industrialized and emerging economies as well.

[6] Most notably that was the case in the UK and the US. In the UK, the Parliamentary hearings led by Margaret Hodge and targeting US MNEs made headlines in the press during 2012. President Obama used the expression "unpatriotic" in connection with *inversion processes* by U.S. MNEs, still not a fully curtailed move and a lasting headache to the US administration.

[7] See footnote 1, above. The ethical approach to taxation still maintain an unwritten chapter on the government's linked side; e.g., on transparency of public affairs (including application of tax funds), public servants' associated behavior, and the legitimacy of methods to access to fraudulent maneuvers in the private sector. The Panama Papers recent affair abridges, as in a Nutshell, all this not yet properly linked, addressed and discussed issues.

[8] See, *inter alia*, Naville & Treavor, Starbucks to Pay 20MM in Tax over Two years after Customers Revolt, The Guardian, December 6, 2012; Bergin, Amazon: Million-Dollar Tax shield, Reuter, UK edition, Dec.6, 2012; White, Foreign Companies Face UK Tax Investigation, The Telegraph, March 25, 2013 (Facebook and Google cases); Dixon, Dawbagh & Artofky, Google plans to litigate Us Tax Dispute with IRS, Reuter, US edition, February 6, 2013; A Choice for Corporate America: Are you with America or the Cayman Island?, Sounders Business Blog, February 9, 2013; Kavoussi, General Electric Avoid taxes by Keeping $108 Billion Overseas, The

Huffington Post, March 11, 2013.

[9] Just as an example think of Bono-U2-One who made headlines because of their tax behavior; by conducting their affairs in an efficient tax manner within the law, they are not retrieving money from the poor but putting themselves in a position to help the most needed, and there should be nothing reproachable in that behavior.

[10] Similarly, Inter-nation equity in an international context is based on other factors ruled by international general and conventional law, but, again, has nothing to do with the observance of the reserve principle in every national legal order.

[11] OECD BEPS (Base Erosion and Profit Shifting) Report

[12] Allocation of tax jurisdiction on the basis of residence and source, attribution of business income to the source country by application of the PE concept, recognition of the legal separate personality of entities for tax purposes, application of the arm's length principle and the correction of dealings between related companies by transfer pricing rules.

[13] *A step Change in Tax transparency,* document prepared for the G8 meeting held in Lough Erne, June 2013

[14] The action plan consisted of 15 specific actions aimed at correcting BEPS issues to be developed and completed over a two-year period (2014-2015).

[15] The Final Reports were released on October 5, and approved by the G20 at the Antalya Summit on November 16, 2015.

[16] BEPS's final reports most notable weakness centered around the level of optionality allowed to national participants at the implementation stage, in my view dangerously exaggerated, but perhaps closely associated to the need of embracing many different opinions.

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