

# Tax Sovereignty in the BEPS Era

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Edited by  
Sergio André Rocha  
Allison Christians

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## Preface

The idea for this book arose during the IFA Congress in Basel (2015). The editors are respectively the general reporters for Subject 1: “Assessing BEPS: Origins, Standards, and Responses” (Professor Allison Christians, writing together with Professor Stephen Shay), and Subject 2: “The Future of Transfer Pricing” (Professor Sergio André Rocha) of the IFA 2017 Congress in Rio de Janeiro. After a meeting discussing the Rio Congress in Basel, the editors were discussing the implications of financial account regulation from a tax sovereignty perspective. That conversation gave birth to this book.

The power of a country to freely design its tax system is generally understood to be an integral feature of sovereignty. However, globalization and income mobility have increased the impacts of a country’s decision on other countries. Now, more frequently than not, one country’s exercise of sovereignty overlaps, interferes with, or even impedes that of another.

In this context, tax sovereignty is sometimes pointed out as cause of some of the most dire problems of the twenty-first century. The idea of sovereignty suggests that countries are independent actors in a global market, freely competing with each other for business and investment opportunities. On the other hand, tax competition is at the center of situations that create base erosion and profit shifting opportunities, which in some cases are viewed as harmful to tax sovereignty.

While the notion of unlimited tax sovereignty has created problems, in the absence of a formal international central power, any reaction against a country’s legitimate action carries the potential to violate such country’s sovereignty. Sovereignty accordingly becomes an impediment to designing a principled allocation of taxing rights across countries, and a typical “risk-society” problem that is embedded in ambivalence and complexity.

Moreover, in a world in which countries’ relative influence and power are unequal, an attempt of a country – or a group of countries – to establish standards that others will follow comes close to the notion of an illegitimate intervention on a nations’ power of self-determination.

Concern with this state of affairs is the main driver of this book. The authors’ contributions deal with different facets of a single topic: How tax sovereignty is shaped in a post-BEPS world. The book unfolds in three parts.

The first, *The Essential Paradox of Tax Sovereignty*, features four chapters. In Chapter 1, Allison Christians introduces the topic by demonstrating how BEPS arose from the paradox of tax sovereignty and analyzing why multilateral cooperation and soft law consensus became the preferred solutions to a loss of autonomy over national tax policy. The chapter concludes that without meaningful multilateralism in the development of global tax norms, the paradox of tax sovereignty will necessarily continue and worsen, preventing resolution of identified problems for the foreseeable future. Ramon Tomazela Santos & Sergio André Rocha pick up this thread in Chapter 2, where they demonstrate that BEPS addresses the symptoms, but not the problems, of the sovereignty paradox. In their view, the central defining problem of this paradox is an ill-defined jurisdiction concept. The chapter demonstrates why tax policymakers need to change the conventional wisdom on sovereignty in order to incorporate new nexus connections due to the changing nature of trade and commerce.

In Chapter 3, Luís Eduardo Schoueri & Ricardo André Galendi Júnior further the inquiry by providing a detailed analysis of the interaction of contemporary cooperation efforts with the sovereignty of states in light of historical claims in economic allegiance, economic neutrality and now cooperation against abusive behavior. Yariv Brauner rounds out this first part in Chapter 4, which establishes the evolution of the concept of tax sovereignty. The chapter proposes an instrumental role for sovereignty in the process of improving cooperation and coordination of tax policies among productive (non-tax haven) countries, to balance claims and serve as a safeguard against political (in this case international) chaos. Brauner concludes that such a change to the business of international tax law would ensure at least an opportunity for all participants to succeed on their own terms.

Part Two of the book, *Challenge to the Foundational Principles of Source and Residence*, takes an in depth look at why residence and source continue to be the two essential building blocks of tax sovereignty and the backbone of the international tax system, surviving BEPS but still subject to multiple challenges in theory and practice. In Chapter 5, Reuven Avi-Yonah and Haiyan Xu argue that BEPS simply cannot succeed in solving the sovereignty paradox because BEPS follows the flawed theory of the benefits principle in assigning the jurisdiction to tax. Avi-Yonah and Xu therefore make a compelling argument that for the international tax regime to flourish in the face of sovereign and autonomous states, countries must commit to full residence-based taxation of active income with a foreign tax credit granted for source-based taxation.

In Chapter 6, Guillermo O. Tejeiro continues the analysis of the fundamental jurisdictional building blocks, demonstrating that by resorting to legal fictions within BEPS and beyond it, states are attempting to enlarge the scope of their personal or economic nexus, or to grasp taxable events and bases beyond their proper reach under well-settled international law rules and principles. Aleksandra Bal furthers the discussion in Chapter 7, with an analysis of how digital commerce has upended traditional notions of source and residence. Bal advocates the consumer's usual residence as a good approximation of the place of actual consumption and therefore the best-justified place of taxation.

Part Three of the book, *Acceptance and Implementation of Consensus by Differently-Situated States*, considers tax sovereignty after BEPS from a range of

perspectives. Chapters 8 through 10 focus on perspectives from lower income or developing countries, while Chapters 11 and 12 review the landscape from the perspective of Europe and the United States, respectively. Accordingly, in Chapter 8, Natalia Quinones explores how developing countries might take advantage of the new international tax architecture, developed for purposes of coordinating the BEPS action plans, to ensure that their voices are truly shaping the standards. She argues that the knowledge gap between developing and developed is getting narrower instead of wider, with major negative impacts expected for the international tax order.

Sergio André Rocha continues this discussion in Chapter 9, with a proposal: instead of simply accepting the BEPS Project's recommendations and their reliance on historical decisions about what constitutes a country's "fair share of tax", developing countries should join in the formation of a "Developing Countries" International Tax Regime to focus discourse on the rightful limits of states' taxing powers. Furthering the theme of autonomous priority-setting, Romero J.S. Tavares focuses in on a key part of the BEPS consensus in Chapter 10, exploring whether implementing the CBCR country by country reporting standard, without a deeper transfer pricing reform, should be viewed as a priority in every country. He further questions whether this particular initiative, even if important, is worthy of mobilization of the scarce resources of developing countries. Tavares concludes with an incisive review of the role of the inclusive framework in prioritizing some needs over others.

Tomas Balco & Xeniya Yeroshenko then consider BEPS implementation from the very different perspective of the EU in Chapter 11. The chapter demonstrates that even, within the EU, BEPS implementation is not straightforward, as the interests of member states sometimes conflict and the basic notion of tax sovereignty remains fundamental even while tax coordination and harmonization across the EU expands. However, the authors note that the progress made in the last several years on key cooperation norms, which was largely inspired by BEPS, has been unprecedented. Finally, Tracey Kaye provides a capstone to the book in Chapter 12, where she makes the convincing case that although some in the United States saw the BEPS Project as a threat to US tax sovereignty, this project was in fact necessary in order for the United States to effectively wield its tax sovereignty. Kaye's chapter thus ends the book with a clear picture of the ongoing paradox of tax sovereignty in the world after BEPS.

The editors would like to take this opportunity to thank the authors for their efforts. We would also like to thank Kluwer, in the person of Simon Bellamy, for all his patience and support.

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