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Multinational Efforts to Limit Intellectual Property Income Shifting: The OECD's Base Erosion and Profit Shifting (BEPS) Project

Jeffrey A. Maine*

Before 2017, there were two major international movements going on at the same time: (1) the Trans-Pacific Partnership (TPP) Agreement¹; and (2) the Organization for Economic Cooperation and Development's (OECD's) Base Erosion and Profit Shifting (BEPS) Project. The movements presented a unique opportunity to consider the intersection of a behemoth multinational trade agreement and ambitious multinational efforts to close international tax loopholes. The opportunity, however, was short lived. In January 2017, newly elected U.S. President Donald Trump unsigned the TPP as a matter of unilateral Executive power, sounding the death knell for the regional trade pact for all countries involved.²

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1. Trans-Pacific Partnership, OFFICE OF U.S. TRADE REP., Feb. 4, 2016. The TPP was a trade agreement among a dozen countries (the United States and eleven Pacific Rim countries) to develop a closer relationship on economic policies and regulation. The TPP would have promoted strong and balanced intellectual property standards to promote innovation and creativity. The TPP would also have removed many tariffs (i.e., taxes on imports) and other barriers to trade.

U.S. President Obama, who was given "fast track" authority for the agreement, highlighted the importance of the trade agreement and the importance of exports for the U.S. economy (e.g., the more U.S. companies export Made-in-America products abroad, the more high-paying jobs can be supported in the United States). *The Trans-Pacific Partnership: What You Need to Know about President Obama's Trade Agreement*, WHITE HOUSE, <https://www.whitehouse.gov/issues/economy/trade> (noting U.S. companies that export pay up to eighteen percent more than companies that do not). It was estimated that the "TPP ha[d] the potential to unleash \$20 billion in new global investment and create 233,000 FDI-related U.S. jobs." *October News Update*, ORG. FOR INT'L INV. (Oct. 23, 2015), <http://www.ofii.org/news/october-news-update>.

The TPP was not without its critics. Some argued that the TPP would intensify competition between countries' labor forces—i.e., American companies would offshore a massive amount of manufacturing jobs to countries offering lower wages to boost company profits. "According to the Economic Policy Institute, the United States [would] lose more than 130,000 jobs to Vietnam and Japan alone. . . ." *The Trans-Pacific Trade (TPP) Agreement Must Be Defeated*, SENATOR BERNIE SANDERS, <https://www.sanders.senate.gov/download/the-trans-pacific-trade-tpp-agreement-must-be-defeated?inline=file>. Critics pointed to jobs lost under previous trade agreements: The United States lost 700,000 as a result of NAFTA, 2.7 million as a result of Permanent Normal Trade Relations with China, and 70,000 as a result of the Korea Free Trade Agreement. *Id.*

2. See Memorandum from the White House, Withdrawal of the United States from the Trans-Pacific Partnership Negotiations and Agreement, 82 Fed. Reg.

Although the TPP is essentially dead, the OECD's BEPS Project is not. Indeed, many nations have been adopting BEPS Project proposals to prevent international tax avoidance by multinational companies. With that said, however, the United States' commitment to adopting BEPS Project proposals is far from certain. For the United States, at least, the end of the era of multinational trade agreements could signal the end of the era of multilateral efforts to close international tax loopholes. This article looks at the OECD's BEPS Project, and its implications for multinational companies and many countries.³

I. THE OECD BEPS PROJECT

At nearly the same time that the TPP was introduced as the first trade deal of the 21st century, the OECD, at the request of the G-20, delivered several recommendations on how to close international tax loopholes used by many multinational companies worldwide. It has become widely known now that many multinational companies with foreign operations have reduced their domestic and foreign tax burdens by transferring their intellectual property assets and operations to controlled foreign subsidiaries in low-tax countries. And there is now evidence that the practice has resulted in significant erosion of domestic tax bases. The United States estimates its loss of corporate revenue to be over \$100 billion every year to low (or zero) tax countries, such as Ireland, Switzerland, and the Netherlands, as well as sandy tax havens like Bermuda and the Cayman Islands.⁴ Economic studies estimate that for the global market, including the United States, revenue losses may exceed \$280 billion per year.⁵ The OECD recently found the annual net tax

8,497 (Jan. 23, 2017) (failure of the United States to ratify the agreement killed the TPP for all other signatories).

3. See JEFFREY A. MAINE & XUAN-THAO NGUYEN, *THE INTELLECTUAL PROPERTY HOLDING COMPANY: TAX USE AND ABUSE FROM VICTORIA'S SECRET TO APPLE* (2017) (detailed treatment of the subject).
4. STAFF OF THE JOINT COMM. ON TAXATION, 121ST CONG., JCX-141R-15, *ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2015–2019* (2015), <https://www.jct.gov/publications.html?func=startdown&id=4857>; Kimberly A. Clausing, *The Effect of Profit Shifting on the Corporate Tax Base in the United States and Beyond 2*, 7 (June 17, 2016) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2685442.
5. Kimberly A. Clausing, *The Effect of Profit Shifting on the Corporate Tax Base in the United States and Beyond 2* (June 17, 2016) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2685442.

revenue loss to be up to \$240 billion.⁶ And developed countries are not alone; base erosion is a large problem in developing countries as well.⁷

Base erosion due to profit shifting by multinationals is viewed as *economically unjustified*. Less tax revenues means cuts in vital government services, increased budget deficits, and higher tax burdens on other taxpayers including individuals and smaller businesses. Beyond their negative revenue effects, tax laws that permit intellectual property income shifting provide multinational companies significant and unfair competitive advantages over smaller domestic companies that cannot use overseas operations and offshore tax gimmicks to lower their effective corporate tax rate.⁸ Such laws also create harmful economic distortions. For example, domestic firms are incentivized to invest and grow business activities abroad rather than in their home country, thus devoting substantial resources to tax planning instead of productive investment.⁹ In addition to being economically unjustified, base erosion due to income shifting has become *socially unacceptable*. In recent years, public outrage at the tax avoidance techniques used by large multinational companies has increased and is particularly pronounced in Europe.¹⁰

The OECD's BEPS Project, which involves a coordinated effort among many countries to reduce corporate tax avoidance, is the most important development in cross border taxation in decades. The final OECD BEPS Project Reports, issued in October 2015, make concrete recommendations to help nations address income shifting problems.¹¹ Many of these recom-

6. OECD, MEASURING AND MONITORING BEPS: ACTION 11 FINAL REPORT 79 (2015), <http://dx.doi.org/10.1787/9789264241343-en> [hereinafter OECD, MEASURING AND MONITORING BEPS].
7. *See id.* at 29; MARK P. KEIGHTLEY & JEFFREY M. STUPAK, CONG. RESEARCH SERV., R44013, CORPORATE TAX BASE EROSION AND PROFIT SHIFTING (BEPS): AN EXAMINATION OF THE DATA 21 (2015).
8. These concerns have been raised by many, including members of Congress. *Hearing Before S. Permanent Subcomm. on Offshore Profit Shifting and the U.S. Tax Code*, 113th Cong. (2013) (statement of Sen. Carl Levin); *Hearing Before S. Permanent Subcomm. on Offshore Profit Shifting and the U.S. Tax Code*, 113th Cong. (2013) (opening statement of Sen. John McCain).
9. These concerns have been raised by many, including the former U.S. Administration. *See* WHITE HOUSE & U.S. DEP'T OF THE TREASURY, THE PRESIDENT'S FRAMEWORK FOR BUSINESS TAX REFORM: AN UPDATE 11 (2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-An-Update-04-04-2016.pdf>.
10. In 2012, for instance, protests in Britain led Starbucks to agree voluntarily to pay an extra sixteen million pounds in British taxes above what it would normally have had to pay. *See* Allison Christians, *How Starbuck Lost Its Social License—and Paid 20 Million to Get it Back*, 71 TAX NOTES INT'L 637, 637–38 (2013).
11. *See* OECD, BEPS 2015 FINAL REPORTS (2015), <http://www.oecd.org/tax/beps-2015-final-reports.htm>.

mended action plans, which provide principles (minimum standards) for appropriate taxation of multinational companies, attempt to tax profits where value is added and to promote greater tax transparency with increased information exchange between tax authorities.¹²

Although the OECD Model Treaty is a residence-based model, many of the BEPS Project actions attempt to increase taxation in the source country (as opposed to the residence country) and *tax profits where value is added*.¹³ For example, current transfer pricing rules rely on the arm's-length principle.¹⁴ The principle looks at which related companies are performing important functions, contributing assets, and controlling risks.¹⁵ But, with its emphasis on contractual allocations of functions, assets, and risks, the arm's length principle can easily be manipulated by multinational companies and result in intellectual property income that does not align with the economic activity that produced it.¹⁶ Actions Eight, Nine, and Ten of the BEPS Project target this issue to ensure that income is allocated to the country *where value is created*.¹⁷ Specifically, in revised guidelines (in the form of amendments to the OECD's Transfer Pricing Guidelines), BEPS attempts to replace or supplement the *contractual arrangements* between the related parties with the *conduct* of the parties if the contracts are incomplete or are not supported by the conduct.¹⁸ This will lead to the allocation of intellectual property income to locations where contributions are made and to where business activities are conducted.¹⁹ In short, Actions Eight through Ten maintain the arm's length principle, but also ensure that transfer-pricing outcomes are more in sync with value creation.²⁰ The actions will not eliminate the use of cash-

12. *Treasury's International Tax Initiatives, Before S. Finance Comm.*, 114th Cong. (2014) (Deputy Assistant Secretary of the U.S. Treasury Department, Robert B. Stack, noting that the "principal target of the BEPS project is so-called 'stateless income,' basically very low or non-taxed income within a multinational group").

13. See H. David Rosenbloom & Joseph P. Brother, *Reflections on the Intersection of U.S. Tax Treaty Policy, U.S. Tax Reform, and BEPS*, 78 TAX NOTES INT'L 759, 764 (May 25, 2015) (noting many of the BEPS actions "point clearly in the direction of greater source-basis taxation").

14. See OECD, BEPS 2015 FINAL REPORTS: EXECUTIVE SUMMARIES 27 (2015), <http://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf> [hereinafter OECD, BEPS 2015 EXECUTIVE SUMMARIES].

15. *Id.*

16. *Id.*

17. *Id.* at 27–28.

18. *Id.* at 28.

19. *Id.*

20. See OECD, BEPS 2015 EXECUTIVE SUMMARIES, *supra* note 14, at 27–28, 30.

rich, low-functioning foreign subsidiaries, but they are designed to make their role less relevant in income-shifting tax planning.²¹

Many countries have enacted so-called “patent box” or “innovation box” regimes, which basically provide a reduced effective tax rate on income associated with eligible intellectual property.²² Patent boxes can “unfairly erode the tax bases of other countries, potentially distorting the location of capital and services,” especially when they are offered to entities that engage in no substantial activity.²³ As a result, Action Five of the BEPS Project requires “substantial activity” by a multinational company in order for the multinational to benefit from the patent box’s lower rate on intellectual property income.²⁴ It uses research and development (R&D) expenditures as a proxy for substantial activity.²⁵ Thus, there must be a link or appropriate nexus between a multinational company’s R&D expenditures and intellectual property income receiving the low rate.²⁶ In effect, if a multinational incurred 100% of the costs to develop an intellectual property asset in a country with a patent box regime, then 100% of the overall income from the intellectual property asset would be eligible for the regime’s preferential rate.²⁷ But, if the multinational outsourced all R&D to related parties, then none of the income from the intellectual property asset would receive tax benefits.²⁸

II. BENEFITS OF THE GLOBAL TRADE AND TAX AGREEMENTS

The TPP was an agreement of twelve countries that make up forty percent of world trade.²⁹ The OECD’s BEPS Project, however, represents the consensus view of a much larger group of countries—forty-four countries that make up roughly ninety percent of the global economy (although over

21. *Id.* at 30.

22. European countries in particular have been implementing patent boxes. *See* OECD, MEASURING AND MONITORING BEPS, *supra* note 6, at 152. China is the only non-European country to adopt a patent box regime thus far. *See id.*

23. OECD, COUNTERING HARMFUL TAX PRACTICES MORE EFFECTIVELY, TAKING INTO ACCOUNT TRANSPARENCY AND SUBSTANCE: ACTION 5—2014 DELIVERABLE 13 (2014), <http://dx.doi.org/10.1787/9789264218970-en>.

24. *Id.*

25. *Id.* at 29.

26. *See id.*

27. *Id.* at 31.

28. *See id.* at 32–33.

29. Kevin Granville, *What Is TPP? Behind the Trade Deal That Died*, N.Y. TIMES (Jan. 23, 2017), https://www.nytimes.com/interactive/2016/business/tpp-explained-what-is-trans-pacific-partnership.html?_r=0.

sixty countries were involved in some way with the BEPS Project).³⁰ As a result, if the BEPS Actions are adopted into domestic law and tax treaties, they “could have a significant impact on cross border trade and investment around the world.”³¹

Multinational trade agreements (like the TPP) and BEPS reflect a coordinated approach to global concerns and a move toward global agreements among nations. Nations differ in their approaches to workers’ rights, tariffs, and intellectual property protections, which can negatively impact global trade. Likewise, nations differ greatly in their income tax policies, which can incentivize the shifting of intellectual property and related income from high-tax countries to low-tax jurisdictions.³² Inconsistent tax rules among countries can also impair export opportunities and economic growth.³³ Both global trade agreements and the BEPS Project reflect a unified approach—they set common legal rules among countries to boost global trade and achieve a fairer international tax system.³⁴

There are many benefits to trade agreements that seek to address inconsistent rules and open up markets. There are also significant advantages to a multilateral approach to international tax reform. For example, a multilateral instrument “would have the same effect as a simultaneous renegotiation of thousands of bilateral tax treaties,” and would allow “for highly targeted changes to the treaty network to be adapted in a synchronized manner without creating the potential for violation of existing treaties that may result from unilateral actions by countries.”³⁵

Of course, with global agreements there will be winners and losers among nations. Under multinational trade agreements, countries invariably rearrange labor forces and rearrange product flows, which may result in certain jobs moving overseas.³⁶ Likewise, the BEPS Project will require countries to rearrange intellectual property profit flows. As a result, we may see

30. See Amanda Heale & Patrick Marley, *BEPS Recommendations Could Significantly Affect Cross Border Trade*, OSLER (Dec. 9, 2015), <https://legalyearinreview.ca/en/beps-recommendation-could-significantly-affect-cross-border-trade/>.

31. *Id.*

32. See STAFF OF THE JOINT COMM. ON TAXATION, 121ST CONG., BACKGROUND, SUMMARY, AND IMPLICATIONS OF THE OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT, at 12, 41 (2015), <https://www.jct.gov/publications.html?func=fileinfo&id=4853>.

33. See *id.* at 6.

34. See *id.* at 9.

35. See *id.* at 32.

36. See, e.g., Robert E. Scott, *What’s Wrong with the TPP? This Deal Will Lead to More Job Loss and Downward Pressures on the Wages of Most Working Americans*, ECON. POLICY INST. (Mar. 17, 2015), <http://www.epi.org/blog/whats-wrong-with-the-tpp-this-deal-will-lead-to-more-job-loss-and-downward-pres->

more robust taxation in countries (like the United States), and less taxation in popular tax haven jurisdictions (like Ireland) where intellectual property is often parked.³⁷ Of course, if a country (like the United States) loses jobs as a result of trade agreements, it is essential that it gets additional tax revenues from those multinationals that realize additional profits from labor cost savings. Otherwise, implementation of trade agreements without the BEPS Project effect could have double negative consequences—a lose-lose proposition.

Some multinational companies may find that they will benefit from trade agreements, but pay more taxes under BEPS. For example, some argued that the TPP agreement regarding patents would have made drugs more expensive and would have profited pharmaceutical companies (i.e., the TPP would have extended monopolies that large pharmaceutical companies have on prescription drugs, which would have expanded their profits).³⁸ Although the TPP might arguably have resulted in more profits for these pharmaceutical companies, the BEPS Project, if implemented, would ensure that those profits get appropriately taxed. BEPS actions most likely will increase tax compliance costs for multinational companies, especially with respect to increased information sharing.³⁹ In addition, BEPS will diminish the rights of multinationals to locate their intellectual property in physical locations they choose.⁴⁰

It is possible that multinational trade agreements like the TPP and BEPS can produce a win-win for some multinational companies. It was suggested, for instance, that both the “TPP and BEPS [would] be of greatest benefit to those companies [that] are seeking to expand and invest across borders from a zero or small base—it is these companies that will be the engine of global growth.”⁴¹

sures-on-the-wages-of-most-working-americans/ (arguing that the TPP would result in more jobs moving from America to Vietnam).

37. See ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2015–2019, *supra* note 4.
38. See Jaelyn Schiff, *Patently Perturbed: Trans-Pacific Partnership Trade Deal Raises Fears About Drug Patent Periods, Higher Costs*, MODERN HEALTHCARE (June 4, 2016), <http://www.modernhealthcare.com/article/20160604/MAGAZINE/306049978>.
39. See Jason J. Fichtner & Adam N. Michel, *The OECD's Conquest of the United States: Understanding the Costs and Consequences of the BEPS Project and Tax Harmonization*, MERCATUS CTR. 30–31 (2016), <https://www.mercatus.org/system/files/Fichtner-BEPS-Initiative-v1.pdf>.
40. See *id.* at 3–4.
41. *A Good Day for International Expansion: Global Agreements on Trade and Transfer Pricing Are Good News for Growing Businesses*, GRANT THORNTON (Oct. 7, 2015), <http://www.grantthornton.global/en/insights/articles/trade-agreements/>.

Both global trade agreements (like the TPP) and the BEPS can produce a win-win for countries as well. New Zealand, for example, hailed both the TPP deal and the BEPS Project. Once fully phased in, the TPP would have eliminated ninety-three percent of New Zealand's tariffs on trade with the other member nations.⁴² New Zealand would also gain to benefit from BEPS. According to its Finance Minister: "It matters because New Zealand is becoming more and more attractive as a place to do business and invest in, so it's critical that we continue to strengthen our tax rules to ensure overseas companies pay their fair share."⁴³

III. THE ISSUE OF NATIONAL SOVEREIGNTY

Global agreements can raise questions about national sovereignty. Today, nations compete with one another to attract and retain jobs and valuable activities within their borders through various means, including tax incentives. Some have questioned whether the multinational trade agreements (like the TPP) trample on democracy and national sovereignty.⁴⁴ Likewise, some have argued that the BEPS Project, designed to harmonize international tax rules, will harm tax competition by protecting high-tax countries at the expense of low-tax countries. Some fear that there is a movement toward a unified international tax system in which tax competition is eliminated completely.⁴⁵ This raises interesting questions about a country's sovereignty in terms of tax policy. Specifically, do multilateral efforts among nations to

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42. Mary Swire, *New Zealand Hails TPP Deal, BEPS Project Conclusion*, GLOB. TAX NEWS (Oct. 7, 2015), http://www.tax-news.com/news/New_Zealand_Hails_TPP_Deal_BEPS_Project_Conclusion___69344.html (quoting Trade Minister Tim Groser: "Overall, TPP is a very positive agreement for New Zealand, further improving access to international markets, which supports our exporters to grow and create new jobs").
 43. *Id.* (quoting Finance Minister Bill English).
 44. Corporations, for example, will have the right to challenge U.S. laws before international tribunals.
 45. The Mercatus Research Center has criticized BEPS' solution to income shifting as attempting "to consolidate rather than coordinate diverse systems." See Fichtner & Michel, *supra* note 39, at 3, 22 (exploring "the unintended and unseen consequences of consolidating international tax rules using the BEPS Project as an example of how such centralization is costly and ultimately ineffective," and also arguing that the OECD's mission has "evolved from issues of double taxation to advocacy for a unified international tax system"). The Coalition for Tax Competition has asked Congress to stop subsidizing the OECD because the BEPS Project is undermining American interests by targeting U.S. companies. According to the group, "[r]educing tax competition results in an overall higher tax environment and a weaker global economy." Letter from Coalition for Tax Competition to Senators and Representatives (May 12, 2016), <http://www.freedomandprosperity.org/files/OECD/ctc-OECDfundingBEPS-2016-05-12.pdf>.

unify domestic tax policies to combat base erosion and achieve more effective market competition somehow weaken each country's sovereignty in terms of tax policy?

The BEPS Project has potentially greater implications for the giving up of national autonomy than the TPP would have had. The OECD, however, has suggested that "acting together will reinforce rather than weaken each country's sovereign tax policies," as countries "have long accepted that they should set limits and that they should not engage in harmful tax practices."⁴⁶ The OECD's BEPS Project is essentially a step to get countries to practice what they have long accepted.

IV. THE FUTURE OF THE BEPS PROJECT

It will be interesting to see how nations respond to the OECD's BEPS recommendations. Just as there was resistance to the TPP, there has been some resistance to BEPS from some U.S. policymakers. Although OECD countries cooperated in developing the BEPS action plans, it is doubtful all will follow through and adopt BEPS compliance measures back home. The United States, in particular, has a long history of "tax exceptionalism" and does not feel bound to any international norms. Although the United States was at the table in developing the BEPS actions, some members of Congress have already expressed reluctance to adopt all of BEPS's sweeping proposals. Senator Orrin Hatch stated that the recommendations contained in BEPS raise a number of serious concerns.⁴⁷ House Speaker Paul Ryan also remarked: "[Regardless of BEPS] Congress will craft the tax rules that it believes work best."⁴⁸ It will be interesting to see whether countries, like the United States, will ultimately opt to relinquish some of their jurisdictional autonomy.⁴⁹

46. Remarks of Secretary-General of the OECD Angel Gurría, OECD (Feb. 11, 2014), <http://www.oecd.org/tax/taxation-and-competition-policy.htm> (discussing taxation and competition policy).

47. Press Release, Sen. Hatch to Hold Finance Hearing on OECD BEPS Reports, Sen. Fin. Comm. (Nov. 24, 2015), <https://www.finance.senate.gov/chairmans-news/hatch-to-hold-finance-hearing-on-oecd-beps-reports>.

48. Letter from Sen. Orrin Hatch & Rep. Paul Ryan to Jacob Lew, Sec'y of the Treasury (June 9, 2015), <https://www.finance.senate.gov/imo/media/doc/Hatch,%20Ryan%20Call%20on%20Treasury%20to%20Engage%20Congress%20on%20OECD%20International%20Tax%20Project.pdf>.

49. ROSANNE ALTSHULER ET AL., LESSONS THE UNITED STATES CAN LEARN FROM OTHER COUNTRIES' TERRITORIAL SYSTEMS FOR TAXING INCOME OF MULTINATIONAL COMPANIES 38 (2015), <http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/2000077-lessons-the-us-can-learn-from-other-countries.pdf> ("As the economic differences between the United States and other countries narrow, however, and the U.S. share of world output declines, the ability of the United States to sustain U.S. tax exceptionalism will also decline.").

Although the United States has killed the TPP, one thing is for certain with respect to international tax reform: doing nothing is not an option for both low-tax countries that are under scrutiny for their harmful tax practices and high-tax countries that are looking for ways to increase tax revenue. Most likely, countries will attempt to pass laws that are BEPS compliant. Despite initial reservations expressed by members of the U.S. Congress, there were some signs that the United States, at least under the Obama Administration, intended to meet the multilateral commitment it made in the OECD's BEPS Project. Under President Obama, for example, the Treasury and the IRS released final regulations that require country-by-country reporting as recommended in BEPS Action Plan Thirteen.⁵⁰

But, several challenges lie ahead. For starters, it is likely we will see incomplete and uneven adoption by OECD member countries.⁵¹ The BEPS Project recommendations (totaling nearly 2,000 pages) could be subject to differing interpretations, which could lead to inconsistent laws.⁵² In addition, countries have different goals and face different constraints, which could result in different types and levels of taxation.⁵³ To the extent countries adopt inconsistent or incoherent rules, more disputes are likely to arise.⁵⁴

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50. 26 C.F.R. § 1.6038-4 (2016) (requiring country-by-country reports from U.S. parent companies with \$850 million or more in annual revenue). In contrast, it does not appear yet that the Trump Administration is interested in pursuing many of the cooperative solutions in the BEPS project. Indeed, recent tax law changes in the United States (e.g., reduction in corporate income tax rate and enactment of several anti-base erosion measures) may signal continued anti-globalization (nationalism), which makes BEPS project success more elusive.
 51. Clausing, *The Effect of Profit Shifting*, *supra* note 5, at 22.
 52. David Rosenbloom has predicted: "Coordination of the BEPS actions seems unlikely. . . . The more foreseeable result is a cacophony of new rules, predicated on BEPS and tempered only by the views of individual countries regarding adverse impacts on the inflow of capital." Rosenbloom & Brothers, *supra* note 13, at 759, 764.
 53. *See OECD's Base Erosion and Profit Shifting (BEPS) Initiative: Summary Results of Second Annual Multinational Survey*, DELOITTE (May 2015), <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-beps-short-summary-survey-results-may-2015.pdf> (finding seventy-five percent of multinationals surveyed expect some form of double taxation as nations respond to the OECD's recommendations).
 54. Action 14 makes dispute solution mechanisms more effective. OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT, MAKING DISPUTE RESOLUTION MECHANISMS MORE EFFECTIVE, ACTION 14 – 2015 FINAL REPORT 11, OECD (2015), http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/making-dispute-resolution-mechanisms-more-effective-action-14-2015-final-report_9789264241633-en#.WNG3PBizNTY. This is important because many BEPS disputes are likely forthcoming.

A major challenge with BEPS will be determining a multinational company's source of income. Substantively, BEPS adheres to separate entity reporting and maintains reliance on transfer pricing and the arm's length principle to limit income shifting.⁵⁵ While adhering to the arm's length principle, BEPS provides steps to ensure that transfer pricing outcomes better align with *value creation*. In essence, BEPS is a move towards more robust *source taxation*. Aligning transfer pricing outcomes with value creation, or identifying a locatable source of income, however, is easier said than done, because it is always debatable where value is created.⁵⁶ Consider a multinational company that conducts research in the United States, has goods based on that research manufactured in China, and then sells those manufactured goods to customers in Europe. Where is the value created? The United States would argue that much of the value lies in the intellectual property that goes into the goods. China, in turn, would argue that much of the value of the firm's products lies in their physical production.⁵⁷ And European nations would insist that the value lies in marketing and product sales to customers in Europe. The problem is magnified even further when we consider that globally integrated multinational companies typically earn more profits than their component parts would have earned alone.⁵⁸

55. Indeed, the relevance of arm's length pricing is a key component of the BEPS Project; it forms the basis of several actions plans as noted above. See JOY HAIL, *BASE EROSION AND PROFIT SHIFTING (BEPS): ARE YOU READY?* 57 (2015).
56. Michael J. Graetz & Rachael Doud, *Technological Innovation, International Competition, and the Challenges of International Income Taxation*, 113 COLUM. L. REV. 347, 416 (2013) (noting that achieving multilateral consensus on where intellectual property income should be sourced—e.g., where R&D is conducted, where intellectual property is legally protected, where intellectual property is exploited, and where products created with intellectual property are consumed—will be controversial); Clausing, *The Effect of Profit Shifting*, *supra* note 5, at 22 (“An essential difficulty lies in the problem of establishing the source of income for firms that are truly globally integrated.”).
57. Keith Bradsher, *China to Crack Down on Tax Collection from Multinational Companies*, N.Y. TIMES (Feb. 4, 2015), <https://www.nytimes.com/2015/02/05/business/international/china-to-enforce-tax-collection-from-multinational-companies.html> (“Officials in China, the world's largest manufacturer, have long contended that much of the value of a good lies in its physical production, and not in the intellectual property that went into the item, which is often created elsewhere.”).
58. Clausing, *The Effect of Profit Shifting*, *supra* note 5, at 23 (“[T]he global integration of businesses generates profits above and beyond what would be generated if domestic businesses merely interacted at arm's-length. Since multinational firms earn more than their component parts would have earned alone, it is an arbitrary exercise to figure out where the additional profit should reside.”).

Identifying source of income is also difficult as value creation activities (whether we define those as actual R&D, the manufacturing of products, or the sale of products) change often in our rapidly changing global economy. Consider, for example the relationship between Apple, Inc. and China. China has historically manufactured a lot of Apple, Inc.'s products. But over time, China has also represented an increasingly greater percentage of Apple's net sales (twenty-five percent in 2015). Moreover, in late 2016, it was reported that Apple was opening its first research and development center in China "to extend its reach in a vital market"⁵⁹ (investing \$45 million in a facility that will have 500 employees, and combine Apple's "engineering and operations teams in China").⁶⁰ Shortly thereafter Apple announced that it was opening another R&D center in China.⁶¹ As Apple's and China's economic relationship evolves, so too does their tax relationship.

Some have questioned whether international income has a locatable source⁶²—a reason the second-best option, *formulary apportionment*, might make sense. Indeed some commentators have suggested that the BEPS Project will encourage countries to move away from separate entity accounting and adopt formulary apportionment to expand their tax base.⁶³ Formulary apportionment would allocate a multinational company's income based on some combination of factors. To illustrate, assume that the United States has a three-factor formula—sales, payroll, and physical assets—and gives equal weight to each factor. Now assume that a multinational company earned \$1 billion worldwide. Thirty percent of the multinational's payroll and assets are

59. Samantha Masunaga, *Apple Reportedly Is Opening a Research and Development Center in China*, L.A. TIMES (Sept. 30, 2016), <http://www.latimes.com/business/la-fi-tn-apple-china-20160930-snap-story.html>.

60. Jethro Mullen, *Apple Ups China Bet with First Research and Development Center*, CNN MONEY (Aug. 17, 2016), <http://money.cnn.com/2016/08/17/technology/apple-china-investment-research-center/>.

61. *Apple to Open Second Research Centre in China*, MSN MONEY (Oct. 12, 2016), <https://www.msn.com/en-sg/money/technology/apple-to-open-second-research-centre-in-china/ar-AAiRGiB>.

62. "[Income] is not susceptible to characterization as to source at all. Income . . . attaches to someone or something that consumes and that owns assets. Income does not come from some place, even though we may construct accounts to approximate it by keeping track of payments that have identifiable and perhaps locatable sources and destinations." Graetz & Doud, *supra* note 56, at 416 (quoting Hugh J. Ault & David F. Bradford, *Taxing International Income: An Analysis of the U.S. System and Its Economic Premises*, in TAXATION IN THE GLOBAL ECONOMY 11, 31 (Assaf Razin & Joel Slemrod eds., 1990), <http://www.nber.org/chapters/c7203.pdf>).

63. See Fichtner & Michel, *supra* note 39, at 31 ("The availability of country-by-country reporting tax information may pressure some countries to use a formulary apportionment standard as a mechanism to artificially expand their tax base").

in the United States, but sixty percent of the multinational's sales are in the United States. Under these facts, the United State's share of that worldwide profit would be \$400 million.

$$\text{\$1 billion earnings} \times \begin{pmatrix} 30\% \text{ payroll factor} \\ +30\% \text{ assets factor} \\ +60\% \text{ sales factor} \end{pmatrix} = \text{\$400 million}$$

With formulary apportionment, profit allocation would be based on factors that reflect real economic activity. Profit allocation would not be sensitive to countries' varying tax policies regarding tax rates, standards for determining corporate residency, and approaches to transfer pricing enforcement. And it would not be determined by arbitrary behavior of multinational companies, such as the number and residency of foreign subsidiaries, or which transfer pricing methods they use.

Commentators, however, have pointed out conceptual and practical difficulties with applying formulary apportionment in the global context.⁶⁴ It may prove difficult for countries to agree on the formula factors.⁶⁵ Countries with large markets would likely want to place greater weight on the "sales" factor over employees or capital; countries with small markets would likely

64. See Rosanne Altshuler & Harry Grubert, *Formula Apportionment: Is It Better than the Current System and Are There Better Alternatives?*, 63 NAT'L TAX J. 1145 (2010); James R. Hines, Jr., *Income Misattribution Under Formula Apportionment*, 54 EUR. ECON. REV. 108 (2010); Susan C. Morse, *Revisiting Global Formulary Apportionment*, 29 VA. TAX REV. 593, 597-99 (2010); Julie Roin, *Can the Income Tax Be Saved? The Promise and Pitfalls of Adopting Worldwide Formulary Apportionment*, 61 TAX LAW REV. 169 (2008) (noting political realities); Jane Gravelle, *Policy Options to Address Corporate Profit Shifting: Carrots or Sticks?*, N.Y.U. COLLOQUIUM ON TAX POL'Y & PUB. FIN. 31-33 (Apr. 26, 2016), http://www.law.nyu.edu/sites/default/files/upload_documents/Jane%20Gravelle.pdf (summarizing barriers to formulary apportionment). See also Walter Hellerstein, *Designing the Limits of Formulary Income Attribution Regimes*, 72 ST. TAX NOTES 45 (2014).

65. Advocates of formulary apportionment typically leave intangibles out of the formula because if they were included, "the same problems of attributing income to a location under transfer pricing would arise." Fichtner & Michel, *supra* note 39, at 29 (citing Charles E. McLure, *U.S. Federal Use of Formula Apportionment to Tax Income from Intangibles*, TAX NOTES TODAY (Mar. 11, 1997)). See also Reuven S. Avi-Yonah, *Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation*, 2 WORLD TAX J. 3, 17 (2010) ("Intangibles are excluded, but in my opinion that is appropriate because (a) their value results from physical and human capital and from the market and those elements are included [in the traditional three factor formula of payroll, sales, and tangible assets], and (b) you cannot allocate their value and trying to include them invites manipulation.").

resist.⁶⁶ Even if countries could agree on the formula factors, formulary apportionment might encourage multinationals to move the formula factors, such as jobs and factories, to low-tax jurisdictions in order to reduce their tax burden.⁶⁷ This illustrates the significant impact one global agreement (like the TPP) could have on another global agreement (BEPS). To the extent the TPP would have encouraged jobs (one of the formula factors) to move offshore from the United States to Vietnam, for example, Vietnam would have seen an increase in corporate income taxation.

V. FINAL THOUGHTS

The BEPS Project, the OECD's crackdown on multinationals' shifting of profits to low-tax jurisdictions, is potentially a bigger deal than multinational trade agreements, such as the TPP. While countries now struggle to figure out what to do considering the death of the TPP, the BEPS Project serves the useful purpose of showing the complex tax practices of multinational companies.⁶⁸

Developing countries should pay close attention to BEPS implementation and its focus on source-based taxation.⁶⁹ They should also be aware of alternatives to BEPS-like, source-based taxation—such as formulary apportionment—that are being discussed as global tax reform alternatives. Vietnam and many other developing countries are aware of the role taxation plays in their economic growth strategies. Vietnam itself has an attractive corporate income tax rate of twenty percent as of January 1, 2016 (decreased from twenty-five percent to twenty-two percent to twenty percent in recent

66. See Mitchel Udell & Aditi Vashist, *Sales-Factor Apportionment of Profits to Broaden the Tax Base*, TAX NOTES TODAY (June 17, 2014). China may benefit from formulary apportionment because of its large employment footprint. Fichtner & Michel, *supra* note 39, at 31. Tax haven countries typically employ relatively few employees of multinationals.

67. Fichtner & Michel, *supra* note 39, at 21 (arguing that with formulary apportionment real profit shifting will replace artificial profit shifting) (citing David Ernick et al., *You Look Familiar: The OECD Looks to U.S. State Tax Policy for BEPS Solutions*, in U.S. STATE TAX CONSIDERATIONS FOR INTERNATIONAL TAX REFORM 111, 116 (Tax Analysts 2014)). Currently, the top employment countries for the foreign affiliates of U.S. multinational companies are large economies with large markets (China, United Kingdom, Canada, Mexico, India, Germany, Brazil, France, Japan, and Australia). Clausing, *The Effect of Profit Shifting*, *supra* note 5, at 8, 32.

68. Gary Clyde Hufbauer, *Four Questions to Ask About OECD's BEPS Project*, PETERSON INST. FOR INT'L ECON. (June 9, 2015), <https://piie.com/blogs/real-time-economic-issues-watch/four-questions-ask-about-oecd-beps-project>.

69. See, e.g., Yariv Brauner, *What the BEPS?*, 16 FLA. TAX REV. 55, 74–75 (2014) (describing source rules as a main source of “controversy between developing countries and the OECD”).

years).⁷⁰ And it offers preferential tax treatments to encouraged sectors, such as high-technology, scientific research, and computer software manufacturing. As its economy changes because of TPP-like trade agreements, so too will its share of total global tax revenues of multinational companies.

In sum, future TPP-like multinational trade agreements and the OECD's BEPS recommendations are rare moments of international collaboration. Their intersection cannot be ignored.

70. For summaries, see INTERNATIONAL TAX: VIETNAM HIGHLIGHTS 2017, DELOITTE (2017), <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-vietnamhighlights-2017.pdf>; VIETNAM TAX PROFILE, KPMG (June 2015), <https://home.kpmg.com/content/dam/kpmg/pdf/2015/11/vietnam-asean-tax-2015.pdf>.