Ensuring a sound tax base in developing countries

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Ensuring a sound tax base in developing countries: Are the current international initiatives sufficient?

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1. Introduction

The taxation of Multinational Enterprises (MNEs) is subject of an intense, hot and global debate. The debate is not only going on in expert tax journals, but also in the general media.[2] In this debate, it is often held that MNEs are not "paying their fair share". This debate mainly, if not only, focusses on corporate income taxation, more specifically on base erosion and profit shifting (BEPS) as if MNEs are not relevant in creating taxable base in the context of other taxes in a wide sense, such as wage taxes, social contributions, and environmental taxes.[3] Furthermore, it should also be noted that states are responsible and accountable for their tax laws, including domestic tax laws and tax treaties. This means that they are also responsible for, e.g., disparities in their tax laws and the lack of cooperation between them from which MNEs may benefit in order to reduce their tax costs. Tax benefits are also often deliberately offered to MNEs to attract foreign direct investments or to retain business activities within a state's border. In other words, states are also involved in tax competition which enables MNEs to reduce their global effective corporate tax rates.[4] On the other hand, the same states belong to the group of complainers who uphold that MNEs erode the tax base and shift profits to low tax jurisdictions. However, BEPS can only be an issue, if a state has a justified tax claim on the income under discussion, such as business profits, interest or royalties. Maybe surprisingly, this essential preceding question in order to identify BEPS is also not really raised in the current debate within, e.g. the OECD/G-20 and the European Union and, therefore, also not answered.[5] As long as this principle-based discussion is avoided, the suggested solutions remain vulnerable. The driving force underlying the current BEPS discussion seems to be that corporate income should be taxed somewhere,[6] but the complainers are less or not interested of whether the state that taxes the income, can also justify this taxation, e.g. on the idea that a corporation should pay its corporation taxes to the state where it adds the value. This position paper will focus on the allocation of tax jurisdiction on corporate income with special attention for the position of

[2] See, e.g., Gaspard Sebag and Joe Brennan, EU to Decide Next Week on Irish, Dutch Tax-Breaks Probe, Bloomberg, 6 June 2014, Eric Platt, Top 50 US boardroom hoarders sit on $1tn in cash, Financial Times, 10 May 2015, and Arash Massoudi and James Fontanella-Khan, US companies regain their appetite for tax inversion deals, Financial Times, 16 June 2015.

[3] See also, e.g., UNCTAD, Investment and Enterprise Division, FDI, Tax and Development, The fiscal role of multinational enterprises: towards guidelines for Coherent International Tax and Investment Policies, Working Paper, 26 March 2015.

[4] See, also, e.g., International Monetary Fund, Spillovers in International Corporate Taxation, Washington D.C, USA, 9 May 2014.

[5] See, e.g., OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing (hereafter also: BEPS Action Plan), and European Commission, A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action, COM(2015) 302 final. See for summaries of the various OECD/G-20 BEPS publications, inter alia, the conference's position paper by Irene Burgers a.o..

[6] See, e.g., BEPS Action Plan, p. 10, as repeated in OECD (2015), Base Erosion and Profit Shifting (BEPS), Public Discussion Draft, BEPS Action 11: Improving the Analysis of BEPS, p. 57:

> "BEPS relates chiefly to instances where the interaction of different tax rules leads to double nontaxation or less than single taxation. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits tax place. No or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it. In other words what creates tax policy concerns is that, due to gaps in the interaction of different tax systems, and in some cases because of the application of bilateral tax treaties, income from cross-border activities may go untaxed anywhere, or be only unduly lowly taxed."

See also, e.g., OECD (2014), Neutralising the Effects of Hybrid Mismatch Arrangements, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, and Council Directive 2014/86/EU of 8 July 2014 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

developing countries. This paper should facilitate the discussion of the second session of the conference 'Pay your taxes where you add the value': 'Ensuring a sound tax base in developing countries: Are the current international initiatives sufficient?'[7]

This session will try to provide an overview of the way the international tax challenges are actually addressed. Issues that will be discussed during this session are:

1. Are developing economies more vulnerable for base erosion and profit shifting by multinationals than developed economies?
2. To what extent will the BEPS project also contribute to better and fairer taxation in developing countries?
3. Should developing countries (also) envisage other measures to raise their tax revenues than those resulting from the BEPS project? What type of measures can we think of?
4. Can developing countries afford to reduce tax incentives for multinationals?
5. Are withholding taxes still a suitable instrument for developing countries?
6. Would developing countries benefit more from a more radical overhaul of the allocation of the tax base between jurisdictions with respect to profits and capital income?
7. If so, which international initiatives could be helpful to this end?
8. Which measures can developing countries take themselves to benefit from international reforms?

This position paper will predominantly focus on questions 5, 6, and 7.

In this context, firstly, a benchmark for determining a sound tax base for states will be developed. Subsequently, this benchmark will be applied to identify non-individuals which can invoke tax treaties and to allocate tax jurisdiction on business income, transferred profits, capital gains on shares, interest, capital gains on debt-claims, royalties, and capital gains on related intangible properties. These topics have been selected, because access to tax treaties and the listed categories of income are major topics in the global BEPS discussion. Furthermore, they are very relevant for the tax position of developing countries.[8] The main conclusions will be wrapped up at the end of this paper.

2. Benchmark for a sound tax base

A large number of non-resident enterprises are carrying on business in developing countries through the operation of branches or subsidiaries established in one or more of these countries. It is assumed that foreign direct investments (FDI) in developing countries contribute to the increase of wealth in these countries.[9] FDI play a role in creating jobs, optimizing resource allocation, transferring technology and

[7] To be held on 2 July 2015 at the Ministry of Foreign Affairs of the Netherlands in The Hague, the Netherlands.

[8] See also, e.g., International Monetary Fund, Spillovers in International Corporate Taxation, Washington D.C, USA, 9 May 2014, and UNCTAD, Investment and Enterprise Division, FDI, Tax and Development, The fiscal role of multinational enterprises: towards guidelines for Coherent International Tax and Investment Policies, Working Paper, 26 March 2015.

[9] Compare, e.g., Andrés E. Bazó , Tax Incentives Offered by Developing Countries: Attracting Foreign Investment or Creating Disaster, Tax Notes International, Vol. 52, No. 4, 2008, Arjan Lejour and Maarten van 't Riet (Centraal Planbureau), De economische betekenis van bilaterale belastingverdragen, August 2013, Den Haag, The Netherlands, Arjan Lejour (CPB Netherlands Bureau for Economic Policy Analysis), The Foreign Investment Effects of Tax Treaties, CPB Discussion Paper | 265,The Hague, The Netherlands, 2014, Julia Braun and Martin Zagler , An Economic Perspective on Double Tax Treaties with(in) Developing Countries, World Tax Journal, Vol. 6, No. 3, 2014, pp. 242-281, International Monetary Fund, Spillovers in International Corporate Taxation, Washington D.C, USA, 9 May 2014, UNCTAD, Investment and Enterprise Division, FDI, Tax and Development, The fiscal role of multinational enterprises: towards guidelines for Coherent International Tax and Investment Policies, Working Paper, 26 March 2015, Sebastian Beer and Jan Loeprick, Profit shifting: drivers of transfer

skills, increasing competition, and boosting trade. Accordingly, in the relationships of developing countries with other states, "economic openness" is key. Economic openness is vital for creating jobs and growth in developing countries and for their international competitiveness. Protectionism, on the other hand, raises prices for consumers and business, and limits choice.

However, it is also clear that taxation affects the decision-making process in the context of FDI. Therefore, taxation has also an impact on FDI in developing countries.[10] In this context the global BEPS debate takes place. As noted, BEPS can only be an issue, if a state has a justified tax claim on the income under discussion, such as business profits, interest, or royalties. The benchmark developed in this section is meant to answer the question: When does a state have a justified tax claim on corporate income if the income should be taxed in the state where the value is added?[11]

2.1. International tax neutrality

In respect of economic openness, tax neutrality should prevail, i.e. taxation should not influence an efficient allocation of the production factors of capital and labour or, at least, should do so as little as possible.[12] The concept of efficiency is based on the assumption that productivity will be highest when

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(mis)pricing and the potential of countermeasures, International Tax and Public Finance, June 2015, Vol. 22, No. 3, 2015, pp. 426-451.

[10] The size of the impact is heavily debated. E.g., UNCTAD, Investment and Enterprise Division, FDI, Tax and Development, The fiscal role of multinational enterprises: towards guidelines for Coherent International Tax and Investment Policies, Working Paper, 26 March 2015, estimates that $100 billion of annual tax revenue losses for developing countries is related to inward investment stocks directly linked to offshore hubs, Christian Aid, Death and Taxes: The True Toll of Tax Dodging, May 2008, arrives at an aggregate annual loss from trade mispricing alone of USD 160 billion, estimates that w A number of these calculations have been criticized. See, e,g,, Clemens Fuest and Nadine Riedel, 2009, Tax evasion, tax avoidance and tax expenditures in developing countries: A review of the literature, Report prepared for the U.K. Department for International Development (DFID), (Oxford: Oxford University Centre for Business Taxation), concludes that "...most existing estimates of tax revenue losses in developing countries due to evasion and avoidance are not based on reliable methods and data." See also, e.g., International Monetary Fund, Spillovers in International Corporate Taxation, Washington D.C, USA, 9 May 2014, p. 17, Bart Kosters, New Netherlands Treaty Policy regarding Developing Countries, Bulletin for International Taxation, Vol. 68, No. 9 (2014), OECD (2015), Base Erosion and Profit Shifting (BEPS), Public Discussion Draft, BEPS Action 11: Improving the Analysis of BEPS. It seems to be that no sufficient data and methods are currently available to make proper calculations. More research work has to be done, but one may question whether consensus can be reached, even if sufficient data on macro (states) and micro (businesses) levels would be available. Especially, the amount of lost tax revenue will be hard to calculate if there is no clear idea on what a sound tax base is.

[11] The benchmark has been developed on the basis of, e.g. Eric C.C.M. Kemmeren, Principle of Origin in Tax Conventions, A Rethinking of Models, Dissertation PhD thesis Tilburg University, Eric C.C.M. Kemmeren/Pijnenburg vormgevers•uitgevers, The Netherlands, Dongen (2001) pp. 35-45, 177-181 (also available on http://webwijs.uvt.nl/publications/304239_ext.pdf), Eric C.C.M. Kemmeren/Daniël S.. Smit, Taxation of EU-non-resident companies under the CCCTB system: Analysis and suggestions for improvement, in Corporate Income Taxation in Europe, The Common Consolidated Corporate Tax Base (CCCTB) (Lang et al. eds. 2013) pp. 51-59, and Eric C.C.M. Kemmeren, The Netherlands: What Are the Right Comparators under Article 63 TFEU When Assessing a Dividend Withholding Tax Refund Claim? - Cases C-10/14 (Miljoen), C-14/14 (X), and C-17/14 (Société Générale), in: Michael Lang, Pasquale Pistone, Josef Schuch, Claus Staringer, and Alfred Storck, ECJ-Recent Developments in Direct Taxation 2014, Series on International Tax Law, volume 91, Linde Verlag Wien, Wien, Österreich 2015, pp. 121-168.

[12] See also, e.g., Hugh J. Ault, Colloquium on Corporate Income Tax: Corporate Integration, Tax Treaties and the Division of the International Tax Base: Principles and Practices, 47 Tax Law Review 565 (1992), p. 572, Gary Clyde Hufbauer and Joanna M. van Rooij, U.S. Taxation of International Income, Blueprint for Reform, Washington, D.C.: Institute for International

the production factors are distributed by a market mechanism without public interference or, at least, with as little interference as possible. A given economic arrangement is efficient if there can be no rearrangement that will leave someone better off without worsening the position of others.[13] Economic considerations, not tax motives, should determine the behavior of economic operators.[14] Complete neutrality is probably not possible but, from an efficiency perspective, the highest possible level of neutrality should be pursued. Taxation should contribute to a level playing field. Other values, like equity, may justify a deviation from the efficiency rule in specific situations.

In the scholarly literature, various approaches to international tax neutrality can be identified. Traditionally, the focus is either on an optimal allocation of savings (under capital import neutrality), an optimal allocation of production (under capital export neutrality), or an optimal allocation of ownership (under capital ownership neutrality).[15] In the author's opinion, international tax neutrality implies that the relation between taxes (burdens) and public goods (benefits) should not be disturbed to the disadvantage of transnational investment. This is because the effect of taxes cannot be isolated from the overall effects of all other state-induced transaction and production costs and benefits.[16] Under this condition, fair competition between foreign and domestic enterprises which carry on the same genuine economic activities under the same market conditions and using the same public goods to the same extent in the same state is promoted. Taxation on the basis of residence is incompatible with such a neutrality approach since no state can ensure that foreign investments made by its residents are subject to the same transaction and other state-induced costs and benefits. Therefore, in the author's view, international tax neutrality is also in line with capital and labor import neutrality (CLIN) which is defined as follows: labor and capital funds originating in various states should compete on equal terms in the

Economics, 1992, p. 50, Albert Raedler and Jens Blumenberg, Harmonization of Corporate Income Tax Systems within the European Community, in: Report of the Committee of Independent Experts on Company Taxation (Ruding Committee), Brussels/Luxembourg, European Commission, 1992, p. 441, Stephen G. Utz, Taxation Panel: Tax Harmonization and Coordination in Europe and America, 9 Connecticut Journal of International Law 161 (1994), p. 785, S. Cnossen, Om de toekomst van de vennootschapsbelasting in de Europese Unie, Weekblad voor Fiscaal Recht 1996/6203, pp. 876 and 889-890, and Sijbren Cnossen, Tax Policy in the European Union, A Review of Issues and Options, Valedictory Address, Erasmus University Rotterdam, 2001, p. 3.

13 See, e.g., Richard A. Musgrave and Peggy B. Musgrave, Public Finance in Theory and Practice, McGraw-Hill Book Company, 1989, p. 60.

14 See, e.g., Otto Gandenberger, Die EinfluB der Einkommen- und Korperschaftsteuer auf die internationalen Wirtschaftstrome, in: Klaus Vogel, Grundfragen des Intemationalen Steuerrechts, Koln: Verlag Dr. Otto Schmidt, 1985, pp. 36-37, Richard Doernberg, International Taxation in a Nutshell, St. Paul, Minnesota, West Group, 1999, pp. 3-6, and US JCT (Joint Committee on Taxation), Reports on International Taxation, 19 Tax Notes International 69 (1999), p. 92. Disagreeing: e.g., D. Juch, Internationaal fiscaal (verdragen)recht, MBB 1999/3, p. 116. Considering some reports on harmful tax competition, some states seem to pursue a policy deviating from this concept of tax neutrality. See e.g. OECD, Harmful Tax Competition, An Emerging Global Issue, Paris, OECD, 1998, the EU report from the Code of Conduct Group (Business Taxation), Brussels, 23 November 1999 (SN4901/99) to ECOFIN Council on 29 November 1999, and OECD (2014), Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.

15 See, e.g., OECD, 'Taxing Profits in a Global Economy', 1991, p. 39 (as concerns CIN and CEN) and Desai, M.A. & J.R. Hines. 'Evaluating International Tax Reform'. National Tax Journal 56, No. 3, 2003, pp. 487-502 (as concerns CON).

16 See also, e.g., K. Vogel, Taxation of Cross-border Income, Harmonization, and Tax Neutrality under European Community Law, Kluwer, 1994, p. 26.

labor and capital markets of a state irrespective of the place of residence of the worker or investor.[17] CLIN is generally regarded as fostering competitiveness, but the author believes that it also fosters efficiency.

Capital and labor export neutrality (CLEN) is defined as: an income recipient should pay the same total (domestic plus foreign) tax irrespective of whether he derives a given amount of labor or investment income from foreign or from domestic sources. It is argued in favor of CLEN that, if a perfect capital market is presupposed, a tax system based on CLEN would not disturb competition in the state in which an investment is made.[18] As long as the investment is profitable, a competing enterprise that is taxed more heavily in its residence state would always be able to compensate its reduced supply of after-tax capital by financing through external funds. By contrast, the author thinks that taxation based on the universality principle creates a non-neutral and, therefore, inefficient system due to the differences in the residence-state taxation of the competitors on the relevant market. Residents of high(er)-tax states will be deterred from investing in low(er)-tax states because the residents of the low(er)-tax states who have a higher after-tax return will have a competitive advantage.[19] In this respect, it should be emphasized that the level of taxation and the level of public goods and services, like infrastructure, are often correlative.[20] Allocating tax jurisdiction based on the territoriality principle should therefore be favored. It enables enterprises to compete on a level playing field with their foreign competitors.[21] "Business competes with business, not owners with owners."[22] In such a case, economic decisions would not be distorted by differences in taxation because all competitors are presumably subject to the same tax treatment. A tax system based on the territoriality principle would contribute to an efficient allocation of the production factors worldwide.[23]

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17 The author adds the factor labor to the regular definitions of CIN and CEN because, as will be explained below, according to the author, labor is the origin of all income. Therefore, the factor labor cannot be missed in neutrality definitions, whereas traditionally these concepts are defined in terms of only capital neutrality.

18 See, e.g., OECD, Taxing Profits in a Global Economy, Domestic and International Issues (Paris: OECD, 1991), pp. 39-40.

19 See also, e.g. Otto Gandenberger, Die Einfluß der Einkommen- und Körperschaftsteuer auf die internationalen Wirtschaftströme, in Klaus Vogel, Grundfragen des Internationalen Steuerrechts (Cologne: Verlag Dr. Otto Schmidt, 1985), p. 42, Hugh J., Ault, Colloquium on Corporate Income Tax: Corporate Integration, Tax Treaties and the Division of the International Tax Base: Principles and Practices", 47 Tax Law Review 565 (1992), p. 572, Garry Hufbauer and Joanna M. van Rooij, U.S. Taxation of International Income, Blueprint for Reform (Washington, D.C.: Institute for International Economics, 1992), pp. 57-61; Klaus Vogel, Worldwide vs. source taxation of income – A review and re-evaluation of arguments (Part I)", Intertax Nos. 8/9, 1988, p. 222, S. Cnossen, "Om de toekomst van de vennootschapsbelasting in de Europese Unie", Weekblad voor Fiscaal Recht 1996/6203, p. 872, and Langbein, Stanley I., The Future of Capital Export Neutrality: A Comment on Robert Peroni's Path to Progressive Reform of the U.S. International Tax Rules", 51 University of Miami Law Review 1019 (1997).

20 See also, e.g. Otto Gandenberger, Die Einfluß der Einkommen- und Körperschaftsteuer auf die internationalen Wirtschaftströme, in Klaus Vogel, Grundfragen des Internationalen Steuerrechts (Cologne: Verlag Dr. Otto Schmidt, 1985), p. 44.

21 See also, e.g., Paul Vlaanderen, Why Exempt Foreign Business Profits", 22 Tax Notes International 1095 (2002), pp. 1098-1100.

22 See also, e.g., Graetz and O'Hear, The 'Original Intent' of U.S. International Taxation, 46 Duke Law Journal 1021 (1997), p. 1036, citing Adams, Thomas S., Fundamental Problems of Federal Income Taxation, 35 Quarterly Journal of Economics 527 (1921), p. 542.

23 See, e.g., Eric C.C.M. Kemmeren, Principle of Origin in Tax Conventions, A Rethinking of Models, Dissertation PhD thesis Tilburg University, Eric C.C.M. Kemmeren/Pijnenburg vormgevers•uitgevers, The Netherlands, Dongen (2001) pp. 74-77.

In the author's view, CON is not rely helpful in the context of establishing tax neutrality, because business compete with business; not owners with owners.

Since CLIN fosters not only competitiveness but also efficiency, it best satisfies the establishment of markets which are based on the idea of an open market economy with free competition.[24] In a global context, these are also the markets for developing countries.

2.2. Origin-based taxation

In the author's view, international tax neutrality implies adherence to a system of origin state-based taxation.[25] That is to say, income should be taxed only in the state where that income has been generated. This is because the public facilities provided by that state have contributed to the operation of the income–producing activities (direct benefit principle). In substance, the direct benefit principle is part of the ability to pay principle. The state where the income has been created, contributes to a person's wealth which gives him the ability to pay taxes. Therefore, an origin-based allocation of tax jurisdiction is in line with the ability to pay principle.

The subsequent question that must be addressed is how one should determine in which state an origin of income is situated. In other words: in which state is the value added? The author thinks that only *individuals* can create income and things in themselves cannot. The intellectual element is the key component for the production of income. Through the action of an individual, with or without using a device, i.e. a capital component, value may be added to things. The author believes that, in a lot of cases, the person of the recipient and the originator of the income will coincide. However, it is also possible that they do not coincide. If the income received is produced to a substantial extent through activities of an independent person, i.e., he is the person who adds the intellectual element, and the benefits from such activities do not regard this person, but are passed on to another person, i.e., the income recipient, then the income does not originate with the recipient but with that independent person, i.e., the originator. The author thinks that such an independent person to whom the income is passed on, can in substance be put on a par economically with a person dependent on the income recipient, for instance an employee.[26]

An origin-based taxation justifies taxation of income by a state if the income is created within the territory of that state, i.e. the cause of the income is within the territory of that state. That state makes the yield or the acquisition of wealth possible. Whereas the causal relationship between production of income and the territory of a state is predominant under the principle of origin, it is of minor or no importance under the principle of source. Therefore, the principle of origin and the principle of source are not necessarily identical. If the income is not generated in a state but, nevertheless, physically appears to be from that state, tax jurisdiction may be allocated to that state on the basis of the principle

[24] See for a more detailed discussion, e.g. Kemmeren, Source of Income in Globalizing Economies: Overview of the Issues and a Plea for an Origin-Based Approach, Bulletin for International Taxation (2006) pp. 438-443.

[25] See also, more elaborately, Eric C.C.M Kemmeren, Principle of Origin in Tax Conventions, A Rethinking of Models, Dissertation Tilburg University, Eric C.C.M. Kemmeren/Pijnenburg vormgevers·uitgevers, 2001, 177-181; K. Vogel, Taxation of Cross-border Income, Harmonization, and Tax Neutrality under European Community Law, Kluwer, 1994. Profit-making must be interpreted in such a way that it includes the situation that losses are incurred.

[26] See also, more elaborately, Eric C.C.M Kemmeren, Principle of Origin in Tax Conventions, A Rethinking of Models, Dissertation Tilburg University, Eric C.C.M. Kemmeren/Pijnenburg vormgevers·uitgevers, The Netherlands, Dongen 2001, 37-40.

of source, but not on the principle of origin.[27] Furthermore, it should be noted that an activity of a person who only hops in and out of a state and produces income in that state generally lacks a sufficient nexus, a sufficient economic relationship with that state to justify taxation. For the allocation of tax jurisdiction on income from activities, a substantial relationship between the activity and the state concerned is required. Such a sufficient relationship should be considered present if a substantial income-producing activity is exercised in the state concerned. An income-producing activity is considered to be substantial if such an activity forms an essential and significant part of the activity as a whole.[28]

In respect of corporate taxation, the author believes that, the case law of the European Court of Justice (ECJ) in the context of the freedom of establishment provides practical guidelines which may also be taken into account outside the European context. These guidelines can also be used more globally and, therefore, they are also useful building blocks for developing states. From this case law, one can infer that the concept of establishment is essentially an economic concept and implies a genuine economic link with the territory of a Member State through the exercise of a genuine economic activity.[29] The notion of economic activity under EU law could be characterized by an activity, not being of a purely marginal or ancillary nature, which is usually carried out, on a continuing basis, by a private undertaking on a market with a business or commercial purpose, in particular the wish to maximize returns from capital invested.[30] A company can carry on a genuine economic activity directly. However, a company which, owning controlling shareholdings in another company, actually exercises that control by involving itself directly or indirectly in the management thereof must be regarded as taking part in the economic activity carried on by the controlled undertaking.[31]

The EU law concept of establishment may find expression in the form of (the setting-up of) agencies, branches or subsidiaries.[32] It furthermore involves a sufficient degree of independence and a sufficient degree of management and control within that Member State.[33] In the case of companies, this implies that a company's essential decisions concerning the general management of that company and the functions of its central administration are carried out in that Member State.[34] The concept of branch

27 Therefore, in the author's view, it is not self-evident that the principle of source, as used generally, may serve as a justification for a tax on income, since the income may be produced in another state than where the person from which the income has been received. See, more elaborately, Eric C.C.M Kemmeren, Principle of Origin in Tax Conventions, A Rethinking of Models, Dissertation Tilburg University, Eric C.C.M. Kemmeren/Pijnenburg vormgevers·uitgevers, The Netherlands, Dongen 2001, pp. 33-35.

28 See, more elaborately, Eric C.C.M Kemmeren, Principle of Origin in Tax Conventions, A Rethinking of Models, Dissertation Tilburg University, Eric C.C.M. Kemmeren/Pijnenburg vormgevers·uitgevers, The Netherlands, Dongen 2001, pp. 35-45.

29 Cf. Opinion of Advocate General Darmon delivered on 7 June 1988, Case 81/87, Daily Mail and General Trust PLC [1988] ECR 5483, point 3 and point 5.

30 See, for example, Case C-176/96, Lehtonen [2000] ECR I-2681, paras. 42-44; Cases C-180/98 to C-184/98, Pavlov and Others [2000] ECR I-6451, para. 75 and Opinion of Advocate General Léger delivered on 12 September 2002, Case C-77/01, EDM [2004] ECR I-4295, points 44-46. See more elaborately: D.S. Smit, Freedom of investment between EU and non-EU Member States and its impact on corporate income tax systems within the European Union, dissertation Tilburg, 2011, pp. 46 et seq.

31 See, e.g., Case C-222/04, Cassa di Risparmio di Firenze and others [2006] ECR I-289, paras 109-110.

32 See, e.g., Case C-55/94, Gebhard [1995] ECR I-4165, para. 24.

33 See e.g., Case C-221/89, Factortame Ltd and others [1991] ECR I-3905, para. 34.

34 See e.g., Case C-73/06, Planzer [2007] ECR I-5655, paras. 60-62. Although this case concerned the interpretation of the concept of business for the purposes of Article 1(1) of Council Directive 86/560/EEC of 17 November 1986 on the

under EU law, in addition, implies a place of business which has the appearance of permanency, has a management and is materially equipped to negotiate business with third parties.[35]

It follows from the above that a clear relationship appears to exist between the benchmark of international tax neutrality, on the one hand, and the prerequisite of a genuine economic link under the freedom of establishment, on the other. International tax neutrality implies that income should be taxed only in the state to which that income can economically be linked. In the context of this paper, this means in basic terms that a sound tax base of developing country should include income originated in this state derived by non-resident companies and, conversely, should exclude income not originated in that state derived by resident companies.

2.3. Interim conclusion

International tax neutrality and CLIN imply that income should be taxed only in the state to which that income can economically be linked. Therefore, creating a level playing field, international tax neutrality, the ability to pay principle, and an origin-based allocation of tax jurisdiction go hand in hand.

3. Allocation of tax jurisdiction on categories of corporate income

The discussion below outlines some key elements of an origin-based tax system which may be helpful in developing tax allocation rules which benefit developing countries, but which can also be applied globally in the context of the BEPS discussion.[36] The focus is on allocation rules included in tax treaties. It is obvious that the current tax treaties need to be adjusted, but, in the BEPS debate, this is no longer prohibitive. In the past, the OECD upheld that changes of tax treaties were not doable, because of the massive number of tax treaties that had to be changed to include new rules. Now, multilateral instruments are explored to make massive changes possible.[37]

Even if CLEN is embraced as the leading economic policy and a tax credit system is applied, it is still possible to give the principle of origin a greater role than is done in the current treaties and model tax conventions.

In an origin-based treaty, the justification for allocating tax jurisdiction with respect to income will be better. Origin-based rules identifying the eligible treaty subject, allocating income, and eliminating double taxation will reduce significantly (at least) the deficiencies of the current tax treaties, because the location of substantial income-producing economic activities is decisive for entitlement to treaty benefits and the allocation of tax jurisdiction with respect to income. An appropriate allocation of tax

harmonisation of the laws of the Member States relating to turnover taxes, the factors listed by the ECJ are remarkably similar to those as listed by Advocate General Darmon in his opinion in Daily Mail under the freedom of establishment; in addition, given the fact that the ECJ also refers to the concept of letter box companies as mentioned in Cadbury Schweppes, there is little doubt that this ruling can be generalized and may be applied in the context of the freedom of establishment under the Treaty as well.

35 See, e.g.,Case 33/78, Somafer [1978] ECR 2183, para. 12.

36 This section has been predominantly based on Kemmeren, Source of Income in Globalizing Economies: Overview of the Issues and a Plea for an Origin-Based Approach, Bulletin for International Taxation (2006) pp. 447-450. See, more elaborately, Eric C.C.M Kemmeren, Principle of Origin in Tax Conventions, A Rethinking of Models, Dissertation Tilburg University, Eric C.C.M. Kemmeren/Pijnenburg vormgevers·uitgevers, The Netherlands, Dongen 2001, pp. 257-300, 321-389, and 429-468.

37 See, e.g., OECD (2014), Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, and OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, and OECD/G20 Base Erosion and Profit Shifting Project (2015), Action 15: A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS, OECD Publishing.

jurisdiction with respect to e-business will also be better guaranteed.[38] Tax arbitration, including the (perceived) abuse of tax treaties, will be significantly reduced. It will not be easy to manipulate the allocation of tax jurisdiction without affecting the economic location of a substantial income-producing economic activity. The level playing field for enterprises, debtors, and lessors and lessees will be improved, because an origin-based system promotes CLIN. The efficient allocation of the production factors of labor and capital will also be improved. Consequently, the functioning of the global markets will be facilitated better than is currently the case. Developing countries will be able to reduce the gap in economic development with developed countries.

The following key elements are addressed: non-individual eligible treaty subject (this is not an allocation rule in a narrow sense, but it is included because it is essential to the system); business income (profits, transferred profits and capital gains on shares); interest and capital gains on debt-claims; and royalties and capital gains on the underlying intangible property. The origin-based approach will be compared, on a high-level basis, with current suggestions made in the BEPS debate by the OECD/G-20 with special attention for the positions of developing countries.

3.1 Non-individual eligible tax treaty subject

3.1.1 Origin-based approach

The underlying concept is that a person who pursues or has pursued a substantial income-producing economic activity within a state is entitled to invoke that state's tax treaties if the income or capital concerned must be attributed to that activity based on a functional analysis, i.e. the income or capital is or was functionally connected with the substantial income-producing economic activity.

In an origin-based system, treaty benefits are connected to objects rather than to subjects. The distinction between residents and non-residents and differentiation based on the legal form are eliminated, or at least substantially reduced. The same is true with respect to (abusive) treaty shopping through (hybrid) (legal) entities. As a consequence, a level playing field will be created which benefits CLIN and the development of global markets. An economic liable-to-tax condition will be partly superfluous in this system.

A person other than an individual is entitled to invoke a state's tax treaty *only* if:

(1) the person pursues or has pursued a substantial income-producing economic activity within that state; and

(2) the income or capital concerned must be attributed to that activity based on a functional analysis.

From the perspective of the principle of origin, the activities of agents, whether or not dependent, should be attributed to the income recipient if the income received is in substance produced through the activities of the agents (i.e. they added the intellectual element) to the extent the benefits from their activities did not accrue to the agents, but were passed on to the income recipient. Not attaching much weight to whether a person or company operates through a dependent or independent agent will also contribute to more CLIN and to the global markets, because the impact of the legal form of the operation on the allocation of tax jurisdiction will be reduced. The question of who is the income-producing agent should be considered on case-by-case basis.

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38 See for perceived BEPS issues relating to the digital economy, OECD (2014), Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.

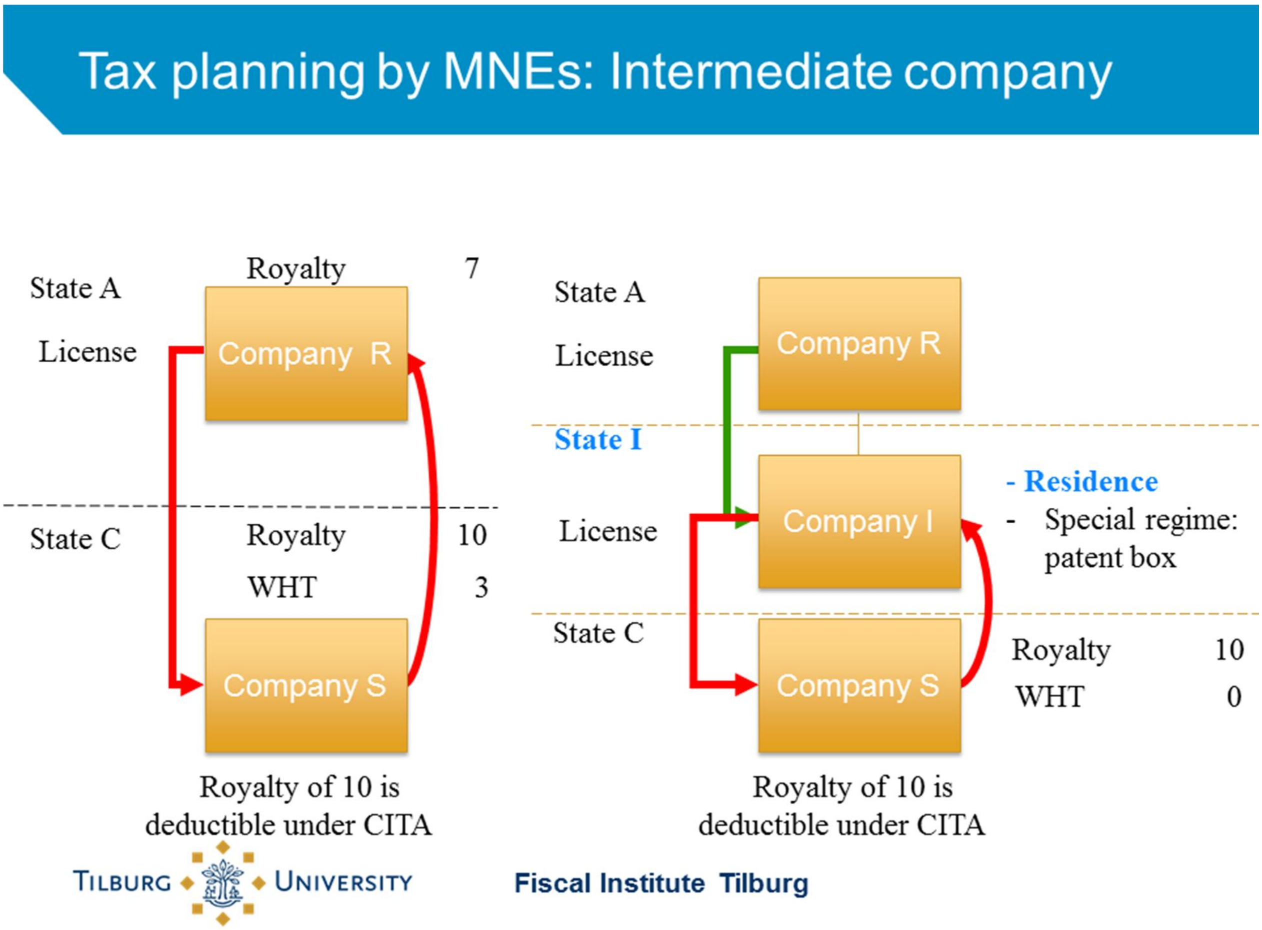
If the income from a contracting state cannot be attributed to a single substantial income-producing economic activity in one state, the income should be attributed *pro rata parte* to all the relevant substantial income-producing economic activities in the contracting states with which the income is functionally connected. A functional connection exists if the property concerned is used for pursuing that economic activity, i.e. the property is managed, and its operations are directed and controlled, from within the state concerned.

To (better) ensure that the income so attributed is taxed in the contracting state of the substantial income-producing economic activity, the suggested rule should be supplemented as follows. The contracting state in which the substantial income-producing economic activity occurs is entitled to and will tax the income flowing from the other contracting state attributable to that activity in the same way as the state taxes such income in the hands of its residents.

The conditions that a non-individual must pursue or have pursued a substantial income-producing economic activity and that the property concerned is respectively was used for pursuing that economic activity, i.e., that the property is respectively was managed, and its operations are respectively were directed and controlled, from within the state concerned actually, satisfy the concept of carrying on a genuine economic activity as required under the freedom of establishment under European law.[39] Therefore, no problems under EU law are expected when the origin-based approach is implemented.

The following example may illustrate the consequence of the origin-based system in respect of tax treaty access for non-individuals and (alleged abusive) tax treaty shopping. Assume that State R does not have a tax treaty with State S, but that State I has. Company R, resident of State R receives annually royalties up to an amount of € 10,000,000 from the unrelated Company S, which is a resident of State S. State S levies a withholding tax of 30%, i.e., an amount of € 3,000,000. Company R incorporates Company I in State I. Under the tax laws of State I, Company I is a resident for corporate income tax purposes merely because it has been incorporated under the company laws of State I. It is taxed on its worldwide income in State I, but the royalty income is lowly taxed, because the royalty income can benefit from a beneficial patent box system. The management of Company I is carried out by an unrelated trust company, which is also a resident of State I and which provides similar management services to hundreds of other companies similar to Company I. The management services are limited to routine day-to-day management activities, such as administration of the royalty income received, bookkeeping, and contacts with a bank and with State I's tax administration. No other persons are involved in the Company I's activities. Company R has contributed its licence to Company I. As a result, Company S no longer pays royalties to Company R, but to Company I. Under the DTC between State S and State I, State I is exclusively entitled to tax royalties. Therefore, Company I claims a refund of € 3,000,000 withholding tax in State S. The simplified structure before and after the transactions may be depicted as follows:

[39] See, e.g., ECJ 25 July 1991, Case C-221/89 (*Factortame II*), paras. 34-36. See further, e.g., Eric C.C.M Kemmeren, *Principle of Origin in Tax Conventions, A Rethinking of Models*, Dissertation Tilburg University, Eric C.C.M. Kemmeren/Pijnenburg vormgevers·uitgevers, The Netherlands, Dongen 2001, pp. 177-181.



Under the current OECD Model Tax Convention on Income and Capital (OECD MC), Company I is a resident for tax treaty purposes.[40] Company I is liable to tax on its worldwide income in State I, because it is a resident of State I according to the tax laws of State I. The low taxation because of the beneficial patent box regime does not change this conclusion. The mere fact that Company I has been incorporated under the company laws of State I, is sufficient for qualifying the company as a tax resident of State I. Therefore, the connecting factor of liability to tax because of its "residence", as required under Article 4(1) OECD MC, has been satisfied. Furthermore, it can be argued that other connecting factors included in this provision, such as "place of management" (management by the trust company) and "any other criterion of a similar nature" (deemed residence because of its incorporation under the company laws of State I if not already covered by the connecting factor "residence") are also satisfied. Because of this deemed residence, even mere letter box companies qualify as tax treaty residents of State I under the current OECD MC.[41]

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[40] See Article 1 in conjunction with Article 4(1) OECD MC.

[41] However, it should be noted that a number of states may not give access to tax treaties or grant tax treaty benefits based on, e.g.:

1. Application of a domestic general anti-abuse rule or doctrine by State S with the result that the royalty income is attributed to Company R instead of Company I and that the DTC between State S and State I cannot be invoked in respect of that royalty income.

Under a DTC based on the principle of origin, Company I would not qualify as an eligible tax treaty subject. Company I does not carry out a substantial income-producing economic activity within the territory of State I, but it is (close to) a letter box company. The only activities are routine day-to-day management activities, such as administration of the royalty income received, bookkeeping, contacts with the bank and State I's tax administration. These activities are predominantly necessary to maintain Company I, but they do not constitute a substantial income-producing economic activity. The licence is not really managed, and its operations are not really directed and controlled, from within State I.

3.1.2 Origin-based approach compared to BEPS approach

This origin-based approach comes close to the active trade or business test as included in the suggested LOB provision in the BEPS debate.[42] However, the suggested LOB test is rather complex and may not be easy to administer, especially by developing countries, given the available resources. The suggested origin-based rule is less complex and may be better to administer whereas the underlying aim of the suggested LOB rules (preventing abusive treaty shopping) is still satisfied. If one believes that the open norm of the origin-based rule should provide more legal certainty, more detailed rules could be included on what a substantial income-producing economic activity is or when the income or capital concerned must be attributed to such an activity. The consequence will be that the rule will inherently become more complex with similar drawbacks as under the suggested LOB rules.

3.2 Tax jurisdiction on business profits, transferred profits, and capital gains on shares

3.2.1 Origin-based approach

Whereas the causal relationship between production of income and the territory of a state is predominant under the principle of origin, it is of minor or no importance under the principle of source. Therefore, the principle of origin and the principle of source are not necessarily identical. If the income is not generated in a state but, nevertheless, physically appears to be from that state, tax jurisdiction may be allocated to that state on the basis of the principle of source, but not on the principle of origin.

In an origin-based system, tax jurisdiction with respect to business profits is allocated to the contracting state in which a person's enterprise carries on its substantial entrepreneurial activities. As a consequence, all income, whether it arose in the contracting state in which the entrepreneurial activity is carried on, in the other contracting state or in a third state, is taxable only in the state of the substantial entrepreneurial activity, unless another income allocation rule of the relevant tax treaty

2. Application of fraus conventionis (also named fraus tractatus; i.e. a general anti-abuse doctrine applied at tax treaty level) by State S with the result that tax treaty benefits are not granted to Company I.
3. Application of a general anti-abuse tax treaty rule by State S with the result that tax treaty benefits are not granted to Company I.
4. Application of a limitation on benefits rule (LOB rule) with the result that tax treaty benefits are not granted to Company I, because it has insufficient (economic) nexus with State I.
5. Application of a main purpose rule included in the royalty provision with the result that tax treaty benefits are not granted to Company I, since the main purpose of establishing or maintaining Company I is to benefit from the tax treaty royalty provision.
6. Application of the beneficial owner concept with the result that tax treaty benefits are not granted to Company I, because it does not qualify as beneficial owner of the royalty.

[42] See, e.g., OECD (2014), Public Discussion Draft, BEPS Action 6: Preventing The Granting Of Treaty Benefits In Inappropriate Circumstances, pp. 3-10, OECD (2014), Public Discussion Draft, Follow Up Work on BEPS Action 6: Preventing Treaty Abuse, pp. 4-10, and OECD (2015), Revised discussion draft, BEPS Action 6: Prevent Treaty Abuse, pp. 4-24.

derogates from this rule. A substantial entrepreneurial activity is present if the relevant entrepreneurial activity in a state forms an essential and significant part of the entrepreneurial, activity of the enterprise as a whole.

For treaty purposes, the term "enterprise" is defined as an independent and durable organization which aims to participate in economic life by means of labor or a combination of labor and capital with the purpose of making a profit, which profit must reasonably be expected. The distinction between entrepreneurial activities and independent personal services has been disregarded. As a rule, services or activities cannot be performed at any place other than where the *individual* performing them is physically present. The decisive point is where that person works, not where the results of his work are exploited.

The enterprise, as defined, must then be attributed to a person who can invoke the tax treaty. This attribution should be guided by the question: On whose account is the enterprise carried on? This person is relevant only in the third phase. First, it must be determined whether there is an enterprise, and second, if so, where that enterprise carries on its substantial business activities; third, it must be determined to whom the substantial business activities should be attributed. This makes a tax treaty less vulnerable to abuse, since real economic activities with a sufficient nexus to a state determine the allocation of tax jurisdiction with respect to business income; this rule applies whether or not tangible property with a(ny) degree of permanence is used, or whether or not a person can be considered to conclude contracts in the name of a principal, in order to create or avoid a permanent establishment (PE), as under the current systems.

Under the principle of origin, the concepts of PE, fixed base and agency PE are considered to constitute unnecessary conditions. It is sufficient that an individual pursues substantial activities for an enterprise in the state concerned: an enterprise carries on or has carried on a substantial entrepreneurial activity in the other contracting state if that activity, carried on by individuals attributable to the enterprise, in itself forms or has formed an essential and significant part of the activity of the enterprise as a whole ("a branch"). If income is attributable to a branch, but is deferred and received after the branch ceases to exist, tax jurisdiction with respect to the deferred income is assigned to the state in which the branch was situated.

The activities of individuals are attributed to the enterprise if the activities are for its account. It does not matter whether the individuals carry on the activities concerned as dependent agents or as independent agents.

If it is considered desirable to define the term "substantial" more precisely, this could be done by reference to the proportionate share of the entrepreneurial activities in the other state, the nature of the activities performed, and the relative contributions made in each contracting state to the entrepreneurial activities. For practical reasons, safe harbors could be introduced. If a minimum period of human activity is considered to be a desirable threshold for practical reasons, the minimum periods for any item of income should be harmonized as much as possible, unless the nature of the activity indicates otherwise. Since a state is assigned tax jurisdiction only if the entrepreneurial activities in that state are substantial, auxiliary and preparatory activities are excluded; so far, the alternative system will, to a certain extent, operate comparably to the current system.

If an enterprise of a person carries on substantial entrepreneurial activities in both contracting states, the profits must be allocated to both states based on the amount of income produced in each state. The attribution of profits to each part of the enterprise must be neutral. The legal form of that part of the enterprise, a branch or a subsidiary, should be irrelevant since the legal form may not affect the tax consequences, or do so as little as possible. In determining whether income is produced in one state or the other, the arm's length principle is decisive.

The expenses incurred for the purposes of each branch should be attributed to the part concerned and should be deductible regardless of where they were incurred. If the expenses cannot be attributed to a single part, they should be attributed *pro rata parte*. If, for example, a head office in one state supplies funds from the equity of the enterprise to finance substantial business activities in another contracting state, economic reality implies that the activities are financed with equity, not with debt. Labelling such funds as internal debt does not change this economic reality. Economic reality prevents an internal flow of interest from a substantial business activity to a head office. Assuming that tax neutrality requires that the profits derived in the state of investment be taxed, it would be equally non-neutral to deduct the interest paid or deemed paid to the parent company from the subsidiary's gross income and to add it to the parent's income if the parent supplies funds from its equity to finance the substantial entrepreneurial activities of its subsidiary in another contracting state. Funds borrowed from third parties which are channeled through the head office or parent should be taken into account at the level of the branch or subsidiary. However, tax jurisdiction with respect to the interest should be assigned to the same state because the interest paid was created through substantial entrepreneurial activities within that state.[43] This way, it is also possible to achieve neutrality between equity and debt financing. Especially where it concerns the relationship between the head office and another substantial entrepreneurial activity of an enterprise of the same taxpayer, the issue of internal interest will not have any, or hardly any, practical relevance. For both theoretical and practical reasons, the author suggests that internal interest calculations not be made under the alternative system if funds are transferred only within an enterprise. If, however, goods or services are internally transferred, it might be appropriate to take the internal interest into account as part of the arm's length conditions. Goods and services supplied by the head office or parent company to a branch or subsidiary should be treated the same as supplies to third parties. When (in)tangibles are transferred internally, the economic activity will change as a rule. Therefore, an internal rent or royalty can be justified based on economic reality, the principle of origin and the arm's length principle.

If an enterprise carries on (substantial) entrepreneurial activities in states with which the enterprise's or branch's state does not have a bilateral tax treaty or if it carries on non-substantial activities in third states with which there are origin-based treaties, the income produced by such activities should be attributed to the branches with which the (non-substantial) entrepreneurial activities are functionally most closely connected, and consequently to the contracting state in which the branches operate. This alternative system is a closed system regarding business profits. In this respect, it should be noted that, in an origin-based system determining the eligible treaty subject, it is stipulated that the income attributed to substantial income-producing economic activities in a contracting state with which it is functionally connected could be taxed in that contracting state. The contracting state in which the substantial income-producing economic activity takes place may tax the income from the other contracting state attributable to that activity the same way as the state taxes such income derived by its residents.

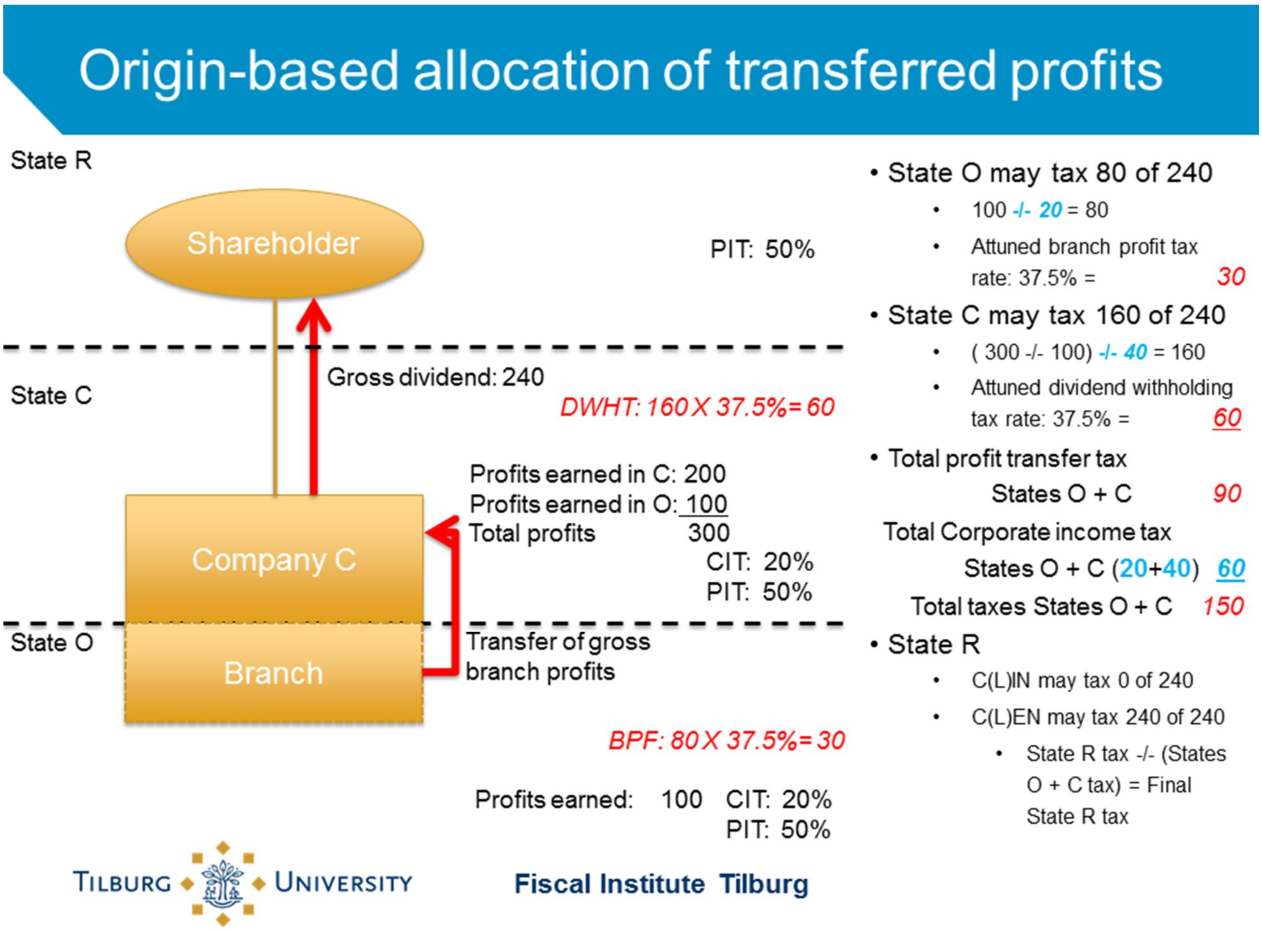
Based on the principle of origin, tax jurisdiction with respect to dividends and capital gains on shares must be assigned to the state in which the profits were produced, which is not necessarily the state in

[43] See section 3.3 of this paper.

which the paying company is resident. The allocation of tax jurisdiction with respect to a company's profits, the dividends paid on its shares, and the capital gains on its shares is harmonized in order to avoid both international juridical and economic double taxation. The shareholder's state should refrain from taxing the company's profits, the capital gains on its shares and the dividends received by the shareholder. It should be noted, however, that the suggested *allocation* rules do not compel this state to apply an income exemption system as a method to eliminate double taxation. The suggested allocation rules can also be applied under a system based on capital-export neutrality.

If the company carries on its enterprise in its residence state, the state of origin and the residence state coincide. If the enterprise also carries on substantial business activities in the other contracting state (a branch), the residence state and the state of origin do not coincide. In this case, a branch profits tax must play a role to ensure that the assignment of tax jurisdiction with respect to profits is neutral regarding the legal form in which the business activities are carried on, i.e. it does not matter whether a subsidiary pays out its profits to its shareholder or a branch transfers its profits to its head office. The same goes for capital gains. The systems are harmonized in order to avoid both international juridical and economic double taxation irrespective of whether the substantial entrepreneurial activities are carried on directly by a sole proprietor, through a branch, or through a company.

Below, two examples have been included to illustrate this system:



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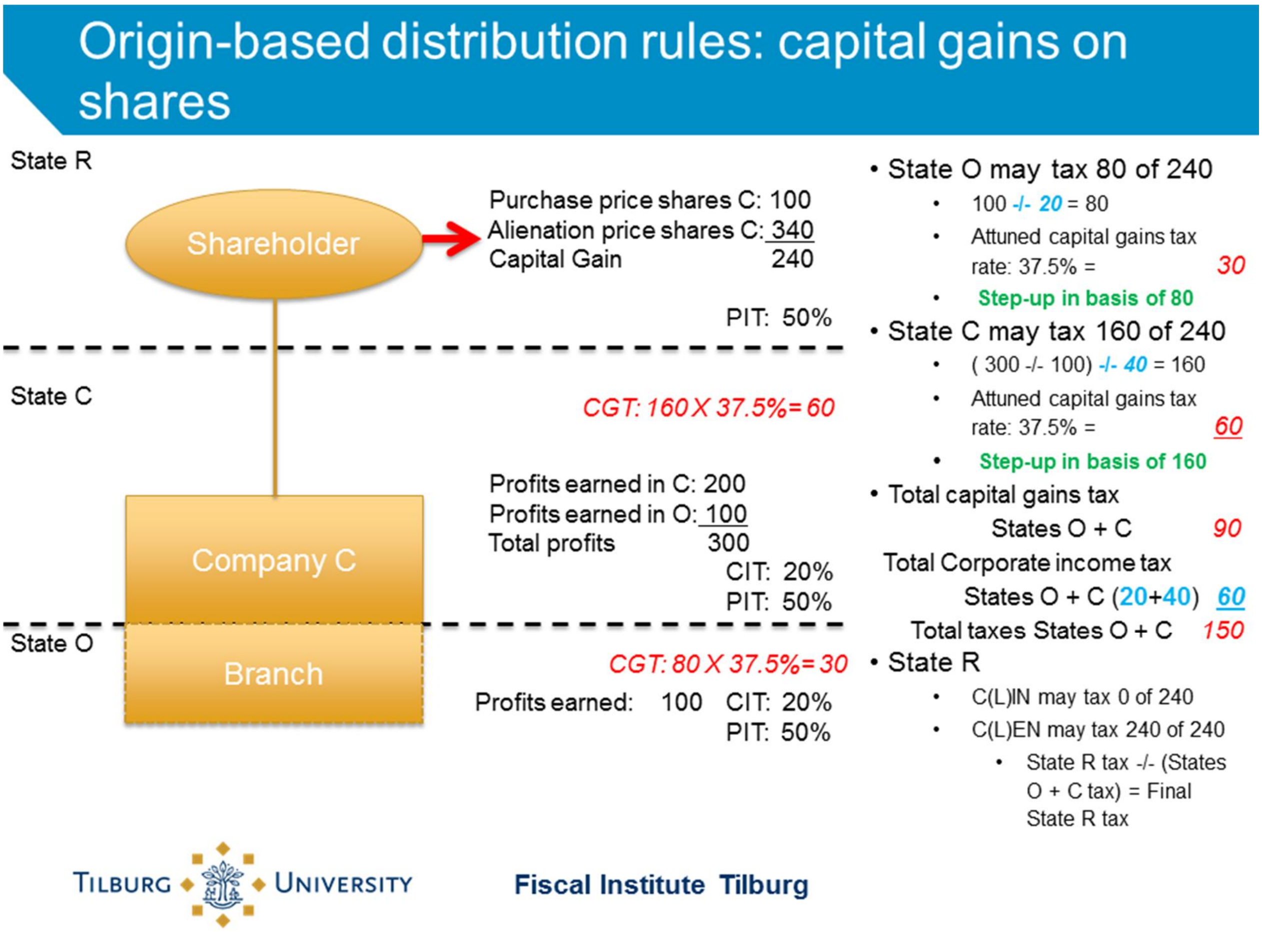

3.2.2 Origin-based approach compared to BEPS approach

If this origin-based approach is applied, the BEPS discussion on preventing the artificial avoidance of a PE status[44] comes to an end, because the PE concept as such will disappear and be replaced by the branch concept. This concept is more attuned to the global service-based economies. It is sufficient that an individual pursues substantial activities for an enterprise in the state concerned, i.e. a substantial entrepreneurial activity is or has been carried on by individuals attributable to the enterprise, which in itself forms or has formed an essential and significant part of the activity of the enterprise as a whole. For example, the current discussion on the commissionaire arrangements and similar strategies will end, because under the branch concept, it is irrelevant whether a person is entitled to conclude contracts in the name of a principal. Furthermore, the artificial avoidance of PE status through the specific activity exemptions under the current Article 5(4) OECD MC will also disappear, because a substantial entrepreneurial activity carried on by individuals will always constitute a branch. Auxiliary and preparatory activities are excluded from the branch concept. To this extent, the suggested BEPS rule to limit the scope of the current exclusions under Article 5(4) OECD MC to PEs with an auxiliary or preparatory character is in line with the suggested origin-based system.

[44] See, e.g., OECD (2014), Public Discussion Draft, BEPS Action 7: Preventing the Artificial Avoidance of PE Status, and OECD (2015), Revised discussion draft BEPS Action 7: Preventing the Artificial Avoidance of PE Status.

Furthermore, the origin-based system relies on the added value created by individuals and in this context also on the arm's length principle. The BEPS developments to put more emphasis on the significant people's function (*w*ho is doing *w*hat and *w*here (www) and what is the added value created by that individual) is in line with the principle of origin.[45] People create income and capital as such not. Therefore, the simple transfer of risks by contracts is also under an origin-based system not very relevant if the substantial income producing economic activity of individuals is not really reallocated.

However, it must also be noted that BEPS does not take away the inconsistencies of the current system in respect of the taxation of business profits, transfer of business profits and capital gains on shares. For instance, the suggested BEPS rules do not address the indirect sale of shares, whereas the origin-based system does. Therefore, the suggested origin-based system in respect of business profits is much more comprehensive than the BEPS suggestions. The origin-based system allocates more tax jurisdiction on business profits, transfer of profits and capital gains on shares, to capital importing countries which is, as rule, benefitting developing countries.

3.3 Tax jurisdiction on interest an capital gains on debt-claims

3.3.1 Origin-based approach

Among other things, an origin-based system with respect to interest and capital gains on debt-claims significantly reduces the current tension between equity and debt financing and mitigates (abusive) rule shopping.

The debtor is considered the originator of interest income. The state in which the debtor produces the interest income, which is not necessarily the residence state of the debtor, is awarded unlimited tax jurisdiction with respect to interest. Capital gains on debt-claims are allocated to the same state. The expenses incurred for purposes of the interest income or capital gains are deductible.

A feasible system can be created by means of the information available in the state of origin, which will facilitate combating tax fraud. Tax neutrality will be improved, and this will also enhance the global capital markets.

With respect to interest received through an intermediary, e.g. a bank, a further refined origin-based system may be developed. Unrestricted tax jurisdiction with respect to the interest will be allocated to the state of the debtor of the bank. This state must take into account the bank's spread as a deductible expense. The spread is attributed to the state in which the banking activities are carried on.

The later situation also shows that a simple withholding tax on a gross interest payment is in itself not a sufficient tool to satisfy an origin-based taxation. Income taxation is by definition a taxation of net income. Nevertheless, a withholding tax could be a good starting-point from an administrative point of view. However, the creditor must also have the opportunity to be taxed on a net basis, e.g. that the bank's spread is taken into account. Various systems could be applied. One of them is a refund system.

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[45] See BEPS Actions 8, 9, 10: Assure that transfer pricing outcomes are in line with value creation which addresses especially intangibles, risks and capital and other high-risk transactions. See, e.g., OECD (2014), Public Discussion Draft, BEPS Actions 8, 9 And 10: Discussion Draft on Revisions to Chapter I of The Transfer Pricing Guidelines (Including Risk, Recharacterisation, And Special Measures), OECD (2015), Public Discussion Draft, BEPS Action 8: Hard-to-Value Intangibles.

The creditor files a tax return in which the net income is reported and overpaid withholding taxes will be refunded. Such a system has cash flow disadvantages. In order to address this issue, a system could be developed under which the creditor previous to the interest payment provides an estimation of expenses to be incurred to the debtor's state tax administration and after which this tax administration issues a license which allows the debtor to take into account a fixed amount as a deductible expenses when withholding the tax on the interest payment. After the tax year, the creditor files a tax return to the debtor's state tax administration to settle the final payment or to receive a refund if, despite the reduction, more withholding taxes have been levied than corporate income tax finally due. In order to assist the tax administration of developing countries, it could be considered that the creditor communicates via the tax administration of his state of residence. Since the developed countries are more often capital exporting countries and the developing countries are more often capital importing countries, the tax administration of the developed countries will in fact act as sort of unpaid agent for the tax administrations of developing countries. This idea could be part of a technical assistance program between these two groups of countries. This way, the author believes, that resources of not only the debtor and the creditor, but also of tax administrations can be made operational in a highly efficient and fair mode.

If neither of the two contracting states can be considered the true state of origin, we rely on the presumption that the debtor's contracting state from which the interest payment is made, is the state of origin for purposes of attributing tax jurisdiction with respect to the interest under the tax treaty, unless it is proved otherwise. The debtor's contracting state is the state in which the debtor carries on his relevant income-producing economic activities or, if this state cannot be identified, the state in which the debtor, being an eligible treaty subject in an origin-based system as described in section 3.1, is situated. In substance, the principle of source is then applied.

Regarding triangular situations, the tax treaty between the bank's state (State B) and the residence state of the interest recipient (State R) must stipulate that State R will not waive its tax jurisdiction if the interest paid by an intermediary, e.g. a bank, in State B did not originate in State B or in a state with which State R has a tax treaty. Earmarking at the level of the bank of its interest earned abroad makes such a system feasible. If there is a direct connection between the funds deposited by a saver at a bank and the loans issued by that bank, the earmarking is easy to apply. If such a connection cannot be found, a *pro rata parte* approach may provide a feasible result. State R will waive tax jurisdiction with respect to the interest received by a saver based on certain formulas. To reduce the administrative burden on the saver, this ratio could be exchanged between the tax administrations of the contracting states in a digitized format and, if considered appropriate, only upon the request of the saver in his tax return.

The example below provides a simple example illustrating how an origin-based system will operate:

Origin-based distribution rules: interest and debt-claims

- Taxes in all States: 20%

		Income	Tax
State O:	- allows Entrepreneur deduction of	6.5	-/- 1.3
	- may tax Bank on	6.5 -/- 0.5 = 6.0	+/+ 1.2
State B:	- may tax Bank on	5.3 -/- 4.8 = 0.5	+/+ 0.1
State R:	- (C(L)IN) may tax Saver on	4.8 -/- 4.8 = 0.0	0.0
	- (C(L)EN) may tax Saver on	6.0	+/+ 1.2
	State R tax -/- State O tax = Final State R tax		-/- 1.2
			0.0

- does not waive tax jurisdiction if interest paid by Bank has not originated in State B or a DTC partner of State R

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3.3.2 Origin-based approach compared to BEPS approach

Under corporate income tax systems, the problem is *not* the deduction of interest payments, but the non-taxation of interest receipts in the state of origin. Therefore, (complex) systems such as suggested in the BEPS discussion which focus on limitation of interest deductions and of payments economically equivalent to interest, such as thin capitalization rules and earnings stripping rules, do not tackle the real cause of the problem of base erosion and profit shifting in respect of interest.[46] Taxation of the interest in the hands of the creditor by the state of origin, independent of whether the creditor is a resident or a non-resident of that state or whether the creditor belongs to the same group as the debtor, enhances the ability-to-pay principle, the direct benefit principle, the territoriality principle, and inter-nation equity.

The result of an origin-based allocation of tax jurisdiction on interest is that the effective tax rate on interest will be the same as effective tax rate on (distributed) profits originated in the debtor's state. An origin-based taxation of interest contributes to a more efficient allocation of the production factors labor

46 See, e.g., OECD (2014), Public Discussion Draft, BEPS Action 4: Interest Deductions and Other Financial Payments, OECD (2014), Public Discussion Draft BEPS Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements (Recommendations for Domestic Laws), OECD (2014), Public Discussion Draft BEPS Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements (Treaty Issues), and OECD (2014), Neutralising the Effects of Hybrid Mismatch Arrangements, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.

and capital, because this system enforces CLIN. Tax neutrality between debt and equity financing will be realized. As a result, tax driven debt financing will be tackled and economic considerations other than tax reasons will determine more the decision-making processes of how to finance investments. An origin-based system reduces tax driven overloaded debt financing (hedge funds, private equity funds, mergers & acquisitions, group financing). Consequently, companies will have more flesh on the bones, i.e. equity, which strengthens the companies' position in case of economic head winds. Companies will be financially less vulnerable in such situations, i.e. the number of companies that will go into bankruptcy will reduce. As a result, the overall the economic infrastructure of the countries involved, i.e. the states or origin, will be strengthened as well.

Taxation of the interest in the hands of the creditor by the state of origin reduces international juridical and economic double taxation, hybrid mismatch arrangements, (abusive) treaty shopping, (abusive) rule shopping and tax fraud.

In short, taxation of the interest in the hands of the creditor by the state of origin reduces tax arbitrage and enhances a fair share taxation.

Especially developing countries will benefit from such a switch in the system, as these countries seem to be more vulnerable to debt financing structures.[47]

3.4 Tax jurisdiction on royalties and capital gains on underlying intangible property

3.4.1 Origin-based approach

In an origin-based system, the state in which the intangible property was produced, not the state in which it is used, is entitled to tax the income from it (lump-sum or periodical payment).

The cause of the royalty income received is the *creation* of the intellectual property. Especially with respect to royalty income, the overwhelming relevance of the intellectual element in the production of income is obvious. The state where the intellectual element is found is the state of origin of the royalty income. Through exploitation of the intangible, the producer of the intangible creates income. The user of the intangible does not produce the royalty income, at least not predominantly. He only uses the intellectual element of someone else producing another item of income, e.g. business income, if he uses the intangible in his own enterprise. Therefore, the user of the intangible cannot easily be put on a par with the user of a sum of money borrowed (a debtor), at least not completely. As will be discussed below, they should be put on a par to a certain extent. A sum of money is capital, i.e. successive instalments of earnings which are capitalized into a fund of wealth.[48] Through the activities of the debtor, the intellectual element is added to the capital, and, consequently, income, i.e. interest, is produced. With the creation of an intangible, we are in the pre-capital phase, i.e. the creation of the (potential) earnings themselves. The intangible is therefore not a fund. The added value is the intangible itself, unlike capital.

47 See, e.g., International Monetary Fund, Spillovers in International Corporate Taxation, Washington D.C, USA, 9 May 2014 and UNCTAD, Investment and Enterprise Division, FDI, Tax and Development, The fiscal role of multinational enterprises: towards guidelines for Coherent International Tax and Investment Policies, Working Paper, 26 March 2015.

48 See, also, e.g., Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp, Report on Double Taxation, submitted to the Financial Committee, League of Nations, Geneva, April 5th 1923, E.F.S. 73 (F.19), p. 24.

Only when the intangible is exploited, i.e., made available in consideration, the received earnings, e.g., a lump sum or periodical payments,[49] create a fund, i.e. capital.

Actually, the creation or the production of an intangible is in an economic sense not different from the creation or the production of tangible goods, such as a machine with which cups can be made. The producer of the cup-machine adds the value, not the user of the machine who rents it. The user of the cup-machine makes new products, cups, and produces new business income with that machine. The user of an intangible does the same. For example, if the user makes a pills based on patented knowledge, the user did not create the patent, but uses the patent to make new products, pills, and produces new business income with that patent.

From an economic perspective, the author believes that operational lease payments, including royalties, may have elements from direct and portfolio investments (business profits and interest, respectively). Therefore, royalties should be subdivided into four parts:

1) a compensation for write-offs on the original market value of the intangible property concerned;
2) a compensation for maintaining the intangible property;
3) a compensation for bearing the risks;
4) an interest component.[50]

In case of periodical payments, an interest component should be distinguished, because a lease can economically, at least partly, be put on a par with financing the intangible property at one's disposal through the lease. In such a case, a lease of intangible property approximates economically, to a certain extent, a purchase of the intangible property against a note. If a person receives royalty income for the use or the right to use an intangible property as a periodical payment, he economically receives the lump sum in a deferred way. Therefore, an interest component shall be distinguished from the royalty.

Considering the analogy with sales and services, the first three components should be attributed to the state in which the lessor performs his activities. This will probably be the place of the lessor's entrepreneurial activities.[51]

Consistent with the origin-based system with respect to interest as discussed above,[52] the interest should be attributed to the state in which the lessee performs his activities, i.e. the state in which the intangible property is used.[53] Insofar as separation of the interest component in each individual case would be considered difficult, a fixed part (a percentage) of the royalty could be classified as interest.[54]

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49 Compare also, e.g., Lawrence Lokken, The Sources of Income from International Uses and Dispositions of Intellectual Property, 36 Tax Law Review 233, 258-261 (1980-1981).

50 Compare also, e.g., Lawrence Lokken, The Sources of Income from International Uses and Dispositions of Intellectual Property, 36 Tax Law Review 233, 238-244, 258-261(1980-1981).

51 See section 3.2.1of this paper.

52 See section 3.3.1of this paper.

53 Compare also, e.g., Lawrence Lokken, The Sources of Income from International Uses and Dispositions of Intellectual Property, 36 Tax Law Review 233, 258-259 (1980-1981), and Klaus Vogel, Worldwide vs. Source Taxation of Income - A Review and Re-evaluation of Arguments, (Part II), Intertax, 1988/10, pp. 317-318, who distinguishes three parts, because he considers parts two and three as constituting one single part: a compensation for maintaining the property and bearing the risks.

54 A 3% withholding tax for *any payment* borne by a State S payer to a State R beneficial owner, as suggested by e.g. Richard Doernberg and Luc Hinnekens, Electronic Commerce and International Taxation, Kluwer Law International, The Hague

For example, this could be settled (yearly) by protocol or mutual agreement. Alternatively, a standard could be included in the tax treaty on the basis of which the interest part could be determined, e.g. LIBOR plus X.[55]

With respect to the compensation for the write-off component, it should be noted that the write-off is based on the costs of the production of the intangible property, i.e. the income produced by creating the intangible property. This income should be allocated to the state of origin, i.e. the state in which the intangible property was produced.[56] Whereas only human beings can create income, the place of their activities determines the state of origin. The origin-based system with respect to enterprises will probably apply to these activities. When a royalty company subsequently exploits the intangible property, i.e. the company is the lessor, the write-off should be a deductible expense in calculating the income of this company, which should be assigned to the state where the individuals attributable to this company carry out their activities.

The activities in conjunction with the royalty's component of maintaining the intangible property will probably be carried out at the same place.

The part of the compensation for bearing the risks should be attributed to the activities of the lessor or his agents, i.e. their exploitation activities. The state where these exploitation activities are carried out should be considered the state of origin, and the place of these activities will probably coincide with the place of activities connected with the previous two components of the royalty.

Expenses which are incurred for the purposes of each of these parts should be attributed to the part concerned and should be deductible. As far as the expenses cannot be attributed to a single part, the expenses should be attributed *pro rate parte*. For example, interest paid will generally be an expense attributable to the activities of the lessee, because the lessor passes on, in substance, a part of the interest component of the royalty to the lessor's creditor, or to put it differently, the lessor economically passes on his loan to the lessee. The lessor in fact functions as an intermediary between the lessee and his own creditor. If the lessor realizes a spread because of these activities, this spread should be allocated to the state where the lessor's activities are carried on. Such a situation is similar to a situation in which the interest is received through an intermediary, e.g. a bank. Therefore, the origin-based outline with respect to such interest as discussed above can be applied. The author thinks that, this way, rather simple solutions are available which do not impede but contribute to the efficient operation of global markets.

With respect to capital gains on copyrights, patents, trademarks, etc., the same rules apply under an origin-based system as with respect to royalties,[57] although an interest component may be considered

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1999, pp. 319-323 does not meet the principle of origin. No payment from State S to State R represents income originated in State S. From the perspective of the principle of origin, the 3% rate is not a low rate although the number may suggest otherwise. Suppose a royalty of 100 is paid from which an amount of 7 is to be considered an arm's length interest payment (i.e. an interest rate of approximately 7.5%). Under the system suggested by Doernberg and Hinnekens, a withholding tax of 3 is due. From the perspective of the principle of origin, the tax rate is not 3%, but 3/7x 100 = 42.86%.

55 The currency in which the property has been denominated by the lessor should be the basis.

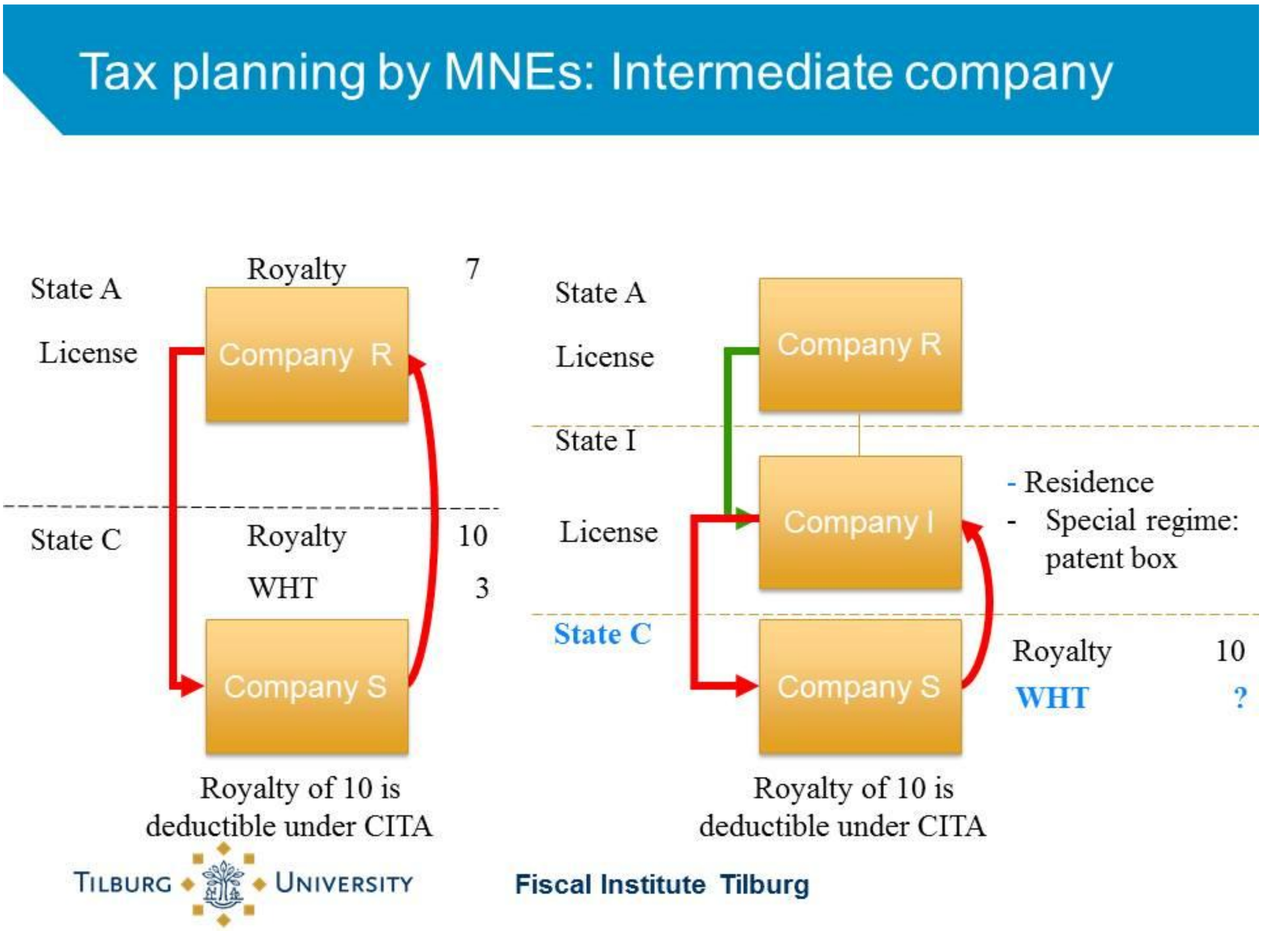
56 Dissenting, e.g., Lawrence Lokken, The Sources of Income from International Uses and Dispositions of Intellectual Property, 36 Tax Law Review 233, 240 (1980-1981).

57 Compare also, e.g., Lawrence Lokken, The Sources of Income from International Uses and Dispositions of Intellectual Property, 36 Tax Law Review 233, 238 (1980-1981).

not constituting a part of the gain concerned. In substance, three of the four compensation components distinguished above remain. If the intangible property is alienated against a note, this may subsequently create interest. But such interest is just interest from a regular debt-claim and can be treated as such.

By structuring tax treaties and model tax conventions as proposed, the author thinks that a conflict of income classification (royalty or business/personal services income) which may arise under the UN Model will be resolved.

The following example may illustrate the consequences of the origin-based system in respect of the allocation of royalty income. The example is an amended version of the example used to illustrate the eligible tax treaty subject under an origin-based system. Again, assume that State R does not have a tax treaty with State S, but that State I has. Company R, resident of State R receives annually royalties up to an amount of € 10,000,000 from the unrelated Company S, which is a resident of State S. State S levies a withholding tax of 30%, i.e., an amount of € 3,000,000. Company R holds Company I in State I. Company I is one the R&D centres of the group. It not only carries out R&D activities, but it also manages a number of the group intangibles in its field of expertise (medication), and directs and controls the connected operations in respect of these intangibles. Under the tax laws of State I, Company I is a resident for corporate income tax purposes, because it has been incorporated under the company laws of State I. It is taxed on its worldwide income in State I, but the royalty income is lowly taxed, because the royalty income can benefit from a beneficial patent box system. Company I is fully staffed with R&D specialist in the field of medication. Company R has contributed its licence in respect of a medicine against Q-fever to Company I. As a result, Company S no longer pays royalties to Company R, but to Company I. The simplified structure before and after the transactions may be depicted as follows:



Under a DTC based on the principle of origin, Company I would qualify as an eligible tax treaty subject. Company I carries out a substantial income-producing economic activity within the territory of State I: carrying out R&D activities and managing and exploiting intangibles related to its field of expertise. Therefore, the licence is really managed, and its exploitation is really directed and controlled, from within State I. Subsequently, under an origin-based tax treaty the royalty must be subdivided as follows:

1) Compensation for write-offs on original market value of medication intangible
2) Compensation for maintaining the medication intangible
3) Compensation for bearing risks
4) Interest component

Parts 1-3 must be allocated to the substantial activity state of the lessor: State I.
Part 4 must be allocated to the substantial activity state of the lessee: State S.

It should also be noted that the transfer of the license from Company R to Company I implies alienation with the result that Company R must report its unrealized capital gains under the arm's length principle. Company I will take into account the amount paid to Company R as a deductible expense when calculating its taxable profit in State I, e.g. through write-offs. This way nothing falls between two stools. The fact that State I taxes the royalty income lowly is as such not relevant in an origin-based system, as long as this low taxation is available for all business in State I. In such a case, the level playing field is not hampered, at least not more than by a low general tax rate in State I compared to other states.

3.4.2 Origin-based approach compared to BEPS approach

The BEPS discussion on intangibles is not much about the royalty allocation rule, but it is much more on valuation issues, i.e. on transfer pricing.[58] As mentioned, the arm's length principle is also in the heart of origin-based taxation. Therefore, the BEPS discussion on valuation issues is also very relevant for the origin-based system. The development of putting more emphasis on the significant people's function in this context, especially in order to allocate the residual profit is welcomed by the author, because it fits perfectly with the fundament of the origin-based system: only individuals can create income and things, such as capital, by itself not.

However, developing countries which claim that they may levy a (withholding) tax on paid royalties will probably not like the above analysis. According to the author, they have only a justified claim on the interest component of the royalty if they are serious about the starting-point that income must be taxed with a corporate income tax in the state where the value is added. In substance, and with the exception of the interest component, a (withholding) tax on paid royalties is *not* an income tax, but a *use* tax and comes close to a consumption tax.

4 Summary and conclusions

Against the background of the current BEPS discussion, the basic questions addressed in this paper are:

1. How should a sound tax base in developing countries be ensured, in the context of paying corporate income taxes where the value is added; and
2. Whether the current international initiatives are sufficient?

In connection with these more general questions, this paper focuses on some more specific questions:

a. Would developing countries benefit more from a more radical overhaul of the allocation of the tax base between jurisdictions with respect to profits and capital income?
b. If so, which international initiatives could be helpful to this end?
c. Are withholding taxes still a suitable instrument for developing countries?

It must be emphasized that BEPS can only be an issue, if a state has a justified tax claim on the income under discussion, such as business profits, interest, or royalties. If a state does not have a justified tax claim, a tax treaty cannot be considered to facilitate BEPS if a state loses tax jurisdiction under such a treaty. In this respect, the relevant question is: When does a state have a justified tax claim on corporate income if the income should be taxed in the state where the value is added? The main answers to all questions follow below.

If, in a global context, the ambition of a corporate tax system is to tax corporate income in the state in which the value is created, a more radical overhaul of allocation of the tax base between jurisdictions with respect to business income, transfer of profits, capital gains on shares, interest, capital gains on debt-claims, royalties, and capital gains on intangible properties is necessary than currently discussed in the BEPS context. Such a system should be based on the principles of international tax neutrality, CLIN, ability to pay, and origin. These principles go hand in hand in creating a level playing field for enterprises, debtors, and lessors and lessees.

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[58] See, e.g., BEPS Actions 8, 9, 10: Assure that transfer pricing outcomes are in line with value creation which addresses especially intangibles, risks and capital and other high-risk transactions. See, e.g., OECD (2014), Public Discussion Draft, BEPS Actions 8, 9 And 10: Discussion Draft on Revisions to Chapter I of The Transfer Pricing Guidelines (Including Risk, Recharacterisation, And Special Measures), OECD (2015), Public Discussion Draft, BEPS Action 8: Hard-to-Value Intangibles.

Taxation based on the principle of origin justifies a state taxing the income created within that state, i.e. the cause of the income is within the territory of that state. That state makes it possible to derive income or acquire wealth. Only *individuals*, not things, can create income. The intellectual element is the key component in producing income. Through the action of an individual, with or without using a device, value may be added to things. The place of origin of a corporate income is where an individual's income-producing economic activity takes place. If the income is produced to a substantial extent through the activities of an independent person (i.e. he is the person who adds the intellectual element) and the benefits from these activities are passed on to another person (i.e. the income recipient), the income originates with the independent person (i.e. the originator), not with the recipient. Only substantial income-producing economic activities should be taken into account. An income-producing economic activity is substantial if it forms an essential and significant part of the activity as a whole.

From the perspective of an optimal allocation of the production factors, investments should be made where production is the cheapest, and the production should be done by the person who can do so most cheaply. In globalizing economies, CLIN fosters efficiency; a CLEN-based system does not. Business competes with business, not owners with owners. The real trade-off is whether the activity will be carried on by a foreign-based firm or a domestic-based firm. CLIN supports an origin-based taxation of corporate income.

The current residence-based system of tax treaties has necessitated source-based corrective actions, such as introducing LOB provisions, allocating capital gains on shares in real estate companies to the situs state, and allowing the state in which a PE is situated to levy a branch profits tax. The current tax treaty system is moving slowly towards more source-based taxation, although the BEPS discussion may accelerate to a certain extent this movement. The most obvious reason for not acting quickly in this direction appears to be the lack of political will, but the pace of globalization worldwide may force politicians to give up (possibly) out-of-date tax policies more quickly than they otherwise would. Economics may be the inevitable driving force for more origin-based corporate income taxation.

Based on the starting-point that corporate income should be taxed with a corporate income tax in the state where the value is added, this paper has presented some key elements of an alternative origin-based tax treaty system which may be helpful in developing future source rules:

1. A person other than an individual is entitled to invoke a state's tax treaty *only* if:
    a. the person pursues or has pursued a substantial income-producing economic activity within that state; and
    b. the income or capital concerned must be attributed to that activity based on a functional analysis.

   This rule is less complex and may be better to administer by developing countries than the suggested LOB rules in the BEPS discussion, whereas the underlying aim of the suggested LOB rules (preventing abusive treaty shopping) is still satisfied.
2. Tax jurisdiction with respect to business profits is allocated to the contracting state in which a person's enterprise carries on its substantial entrepreneurial activities. Under the principle of origin, the current concepts of PE, fixed base and agency PE constitute unnecessary conditions. It is sufficient that an individual pursues substantial activities for an enterprise in the state concerned: an enterprise carries on or has carried on a substantial entrepreneurial activity in the other contracting state if that activity, carried on by *individuals* attributable to the enterprise, in itself forms or has formed an essential and significant part of the activity of the enterprise as a whole ("a branch"). Tax jurisdiction with respect to dividends and capital gains

on shares must be assigned to the state in which the profits were produced. If dividends are taxed, a branch profits tax must also play a role when profits are transferred from a branch to a head office. The origin-based system allocates more tax jurisdiction on business profits, transfer of profits, and capital gains on shares, to capital importing countries which is, as rule, beneficial for developing countries.

3. The state in which the debtor produces the interest income is awarded unlimited tax jurisdiction with respect to interest. Capital gains on debt-claims are allocated to the same state. The expenses incurred for purposes of the interest income or capital gains, such as bank's spread, are deductible. A simple withholding tax on a gross interest payment is in itself not a sufficient tool to satisfy an origin-based taxation. Nevertheless, a withholding tax could be a good starting-point from an administrative point of view. However, the creditor must also have the opportunity to be taxed on a net basis. Especially developing countries will benefit from such a switch in the system, as these countries seem to be more vulnerable to debt financing structures.
4. The state in which the intangible property was produced, not the state in which it is used, is entitled to tax the income from it: lump-sum or periodical payments (royalties). A royalty must be subdivided as follows:
    1) Compensation for write-offs on original market value of the intangible property concerned
    2) Compensation for maintaining the intangible property
    3) Compensation for bearing risks
    4) Interest component

    Parts 1)-3) must be allocated to the substantial activity state of the lessor. Part 4) must be allocated to substantial activity state of the lessee.

   With respect to capital gains on copyrights, patents, trademarks, etc., the same rules apply as with respect to royalties, although an interest component may be considered not constituting a part of the gain concerned. Thus, claims of developing countries that, under tax treaties, they may levy a (withholding) tax on paid royalties are not justified. They have only a justified claim on the interest component of the royalty. In substance, and with the exception of the interest component, a (withholding) tax on paid royalties is *not* an income tax, but a *use* tax and comes close to a consumption tax.

Thus, the rules of the current tax treaties need to be adjusted. Domestic tax systems, however, do not necessarily need to be changed assuming that tax treaties override domestic law which is inconsistent with the provision of tax treaty. A consideration for not changing initially domestic law could be that non-origin-based domestic laws may give developing countries a stronger tax treaty negotiation position. However, it must also be clear that domestic tax laws may not frustrate the implementation of origin-based tax treaties. Tax treaty override is inconsistent with international law and not acceptable.

In conclusion, in the BEPS discussion, an origin-based restructuring of tax treaties should be taken as serious alternative, because origin-based tax treaties are justified and feasible, they improve the efficiency of globalizing economies and worldwide prosperity, and they enable developing countries to reduce the gap in economic development with developed countries. Especially, developing countries have much to gain under origin-based tax treaties, although they may not always be happy with the results, e.g. with the non-taxation of royalties in the state where the intangible is used with the exception of the interest component. However, the author strongly thinks that origin-based tax treaties are very helpful instruments to ensure a sound tax base in developing countries. The G-20, the OECD and the EU should support the developing countries in making the switch from residence-based tax treaties which are predominantly for the benefit of the developed countries as capital exporting countries, to origin-based tax treaties which are predominantly for the benefit of developing countries. The current OECD/G-20 initiatives are not sufficient to realize such a switch. A global different mind-setting is necessary. This requires political courage.