



CATÓLICA
FACULDADE DE DIREITO

ESCOLA DE LISBOA



CATOLICA
Global
School of
Law

The Role of Domestic Law in Determining Deductibility of Interest: From Arm's Length Principle to Comprehensive Interest Barriers

Joana Sara Akram Jawa

Master Dissertation in Transnational Law
Under the supervision of Dr. Leonardo Marques dos Santos

Universidade Católica
Católica Global School of Law | Escola de Lisboa
March 31st, 2022

To my family.

Abstract

In corporate income tax there is a fundamentally different tax treatment of equity investments and loan financing. The problem dealt with in this master thesis stems from the rule that interest is deductible in computing the taxable income, unless the interest is caught by thin capitalization rules or other anti-abuse provisions. In an international context, from a tax point of view, it may be more advantageous to arrange fund for a company by ways of loan rather than resorting to an equity contribution. Multinational groups can take advantage of this contrast and plan their worldwide leverage to minimize their overall tax liability. Following the increasing awareness of national tax authorities and international institutions on this subject, this has led international institutions to recommend the introduction of new rules referred in this study as “Comprehensive Interest Barriers”.

This master dissertation study has the purpose to assess Comprehensive Interest Barriers in light of Article 9 OECD Model Convention. In literature, there has been conflicting ideas regarding the interaction of these rules with the OECD Model Convention, particularly with Article 9. Within this context, the OECD released a public discussion draft, which contains proposed amendments on the commentaries of Article 9 in order to clarify its application. This study will demonstrate how, with the proposed amendments, the OECD is able to restore the certainty in the international playing field. On the basis of this conclusion, this study will come up with a potential “price to pay” for that said certainty and all the consequences attached to it.

Keywords: Comprehensive Interest Barriers; OECD Public Discussion Draft; Article 9 OECD Model Convention

Index

Abstract	3
Acronyms and Abbreviations	6
Chapter I	7
Introduction	7
1. Background	7
1.1 Preliminary Considerations	7
1.2. Dissertation Goals	11
1.3. Object	12
1.3.1. Positive Delimitation	12
1.3.2. Negative Delimitation	12
1.4. Methodology and citation method	13
1.5. Sequence	13
Chapter II	14
2. Transfer Pricing	14
2.1. General Considerations	14
2.2. Arm’s Length Principle – Transfer Pricing Approach	16
2.3 Income Shifting – Transfer Pricing Manipulation	19
3. Article 9 OECD Model Convention – Associated Enterprises	21
3.1 Tax treaties: Historical Overview	21
3.2 Article 9 OECD: Background	22
3.3 Article 9 OECD: General Considerations	23
Chapter III	25
4. The arm’s length standard: Article 9 of the OECD Model Convention	25
4.1. Article 9 of the OECD Model Convention: Illustrative or Restrictive?	25
4.2. Transfer Pricing Adjustments	26

5. Article 9 OECD Model Convention and Thin Capitalization rules	27
5.1. Thin Capitalization Rules	27
5.2. Article 9 OECD Model Convention: Scope	28
5.3. The Consequences of Article 9 OECD Model Convention for Thin Capitalization Rules.....	30
6. The Interest Limitation Rule	31
6.1. The OECD best practice approach – Comprehensive Interest Barriers	31
6.1.1. Policy Objectives	31
6.1.2. Consequences	33
6.2. Assessment of the Comprehensive Interest Barriers against the arm’s length standard set by Article 9 of the OECD Model Convention	34
7. The proposed changes to Commentaries on Article 9 OECD Model Convention	37
7.1. Paragraph 3.1. - What is the Fuss About?	37
7.1.1. What has changed.....	37
7.1.2. The Proposed Changes Scrutinized.....	38
7.1.3. The impact (or not) of the proposed new commentary	39
Final Conclusions.....	42
Bibliographic references.....	46

Acronyms and Abbreviations

Art. - Article

ATAD – Anti-Tax Avoidance Directive

BEPS – Base erosion and profit shifting

CJEU – Court of Justice of the European Union

EBITDA – Earnings before interest, taxes, depreciation and amortization

EU – European Union

Ibid – Ibidem

IBFD – International Bureau of Fiscal Documentation

MAP – Mutual Agreement Procedure

MNE – Multinational enterprise

N. – Note

No. - Number

OECD – Organization for Economic Co-operation and Development

P. - Page

Para. – Paragraph

PE – Permanent establishment

Pp. – Pages

Sec. – Section

UNCTAD – United Nations Conference on Trade and Development

Vol. - Volume

Chapter I

Introduction

1. Background

1.1 Preliminary Considerations

The world has experienced two globalization booms, the first one about 1820, that lasted until the advent of World War I, and the second, that began at the end of World War II and has continued since¹. One major consequence of the globalization movement was the emergence, in the late 19th century, of a novel strategic problem among nations: how to divide the international income tax base in the absence of a centralized authority².

Developed countries eventually reached a fundamental consensus on how to solve this problem³. That consensus is currently embodied in the OECD Model Tax Convention on Income and on Capital⁴. The OECD Model Convention is the foundation for a network of over 3,000 bilateral tax treaties⁵. As I will expand below, its central role is to minimize international double taxation by establishing some structural legal fictions to guide the divisions of the international income tax base⁶.

Globalization has also led to the concentration of economic activity within multinational enterprise, which is a case in point within the international taxation⁷. Since about 1928, by agreement, developed countries created the legal fiction of the separate entity approach. Under this approach, the different profit units of a given MNE should be deemed independent enterprises, i.e. parent company and each of its subsidiaries (based in a number of other countries) should be considered separate taxpayers for purposes of national corporate income

¹E. Baistrocchi, *The Transfer Pricing Problem: A Global Proposal For Simplification* vol. 59, no. 4, (American Bar Association ed., The Tax Lawyer 2006).

² *Ibid.*

³ W. H. Coates, *League of Nations Report on Double Taxation Submitted to the Financial Committee by Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp*, 87, no. 1 Journal of the Royal Statistical Society, (1924).

⁴ Baistrocchi, *supra* n. 1.

⁵ *Ibid.*

⁶ R. T. Davis, *Tax and Social Context: Legal Fictions and Tax* vol. 4, no. 1, (American Legal Fictions Symposium, Savannah L. Rev. 31, 2017). See section 3.1.

⁷ L. Liu, et al., *International Transfer Pricing and Tax Avoidance: Evidence from Linked Trade-Tax Statistics in the UK* vol. 110 (International Finance Discussion Paper No. 1214, 2017).

taxes⁸. Profits made by one enterprise can be influenced through special conditions with an associated enterprise. Hence, MNEs have possibilities to shift income between jurisdictions in order to lower their gross tax burden⁹. Predictably, States are not willing to accept such strategies. As a consequence, on one side, following the development and increasing awareness of national tax authorities on transfer pricing issues and the consciousness that it mainly is in cross-border transactions that tax adjustments may result in relevant financial gains, the valuation of these transactions rises in importance¹⁰.

Developed countries also agreed that the fiction of the separate entity approach should be enforced via the arm's length principle, the basic transfer pricing rule used in international tax arena¹¹. Under this principle, national tax jurisdiction over income produced by an MNE should be allocated among countries on the basis of how comparable independent enterprises would have realized income in comparable circumstances¹². With other words, related taxpayers, so called associated enterprises, must set transfer prices for any inter-company transaction as if they were unrelated entities and all other aspects of the relationship were unchanged¹³. Ultimately, this means that the conditions of controlled transactions should not differ from those that would be obtained in comparable uncontrolled transactions¹⁴. As such, transfer prices should mimic market forces.

However, when transfer prices do not reflect the arm's length principle, the tax liabilities of the associated enterprises and the tax revenues of the other tax jurisdiction could be distorted. This is where article 9 of the OECD Model Convention should be called into action¹⁵.

⁸ M.B. Carroll, *Taxation of Foreign and National Enterprises, Methods of Allocating Taxable Income*, (League of Nations, Geneva, 1932) hereinafter the Carroll Report; Baistrocchi, *supra* n. 1.

⁹ *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators: Preface* para.7 (OECD 2022), International Organizations' Documentation IBFD [hereinafter OECD Guidelines].

¹⁰ D.N.T.F. Dos Reis, *The tension between Transfer Pricing and Customs Valuation* (repository ISEG, Instituto Superior de Economia e Gestão, 2012).

¹¹ *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators* para.2 (OECD 1995), International Organizations' Documentation IBFD & *OECD Guidelines*, *supra* n. 9, at Preface para. 6.

¹² "When independent enterprises transact with each other, the conditions of their commercial and financial relations (e.g. the price of goods transferred or services provided and the conditions of the transfer or provision) ordinarily are determined by market forces." – *OECD Guidelines*, *supra* n. 9, at Chapter I, The Arm's Length Principle, Introduction, para. 1.2..

¹³ The concept of associated enterprises is codified by *OECD Model Tax Convention on Income and on Capital* art. 9 (18 December 2017), Models IBFD (hereinafter OECD Model).

¹⁴ V. Solilova, *Practical Application of Art.9 OECD Model Convention: the Czech Republic* vol.62, no.2 (Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis, 2014).

¹⁵ *OECD Guidelines*, *supra* n. 9, at Chapter 1, para. 1.3.

Article 9 covers the allocation of income of MNEs with the main purpose of avoidance of economic double taxation – the last described in the Commentary of the OECD Model Convention as the imposition of comparable taxes in two or more States in respect of the same income or capital for identical periods¹⁶. At the same time, it indicates that business profits should be taxed where they originate economically¹⁷.

When distortions occur those may be subjected to correction by a primary adjustment, that can be carried out by imputing or reducing of profits/expenses among associated enterprises¹⁸.

Moreover, article 9 also involves the concept of corresponding adjustment of profits in cases where one tax administration adjusts associated enterprise's taxable profits due to a primary adjustment – applying the arm's length principle to controlled transactions involving an associated enterprise in a second tax jurisdiction¹⁹. In addition, after a corresponding adjustment the allocation of profits between the two jurisdictions in case of associated enterprises is consistent with the primary adjustment and no double taxation occurs²⁰. Thus, Art. 9 shall prevent economic double taxation caused by transfer pricing adjustments and consist of two parts, Article 9(1) dealing with primary adjustments, whereas Article 9(2) dealing with corresponding adjustments.

Another loophole that MNE's have demonstrated to take advantage off, is the fundamentally different tax treatment of equity investments and loan financing²¹. While interest is deductible from the taxable income of an enterprise, dividends are non-deductible²². Hence,

¹⁶ *OECD Model Tax Convention on Income and on Capital: Commentary on articles 23A & 23B*, 9 paras. 2 and 5 (respectively).

¹⁷ M. Lehner, *Article 9 Associated Companies*, at pp. 387-409.

¹⁸ *OECD Guidelines*, *supra* n. 9, at Chapter 1, para. 1.3.

¹⁹ *OECD Guidelines*, *supra* n. 9, at Chapter 1, Section B; Solilova, *supra* n. 15.

²⁰ *OECD Guidelines*, *supra* n. 9, at para. 4.32-4.39; Para 11 *OECD Model on Article 9* (2017).

²¹ OECD Report, *R(4). Thin Capitalization*, adopted by the OECD Council on 26 November 1986, in *Model Tax Convention on Income and on Capital 2014 (Full Version)*, OECD Publishing, at para. 9-10 (OECD 1987) (hereinafter "Thin Cap Report").

²² The definition of the term interest employed throughout this thesis will correspond to the definition provided in art. 11, para. 3, *OECD Model (2017)*. The concept of dividends is codified in art. 10, para. 3, *OECD Model (2017)*. "In the 1982 IFA General Report, on the basis of the national reports, the general reporter also concludes that, in principle, interest payments incurred to earn taxable income should be deductible and interest income should be taxed as a direct consequence of the principle of net profit taxation. The underlying reason for that understanding is that interest payments decrease the earning capacity of the taxpayers and should therefore be deductible, while interest income increases their earning capacity and should, as a result, be taxed." – See S. M. Fernandes, *International Double Taxation of Interest: Assessing Recent Developments in Thin Capitalization Regimes*, (IBFD Doctoral Series, 2019) & E. Höhn, *The Tax Treatment of interest in international economic transactions: General Report* vol. LXVIIa (IFA Cahiers de Droit Fiscal International, Kluwer, 1982).

the financing of MNE's has become a worldwide problem due to the strong concern that MNE's can plan their worldwide leverage to minimize their overall tax liability. In other words, the asymmetric allocation of taxing right in relation to dividends and interest can clearly influence the decision of, *inter alia*, the shareholder, manager or director to finance the company with debt rather than equity²³. As a result, in order to protect their tax revenues and avoid the erosion of their tax base, the majority of the countries have adopted rules that target thinly capitalized companies, i.e. companies whose financing sources are mainly debt instead of equity financing instruments²⁴. These rules generally refer to the arm's length principle, to determine whether the quantum of loans provided, and the interest rate agreed between related parties are consistent with what unrelated parties would have agreed upon under conditions of free and fair competition²⁵. The main purpose of these rules is to prevent MNE's from shifting their profits from one jurisdiction to another using excessive debt financing²⁶.

In 2013 the OECD launched its BEPS action plan comprising fifteen actions to change the international tax landscape in order to “restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created”²⁷. The BEPS Action Plan identified, under its Action 4, the need to limit base erosion via interest deductions and other financial payments, regardless of whether the borrower and the lender are related parties²⁸. Pursuant to the 2015 final report on BEPS Action 4 and the updated report thereon released in December 2016, the recommended approach by the OECD regarding the limitation of interest deductions and other financial payments is based on: “a fixed ratio rule which limits an entity's net deductions for interest and payments economically equivalent to interest to a percentage of its EBITDA. As a minimum, this should apply to entities in multinational groups. (...) The approach can be supplemented by a worldwide group ratio rule which allows an entity to exceed this limit in certain circumstances”²⁹.

²³ Fernandes, *supra* n. 22.

²⁴ Fernandes, *supra* n. 22 & L. De Broe, *International Tax Planning & Prevention of Abuse* (IBFD Doctoral Series, 2008).

²⁵ Fernandes, *supra* n. 22.

²⁶ Fernandes, *supra* n. 22 & De Broe, *supra* n. 24.

²⁷ The analysis of all BEPS Action Plan is out of the scope of this study, we will solely focus to the analysis of BEPS Action 4, dealing with deduction of interest. See OECD, *Explanatory Statement: OECD/G20 Base Erosion and Profit Shifting Project* at p.4 (OECD Publishing, 2015).

²⁸ OECD, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2016 Update: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project* p.13 (OECD Publishing, 2017) (hereinafter BEPS Action 4).

²⁹ *Ibid.* The best practice approach endorsed by the OECD will hereafter be referred to as “Comprehensive Interest Barriers” for practicality reasons. The authorship of this term is ascribed to Fernandes, *supra* n. 22.

The BEPS Action 4 recommended rules have been in the center of a longstanding debate in relation to their interaction with the above-mentioned article 9 OECD Model. On one side of the coin, we have those who believe that they are in clear violation with article 9 OECD Model and the arm's length principle related thereto. On the other those who ascertain that these new rules are not in the scope of article 9. Hence, not violating the arm's length principle.

In 2021, the OECD came up with a public discussion draft with proposed changes to the OECD Model Tax Convention Commentaries on Article 9 and related articles, and clarified their application, especially as it relates to domestic laws on interest deductibility i.e. in order to address the above mentioned debate. This discussion draft and its implications will figure the heart of this study.

1.2. Dissertation Goals

The mantra of the OECD Model Convention is to provide a means of settling on a uniform basis the most common problems that arise in the field of international juridical double taxation. In that sense, the OECD Model Convention and most of all its commentaries are regularly reviewed and updated to address new tax treaty issues.

The OECD has recently undertaken work to amend the Commentary on Article 9 OECD Model. The main purpose of this revision is to clarify its application, especially as it relates to domestic laws on interest deductibility, such as those recommended in the final report on BEPS Action 4, where some commentators have questioned the interaction of Article 9 OECD Model Convention with those rules. This attempt made by the OECD clearly reflects the above-mentioned aim.

The purpose of this study is to investigate the Comprehensive Interest Barriers and their interaction with of Article 9 OECD Model Convention. Will be doing so by confronting two different approaches to the same question: Are the best practice approach recommended by the OECD in line with article 9 and the arm's length principle related thereto? These underlying differences were the bullet trigger for the proposed commentary changes on Article 9, made by the OECD. The current endeavor will attempt to answer the following research question: *Has the OECD been able to brighten the international community in regards the interaction of Article 9 OECD Model and the Comprehensive Interest Barriers?*

1.3. Object

1.3.1. Positive Delimitation

This thesis will lie on assessing if the best practice approach recommended by the OECD regarding interest deduction is in line with article 9 OECD Model Convention and the arm's length principle. Afterwards we will investigate if the proposed new commentary changes, will switch (or not) the scenario of the previous assessment. We will focus solely on the inclusion of proposed paragraph 3.1 (reading in conjunction with para.6.1.), relating to the role of domestic law in determining interest deductibility.

1.3.2. Negative Delimitation

In this investigation, we will not include all the proposed changes to commentaries on the OECD Model Convention on Article 9. Political or economic nature questions, connected with the matter, will not be raised. Furthermore, the legal status of the OECD Commentaries will not be analyzed.

Even though the public discussion draft on the proposed changes to the Commentary on Article 9 is closely linked to the report Transfer Pricing Guidance on Financial Transactions published on 11 February 2020, we will solely focus on the interaction of the mentioned draft with the final report on BEPS Action 4.

In relation to Article 9 OECD Model Convention, we will not cover the dispute of whether thin capitalization rules have to conform to the arm's length principle stipulated under Article 9.

Moreover, in regard to Thin Capitalization Rules the author excludes from this study the assessment of the design of thin capitalization rules and their recent development, except the recommended best practice approach made by the OECD, i.e. Comprehensive Interest Barriers. Hence, the follow up made by the ATAD is also not included. Furthermore, the mechanics of determining the true nature of the investment and the return paid thereon will not be touched upon. Finally, the consequences of applying these domestic rules, as such, recharacterization debt to equity and interest into a hidden profit are disregarded.

1.4. Methodology and citation method

The study carried on in this thesis will be done through bibliography analysis, mostly of scholarly articles and international organizations such as the OECD.

The investigation carried out in this thesis has only taken into account legislative materials, case-law and doctrine issued until January 2022.

The citation method adopted comply with the IBFD's House Style rules³⁰.

1.5. Sequence

The core investigation will start in chapter II with an analysis of the current state of the transfer pricing world in light of the arm's length principle, and their related problems such as income shifting. For a smooth and more reasoned transition for the fundamental issues of this investigation it will be provided an historical analysis of Tax Treaties and Article 9 of the OECD Model Convention.

This study will then follow with chapter III where the author will provide an analysis of the current Article 9, including scrutiny of the respective OECD Commentary and relevant OECD reports. This will be followed by the study of the application of the arm's length principle embodied in article 9 to the issue of thin capitalization. Moreover, the same test will be done with Comprehensive Interest Barriers. By doing so, the author will come with a brief analysis of thin capitalization and the latest related development, such as the introduction of Comprehensive Interest Barriers, recommended by the OECD under BEPS Action 4, and its related problems. The aim of this analysis is to illustrate the main characteristics and practical effects of the best practice approach recommended by the OECD. Departing from this, this study will investigate whether Comprehensive Interest Barriers represent (or not) a major departure from the arm's length principle, regarding the deduction and taxation of interest. Finally, this thesis will be concluded by a scrutiny of the proposed amendments made by the OECD, and their underlying meaning and potential impact, in the international world, in the author's perspective.

³⁰ <https://www.ibfd.org/sites/default/files/2021-06/Guidelines-IBFD-Standard-Citations-References.pdf>

Chapter II

Transfer Pricing: Where do we stand?

2. Transfer Pricing

2.1. General Considerations

Transfer pricing is one of the main problems in international tax law. The term “transfer pricing” refers to prices in transactions between associated enterprises³¹. The tax law problems resulting from transfer pricing relate, in particular, to diminishing the tax base for individual associated enterprises, the international allocation of the tax base, enforcement of the law and international double taxation.

The globalization of the economy has led both to an increase in world trade and in foreign direct investment. This driving force behind this has been developments in telecommunications and information technology, falling transport costs, deregulation of financial transactions and the integration of financial markets, as well as the growth of new markets in Asia and Eastern Europe³².

A large piece of the pie of the world trade is carried on by MNEs. According to UNCTAD (2011) MNEs account about 80% of world trade, appointed to be due to globalization³³. Nonetheless, these estimates are subject to some uncertainty, as only few countries calculate trade between associated enterprises as a share of overall foreign trade. In addition, in the debate a clear distinction is not always made between the internal trade and market trade of MNEs. Despite the ambiguity, it is accepted that internal trade between associated enterprises of MNEs is large and growing³⁴.

An MNE appears to be and to function ideally as an economic unit with a common goal. Transfer pricing between associated enterprises is thus not normally the result of negotiation

³¹ *OECD Guidelines*, *supra* n. 9, at Preface para. 11.

³² See OECD, *Measuring Globalization: OECD Handbook on Economic Globalization Indicators* (OECD 2005), International Organizations’ Documentation IBFD.

³³ See OECD, *Multinational enterprises in the global economy: Heavily debated but hardly measured* (OECD, 2018), International Organizations’ Documentation IBFD & Commission Staff Working Paper: *Company Taxation in the Internal Market*, para. 5, SEC (2001) 1681.

³⁴ J. Wittendorff, *Transfer Pricing and the Arm’s Length Principle in International Tax Law* (Wolters Kluwer 2010).

between parties with competing economic interests. The extent to which transfer prices are significant to business of an MNE depends on factors such as the internal systems for performance measurement and profitability, the organizational structure, and public regulations³⁵. Regardless of the economic unit, the individual companies of a corporate group are usually taxed as separate entities under domestic law³⁶. According to international law a subsidiary is also recognized as a separate entity for tax purposes under the separate entity approach in article 5(7) of the OECD Model Convention³⁷. There is therefore a divergence between economic reality and the tax treatment of associated enterprises of MNEs as separate entities³⁸.

The allocation, for tax purposes, of the profits between the individual enterprises of a MNE can be made according to various allocations norms. In an international context the choice has been between the direct method of separate accounting combined with the arm's length principle, and an indirect method based on formulary apportionment³⁹. Based on the direct method the profits are calculated on the basis of the accounts of the individual associated enterprise⁴⁰. This means that, in principle, there is an acknowledgment under tax law of the undertaking's transactions with both independent enterprises and associated enterprises. In relation to transactions with associated enterprises, the direct method is supplemented by the arm's length principle⁴¹. Transfer prices thus affect the allocation of profits between associated enterprises according to the arm's length principle⁴². With other words, although intercompany transactions are eliminated when consolidating the financial results of controlled foreign corporations and their domestic parents, for tax purposes such entities are not consolidated, and the transactions are therefore not eliminated⁴³. Transfer prices directly affect the allocation of

³⁵ *OECD Guidelines*, *supra* n. 9, at para. 1.5.

³⁶ Separate entity approach and The Carrol Report, see Introduction above.

³⁷ *OECD Guidelines*, *supra* n. 9, at Preface para. 5.

³⁸ Wittendorff, *supra* n. 34.

³⁹ M.B. Carroll, *Taxation of Foreign and National Enterprises, Methods of Allocating Taxable Income* vol. IV, (League of Nations, 1933) – “US Lawyer, Mitchell B. Carrol conducted a study setting out rules on the allocation income. An investigation into the practice of taxation of business income in 35 jurisdictions demonstrated that most countries used the separate accounting method in considering associated enterprises as separate entities for tax purposes. Consequently, the Carrol Report (1933) recommended that the primary rule for the allocation of business income should be the separate accounting method.” – M. Steindl & V. Solilová, *Tax Treaty Policy on Article 9 of the OECD Model Scrutinized* vol. 67, no. 3 (Bulletin for International Taxation, IBFD, 2013). See *OECD Guidelines*, *supra* n. 9, at para. 3.58.

⁴⁰ Wittendorff, *supra* n. 34.

⁴¹ *Ibid.*

⁴² *Ibid.*

⁴³ J. Mckinley et al., *Transfer pricing and its effect on financial reporting* (Journal of Accountancy, 2013).

groupwide taxable income across national tax jurisdictions. Hence, a company's transfer pricing policies can directly affect its after-tax income to the extent that tax rates differ across national jurisdictions.

Transfer pricing is in the cross hairs of tax policy as it relates to the competing objectives of three parties: the revenue-maximizing objective of the domestic tax authority, the revenue-maximizing objective of the foreign tax authority, and the tax-minimizing objective of the taxpayer⁴⁴. Because of the inherent differences in judgment and interpretation of facts when analyzing a company's transfer pricing, together with the clashing revenue objectives of multiple tax authorities and taxpayers, the risk of adjustments to taxable income, double taxation, and potential for penalties is nontrivial, even for multinationals that make good-faith efforts to comply with it⁴⁵.

2.2. Arm's Length Principle – Transfer Pricing Approach

In 1995, the OECD issued the first original version of Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations providing guidance on the application of the arm's length principle for tax purposes on transactions between associated enterprises⁴⁶. The aim was to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein, while limiting the risks of economic double taxation that may result from a dispute between two countries on the determination of the arm's length remuneration for their cross-border transactions with associated enterprises⁴⁷.

According to the arm's length principle, MNEs should carry out controlled transactions at arm's length prices. Taxation is thus levied in relation to a hypothetical normal transaction, where the yardstick is market transaction⁴⁸. From the tax policy standpoint, the choice of the arm's length principle is justified by the fact that it contributes to tax equality and neutrality between associated enterprises and independent enterprises – it puts associated and independent

⁴⁴ *Ibid.*

⁴⁵ *Ibid.*

⁴⁶ OECD Transfer Pricing Guidelines have, since then, been updated – 2008, 2009, 2010, 2013, 2015, 2017 and 2022 – *OECD Guidelines*, *supra* n. 9, at Foreword.

⁴⁷ Dos Reis, *supra* n. 10.

⁴⁸ Wittendorff, *supra* n. 34.

enterprises on a more equal footing for tax purposes, avoiding the creation of tax advantages/disadvantages that would otherwise distort the relative competitive positions for either party⁴⁹. At the same time the separate entity approach and the arm's length principle are regarded as leading to a fair international income allocation⁵⁰.

In the OECD Model Convention, the arm's length principle is both laid down as the norm for the allocation of profits in Article 9(1), which concerns associated enterprises, and in Article 7(2), which concerns head offices and permanent establishments⁵¹. In addition, the arm's length principle is also laid down as the standard to follow for income allocation in the domestic law of most countries. There is, therefore, normally a congruence between the allocation norm in domestic law and in international tax law⁵². In the OECD Transfer Pricing Guidelines, the arm's length principle is supplemented with rules and methods which are intended to create a uniform international legal approach, across national boundaries and different legal traditions⁵³. The tax law problems associated with transfer pricing arise from the fact that the allocation of profit under the arm's length principle depends on the transfer price of the controlled transaction⁵⁴. For tax purposes the transfer price effect on two levels: on the one hand the transfer price affects the allocation of profit between the two companies, and on the other hand the transfer price affects the basis for taxation between the two countries⁵⁵.

The main argument in favor of applying the arm's length principle is arguably that it is based on the specifics of each transaction⁵⁶. Establishing what conditions independent enterprises would have agreed to will inevitably be a challenging task, precisely because the prevailing circumstances are unique for each MNE⁵⁷. There is also no denying that applying

⁴⁹ *OECD Guidelines*, supra n. 9, at Preface para. 3. *OECD Guidelines*, supra n. 9, at Chapter 1 para. 1.8.

⁵⁰ *OECD Guidelines*, supra n. 9, at Preface para. 7.

⁵¹ J. Wittendorff, *The Object of Art. 9(1) of the OECD Model Convention: Commercial or Financial Relations* vol. 17, no. 3, (International Transfer Pricing Journal, *IBFD* 2010).

⁵² *OECD Guidelines*, supra n. 9, at Preface para. 16; Wittendorff, supra n. 34; G. Kofler, & I. Verlinden, *Unlimited Adjustments: Some Reflections on Transfer Pricing, General Anti-Avoidance and Controlled Foreign Company Rules, and the "Saving Clause"* vol. 74, no. 4/5 (Bulletin for International Taxation, *IBFD*, 2020).

⁵³ *OECD Guidelines*, supra n. 9, at Chapter 1 para. 1.1, 1.14, 1.15.

⁵⁴ "The existence, form and content of a controlled transaction must be determined on the basis of domestic law prior to the application of the arm's length principle of Article 9(1)" – The objective scope of Art.9(1) OECD Model convention is defined in terms of "commercial or financial relations", a concept that is not defined in Art. 9(1) or elsewhere in the OECD Model Convention – "Hence, the arm's length principle does not address the object qualification and Art.9 does not safeguard against economic double taxation caused by conflicts of qualification" - Wittendorff, supra n. 51.

⁵⁵ Wittendorff, supra n. 51.

⁵⁶ O. Treidler, *The Arm's Length Principle In the Times of BEPS* (Discussion Paper, University of Wuerzburg, 2016).

⁵⁷ *OECD Guidelines*, supra n. 9, at Chapter 1 para. 1.5 and 1.11.

the arm's length principle often heavily depends on working assumptions made in the context of a comparability analysis⁵⁸. Provided one accepts that transfer pricing is not an exact science and that for most transactions an objectively “true price” does not exist, however, the degree of subjectivity should not cause too much concern⁵⁹. The impact of extreme or unsubstantiated assumptions is likely to be limited by the fact that MNEs are required to substantiate and defend their respective assumptions – i.e. in the context of transfer pricing documentations⁶⁰. While the burden of proof generally rests with the tax authorities, the authorities generally have an adequate toolbox at their disposal to level the playing-field⁶¹.

A conscientious application of the arm's length principle should most often result in an allocation of the value-added that approximates an allocation that could be expected to result on the market under comparable conditions – i.e. reflecting the result of a negotiation between independent entities⁶². From a conceptual perspective, the arm's length principle is therefore a feasible method for ensuring the alignment of taxation and economic substance in respect to the geographic distribution of the value created by the individual firm – reflecting the “true source” of value-added by simulating a market process⁶³. Cumulatively, the reforms introduced by the OECD amount to a significant overhaul of the current arm's length principle-based system. The enhanced focus on the economic substance of a transaction will substantially limit the tax viability of transfer pricing structures allocating profits to entities that do not perform

⁵⁸ *OECD Guidelines, supra* n. 9, at Chapter 1 para. 1.6.

⁵⁹ Treidler, *supra* n. 56.

⁶⁰ *OECD Guidelines, supra* n. 9, at Chapter 1 para 1.12.

⁶¹ Treidler, *supra* n. 56.

⁶² “The theory behind value creation appears to be that it not only reflects the contributions of the taxpayer's business units with regard to the overall profit of the firm, but also the size of the benefits from the local government in that process” - Kofler and Verlinden, *supra* n. 52; “The arm's length principle has proven useful as a practical and balanced standard for tax administrations and taxpayers to evaluate transfer prices between associated enterprises, and to prevent double taxation. However, with its perceived emphasis on contractual allocations of functions, assets and risks, the existing guidance on the application of the principle has also proven vulnerable to manipulation. This manipulation can lead to outcomes which do not correspond to the value created through the underlying economic activity carried out by the members of an MNE group. As part of the BEPS package, the Actions 8-10 Reports enhance the guidance on the arm's length principle to ensure that what dictates results is the economic rather than the paper reality. In this regard, the work under Actions 8-10 seeks to align transfer pricing outcomes with the value creation of the MNE group.” – OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports: OECD/G20 Base Erosion and Profit Shifting Project*, at p. 9 (OECD, 2015).

⁶³ “It may be challenging to divide the tax take using this paradigm when countries compete with each other and it can demonstrate that taxpayers exercise real economic functions on their territories and benefit from public goods provided by local government. In academia, the correlation between the level of economic activity in a jurisdiction and the corresponding amount of value created has been criticized as being tenuous at best and non-existent at worst (...) The logic of value creation inevitably assign more profits to higher income countries, as most of the valuable inputs associated with concept, branding, design, marketing and sales and after-sales service occur in higher-income countries, i.e. they reap the credit of cooperation” – Kofler and Verlinden, *supra* n. 52.

significant functions – i.e. artificial holding structures that are characteristic of aggressive tax planning⁶⁴. Considering the scale and fundamental nature of the revisions, one could arguably term the results reflected in the Final Report for Actions 8-10 (2015) to embody a sort of arm’s length principle 2.0⁶⁵.

2.3 Income Shifting – Transfer Pricing Manipulation

Literature on corporate taxation accumulates remarkable evidence that MNEs adjust the transfer pricing on transactions with related parties, thus, to transfer taxable profits from high-tax to low-tax countries⁶⁶. Information on a sample of European MNEs in 1999, show, for example, that the corporate tax base of Germany, which was the country with the highest corporate tax rate in Europe at that time, would have increased by 14 % in the absence of profit shifting incentives⁶⁷. In consequence, high-tax economies suffer from considerable tax revenues losses⁶⁸. Governments consider these adjustments artificial maneuvers, where MNEs have the single objective to segregate the taxable income from the economic activities that generate it. Major economies have historically implemented different types of regulatory and operational mechanisms in the attempt to monitor and to rule these activities⁶⁹. In this regard, the OECD guidelines on transfer pricing, approach the baseline standard of transfer pricing extensively accepted among countries, which establishes the arm’s length principle as the fundamental parameter for appropriate valuation of intra-firm transactions⁷⁰.

⁶⁴ “Value creation has been a useful political device under the OECD/G20 BEPS Action Plan in excluding tax havens from claiming jurisdiction over a firm’s profits and has served as a negative source rule” - Kofler & Verlinden, *supra* n. 52.

⁶⁵ Treidler, *supra* n. 56.

⁶⁶ Several studies provide substantial evidence of profit shifting by means of direct transfer pricing manipulation – See, *inter alia*, R.B. Davies, et al, *Knocking on Tax Haven’s Door: Multinational firms and Transfer Pricing* vol. 100 (The Review of Economic and Statistics, MIT Press, 2018); A.D. Cristea & D.X. Nguyen, *Transfer Pricing by Multinational Firms: New Evidence from Foreign Firm Ownerships* vol. 8 (American Economic Journal: Economic Policy, 2016); K.A. Clausing, *Tax-motivated transfer pricing and US intrafirm trade prices* vol. 87 (Journal of Public Economics, 2003); J.R. Hines, *Lessons from Behavioral Responses to International Taxation* vol. 52, no. 2 (National Tax Journal, The University Chicago Press, 1999);

⁶⁷ H. Huizinga, & J. Voget, *International taxation and the direction and volume of cross-border M&As* vol. 64, no. 3 (The Journal of Finance, 2009).

⁶⁸ M. Dischinger, B. Knoll, & N. Riedel, *The role of headquarters in multinational profit shifting strategies* vol. 21, issue 2 (R.B. Davis and K. Scharf eds., International Tax and Public Finance, 2014).

⁶⁹ A.A.T. Rathke, *Studies on transfer pricing systems and profit shifting: impact of the international regulation on the shifting behavior of Brazilian firms* vol. 32, no. 85 (R. Cont. Fin., USP, São Paulo, 2021).

⁷⁰ *OECD Guidelines*, *supra* n. 9, at Preface para 6.

Despite the broad application of OECD transfer pricing guidelines as a baseline standard, countries maintain unilateral rules to prevent transfer pricing manipulation⁷¹. Countries typically implement the core of OECD guidelines into their domestic tax systems, and include specific provisions according with their regulatory background⁷². Although, transfer pricing rules have demonstrated to have positive impact on preventing income shifting, some evidence show that MNE still manage loopholes and weaknesses in domestic transfer pricing regulations to distort intra-firm prices⁷³.

The OECD BEPS Action Plan proposes a thorough review of current transfer pricing guidelines. The main objective is to adapt the current guidelines for contemporary unprecedented arrangements, to mitigate breaches that still allow transfer pricing abuse⁷⁴. OECD transfer pricing guidelines were reviewed in 2017 based on the Report on BEPS Actions 8-10 endorsed in 2015⁷⁵. These actions attain to review transfer pricing rules for high-risk transactions, in special for internal services, profit splits and intangibles⁷⁶. Also, the OECD advocates for the harmonization of transfer pricing standards across countries, on the argument that regulatory overlaps and gaps result from the interaction of distinct domestic transfer pricing rules⁷⁷. For example, there are still great differences across countries about how arm's length prices should be determined, how they should be documented or what penalties arise on noncompliance⁷⁸. With that said, the effectiveness of these actions depends upon the consistent implementation of the BEPS package by a large number of countries, in order to ensure a level playing field among countries and jurisdictions in the fight against tax avoidance⁷⁹.

⁷¹ T. Lohse, N. Riedel, & C. Spengel, *The Increasing Importance of Transfer Pricing Regulations – A Worldwide Overview* Working Paper 12/27 (Oxford University Centre for Business Taxation, 2012).

⁷² Kofler and Verlinden, *supra* n. 52.

⁷³ C. Beuselinck, M. Deloof, & A. Vanstraelen, *Cross-jurisdictional income shifting and tax enforcement: evidence from public versus private multinationals* vol. 20 (Review of Accounting Studies, 2015); S. Beer, J. Loeprick, *Profit shifting: drivers of transfer (mis)pricing and the potential of countermeasures* vol. 22 (International Tax Public Finance, 2015).

⁷⁴ See OECD, *Action Plan on Base Erosion and Profit Shifting*, Chapter 2 (OECD, 2013).

⁷⁵ *OECD Guidelines*, *supra* n. 9, at Foreword.

⁷⁶ See OECD, *supra* n. 74, at Chapter 3, Actions 8,9,10.

⁷⁷ B. Knoll, & N. Riedel, *Transfer Pricing Laws* (CESifo DICE Report, 2014).

⁷⁸ T. Lohse, & N. Riedel, *Do Transfer Pricing Laws Limit International Income Shifting? Evidence from European Multinationals* Working Paper No. 4404 (CESifo, 2013).

⁷⁹ European Parliamentary Research Service, *Multinational enterprises, value creation and taxation: Key issues and policy developments*, (Ioannis Zachariadis, Members' Research Service, PE 637.971, July 2019).

3. Article 9 OECD Model Convention – Associated Enterprises

3.1 Tax treaties: Historical Overview

Tax treaties play an important role in international relations, particularly in facilitating economic integration in regional blocs such as the EU⁸⁰. It is therefore interesting to find that the earliest double taxation treaty between Prussia and Saxony in 1869 was essentially concerned with the same kind of issues – enabling movement of people between states without the burden of double taxation⁸¹.

Tax treaties originated in late 19th and early 20th century “friendship, commerce and navigation” treaties⁸². These early model income tax treaties were significantly influenced by a basic recognition that countries have an interest, both for themselves as nations and on behalf of their nations, in avoiding impediments to trading relationships and commercial activity occasioned by uncoordinated multiple taxation of the same income and the same taxpayers⁸³. At the same time, it must be recognized that each country may nevertheless have a legitimate claim to a shared tax base associated with international commerce – a reliable means of sharing is critical⁸⁴. Countries recognize as well that their national interests are well served, for example, in attracting capital investment, by recognizing their reciprocal tax interests⁸⁵.

Scant attention is generally paid to the development of tax treaties prior to World War ⁸⁶. These early treaties establish some of the foundations underpinning the modern international taxation system, despite the effects of globalization⁸⁷. A number of authors, such as C.J. Taylor, have traced specific terminology or aspects of modern tax treaties to the 19th century treaties,

⁸⁰ S. Jogarajan, *Prelude to the International Tax Treaty Network: 1815-1914 Early Tax Treaties and the Conditions for Action* vol.31, no.4 (Oxford Journal of Legal Studies, Oxford University Press, 2011).

⁸¹ *Ibid.*

⁸² L. Friedlander, & S. Wilkie, *Policy Forum: The History of Tax Treaty Provisions – And Why It Is Important To Know About It* Vol.54, no. 4 (Canadian Tax Journal, 2006).

⁸³ *Ibid.*

⁸⁴ *Ibid.*

⁸⁵ *Ibid.*

⁸⁶ *Ibid.*; A. Savitskiy, *The first Tax Treaties: In Search of Origins* vol. 49, Issue 6 & 7, (Intertax, Kluwer Law International BV, 2021).

⁸⁷ M. Kobetsky, *International Taxation of Permanent Establishments Principles and Policy*, (Cambridge University Press, 2011).

for example the method of relieving double taxation⁸⁸. Regardless the significant changes in international trade and commerce that have occurred since the early treaties, the main international tax issues are still the same – resolving the competing claims of a source and a residence country to prevent double taxation, tax avoidance and tax evasion⁸⁹.

3.2 Article 9 OECD: Background

In the beginning of the 19th century several jurisdictions considered subsidiaries as an example of a PE of their parent company for tax purposes⁹⁰. Matter in fact, associated enterprises were treated as a PE under the League of Nations Draft (1927), and therefore there was no need for any provision along the lines of Article 9 OECD Model⁹¹. It was until 1928 that the scenario changed, this affiliated companies were excluded from the definition of permanent establishment⁹². In lack of a new provision related to the allocation of business income between associated enterprises, this turnover risked them being subject to double taxation, it was, therefore, paramount to include a provision related to that matter⁹³. In 1933, after an investigation into the practice of taxation of business income in 35 jurisdiction that demonstrated that most countries used the separate accounting method in considering associated enterprises as separate entities for tax purposes, the Carrol Report recommended the same method as the primary rule for the allocation of business income⁹⁴. Furthermore, the report also referred to the arm's length principle as a suitable allocation norm⁹⁵. In addition, the League of Nations Draft Model Tax Treaty (1933), gave the arm's length principle a sound

⁸⁸ As an example, now commonly referred to as the exemption and credit method of relief; Jogarajan, *supra* n. 80; C.J. Taylor, *Twilight of the Neanderthals, or are bilateral double taxation treaty networks sustainable* vol. 34 (Melbourn University Law Review, 2010).

⁸⁹ Kobetsky, *supra* n. 87.

⁹⁰ Solilová, *supra* n. 14.

⁹¹ The first League of Nations Draft Model Tax Treaty (1927) dealt with the taxation of business taxation in article 5. This was intended to prevent double taxation of business income by allocating the taxing right between the contracting states according to the permanent establishment concept – Wittendorf, *supra* n. 34 and Solilová & Steindl, *supra* n. 39.

⁹² See Solilová & Steindl, *supra* n. 39 and Solilová, *supra* n. 14.

⁹³ Solilová, *supra* n. 14 and Wittendorf, *supra* n. 34.

⁹⁴ The separate accounting method was set out in article 3 of the *League of Nations Draft* (1933).

⁹⁵ The arm's length principle was used as an allocation norm in US legislation. See US: Revenue Act 1928, sec 45, as referred to in the US national report to the League of Nations in 1932. In regard to international tax law, the arm's length principle was implemented into the *France-US Tax Treaty* (1932). See Wittendorf, *supra* n. 34 and Solilová & Steindl, *supra* n. 39.

basis in international taxation⁹⁶. Until the first OECD Model Convention (1963), the classification of article dealing with the arm's length principle was several times changed⁹⁷, but into the first OECD Model convention was included as Article 9(1) based on the London Model (1946)⁹⁸. What is important to notice is that the wording of article 9(1) has remained unchanged since then⁹⁹. The historical background to article 9(1) of the OECD Model Convention clearly suggests that it is a treaty provision relating to business income between associated enterprises the purpose of which is to prevent the contracting states from applying national tax law that conflicts with the arm's length principle, thereby resulting in economic double taxation¹⁰⁰.

The provision about corresponding adjustments in cases of associated enterprises was not included in the OECD Model Convention (1963)¹⁰¹. After a targeted campaign from the US side¹⁰² with the intention of creating an international consensus relating to rules on corresponding adjustments, article 9(2) was added to the OECD Model Convention (1977) as the Committee agreed with the recommendation of Working Party 7¹⁰³.

3.3 Article 9 OECD: General Considerations

Article 9 of the OECD Model Convention covers the allocation of income of MNEs¹⁰⁴. As stated before, over the last decades the apportionment of income of associated enterprises resident in different countries has been of increasing importance in international taxation. Major obscurities due to the broadness of the wording lead to uncertainties about the scope and purpose of this article¹⁰⁵. In international tax law each enterprise within the MNE group should

⁹⁶ See Solilová & Steindl, *supra* n. 39.

⁹⁷ See Solilová & Steindl, *supra* n. 39 and Solilová, *supra* n.14.

⁹⁸ *Ibid.*

⁹⁹ *Ibid.*

¹⁰⁰ In this sense, see Working Party No. 7 of the Fiscal Committee, *Apportionment of Profits of Permanent Establishments and Associated Enterprises*, para. 6, FC7WP7 (67) 2. Solilová & Steindl, *supra* n. 39 and Wittendorf, *supra* n. 34.

¹⁰¹ See Wittendorf, *supra* n. 34 and Solilová & Steindl, *supra* n. 39; A statement regarding corresponding adjustments was first made in the Protocol to the London Draft – See art. VI(1) (b) of the Protocol to the *London Draft* (1946) – However, it only related to the transactional allocation of business income between head offices and Pes.

¹⁰² See *Draft report of the Fiscal Committee to the Council FC (63) 4: Letter from the United States Delegation to the Chairman of the Fiscal Committee May 8 1963*, TFD/FC/158; Wittendorf, *supra* n. 34.

¹⁰³ OECD, *Model Tax Convention on Income and on Capital* (11 Apr. 1977), Models IBFD; Report by Working Party No. 7 of the Fiscal Committee, FC/WP7(70) (2), *Corresponding adjustments*.

¹⁰⁴ Para. 1 OECD MODEL: *Commentary on Article 9* (2017).

¹⁰⁵ Lehner, *supra* note 17.

be treated as separate entity. Thus, each individual group member is subject to tax on the income arising to it (on a residence or source basis)¹⁰⁶. In intra-group transactions, in order to apply the separate entity approach, individual group members must be taxed on the bases that they act at arm's length in their transactions with each other. However, the relationship among members of an MNE may permit the group members to establish special conditions in their intra-group relations that differ from those that would have been established had the group members been acting as independent enterprises operating in open markets¹⁰⁷. Hence, MNEs have possibilities to shift income between jurisdictions in order to lower their gross tax burden¹⁰⁸.

The main purpose of Article 9 is the avoidance of economic double taxation, it indicates that business profits should be taxed where they originate economically¹⁰⁹. A transfer pricing adjustment of commercial or financial relations between associated enterprises whereby the profits of one enterprise are included in the profits of the other enterprise, can lead to economic double taxation¹¹⁰. So, article 9 is concerned with international economic double taxation caused by transfer pricing¹¹¹. To reach the goal of avoiding double taxation, adjustments of profits may have to be made by both contracting States¹¹². As a secondary purpose Article 9 ensures a balanced allocation of taxing right between the contracting States. The allocation of taxing rights of MNEs can have a major impact on the tax revenue of states, since a large portion of the world trade is between associated enterprises. Thus, Article 9(1) not only has the purpose of protecting associated enterprises against economic double taxation but also to achieve an equitable allocation of taxing rights between states¹¹³.

¹⁰⁶ *OECD Guidelines, supra* n. 9, at Preface para. 5.

¹⁰⁷ *OECD Guidelines, supra* n. 9, at Preface para. 6.

¹⁰⁸ *OECD Guidelines, supra* n. 9, at Preface para. 7.

¹⁰⁹ “The wording of Article 9(1) and the Commentary do not reveal its purpose. The Commentary on Article 25, however, indicates the reason for inserting a provision like Article 9(1) in a treaty is to ensure that economic double taxation is covered by the treaty. The placing of Article 9(1) among the distributive article of the OECD Model and the relationship to Article 7(1) and 8 also suggest that the primary purpose of Article 9(1) is to prevent double taxation” - Wittendorff, *supra* n. 27; Para. 11 *OECD MODEL: Commentary on Article 25* (2017) & Para. 1 *OECD MODEL: Commentary on Article 7* (2017); Introduction *OECD Model* (2017).

¹¹⁰ Wittendorff, *supra* n. 34.

¹¹¹ *Ibid.*

¹¹² Para. 5 *OECD MODEL: Commentary on Article 9* (2017).

¹¹³ *OECD Guidelines, supra* n. 9, at Preface para. 7; Wittendorff, *supra* n. 34.

Chapter III

Interest deduction limitations and the relation with Article 9 of the OECD Model Convention

4. The arm's length standard: Article 9 of the OECD Model Convention

4.1. Article 9 of the OECD Model Convention: Illustrative or Restrictive?

The purpose and practical reach of article 9(1) of the OECD Model is surprisingly unclear, as contracting states can still operate their domestic legislation to increase tax on their domestic companies even if Article 9 were entirely omitted, as long as the non-discrimination provisions of article 24 are observed¹¹⁴.

Article 9(1) states that “(...) any profits which would (...) have not so accrued, may be included in the profits of that enterprise and taxed accordingly”. In our opinion, the wording of article 9(1) i.e. by using “may”, gives leeway to the interpreter to conclude that there is no treaty obligation nor does it give rise to upward adjustments independent of domestic laws. So, the question that the author now looks to be answered is what, then, does article 9 of the OECD Model really do.

In one side of the coin, we have B.J. Arnold that defends that article 9(1), while permitting the adjustment of profits up to the arm's length amount, does not prohibit the taxation of a higher amount in appropriate circumstances or the use of a different allocation standard¹¹⁵. On the other side, the majority view, held by in legal scholarship, as well as numerous tax administrations¹¹⁶, such as the Australian one. In fact, George Kofler considers that a treaty provision like article 9(1) requires the contracting state to use its specific allocation

¹¹⁴ Wittendorff, *supra* note 34; Kofler and Verlinden, *supra* note 52.

¹¹⁵B.J. Arnold, *The Relationship Between Restrictions on the Deduction of Interest Under Canadian Law and Canadian Tax Treaties* (Canadian Tax Journal, 2019).

¹¹⁶See for example, C. Thomas, *Customary International Law and State Taxation of Corporate Income: The case for the Separate Accounting Method* (Cornel Law Faculty Publications, 1996) & F. M. Horner, *International Cooperation and Understanding: What's New About The OECD Transfer Pricing Guidelines* (University of Miami Law Review, 1996); Wittendorff, *supra* note 34. An example of tax administrations see, *inter alia*, AU: Income tax: application of Division 13 of Part III (international profit shifting) – some basic concepts underlying the operation of Division 13 and some circumstances in which section 136AD will be applied, Taxation Ruling 94/14, at para 18 and 184-186.

norm, and, therefore, prohibits an adjustment of the profits to any amount exceeding the arm's length profit¹¹⁷. The author shares the latter view for the reasons mentioned below.

If one pays close attention to the wording of the commentary on article 9 it appears to support the majority view of a restrictive scope. The commentary takes position by defending that the application of such rules should normally not have the effect of increasing the taxable profits of the relevant domestic enterprises to more than the arm's length profit¹¹⁸. To add, the 1987 OECD Thin Capitalization Report have also endorsed the restrictive nature of that provision¹¹⁹. Furthermore, under a merely permissive reading, the purpose of article 9 to eliminate economic double taxation would be undermined, as article 9(2) requires a corresponding adjustment only if the other state considers that the adjustment made were at the arm's length. With that said, if article 9(1) does not restrict a contracting state only to arm's length adjustments, the result would be that the appropriate tax base in each jurisdiction would not be secured, and economic double taxation could still systematically persist within the framework of article 9¹²⁰. Hence, Article 9(1) ensures that the domestic rules, in respect of transactions regarding business income between associated enterprises, i.e. income adjustments, comply with the arm's length principle with the objective of mitigating economic double taxation¹²¹.

4.2. Transfer Pricing Adjustments

Article 9 OECD Model Convention is also concerned with international economic double taxation caused by transfer pricing adjustments. The basis for such double taxation may be of a legal or factual nature¹²². Legally caused economic double taxation may arise as result of the application of different allocation norms in the domestic tax laws of the contracting states¹²³. For example, one state may apply the arm's length principle and the other may apply formulary apportionment¹²⁴. The purpose of Article 9(1) is to protect taxpayers against primary

¹¹⁷ Kofler and Verlinden, *supra* note 52.

¹¹⁸ Paras. 2 and 3(c) *OECD MODEL: Commentary on Article 9* (2017).

¹¹⁹ See Thin Cap Report, *supra* n. 21, at para. 50.

¹²⁰ Kofler and Verlinden, *supra* note 52.

¹²¹ Steindl and Solilová, *supra* note 39.

¹²² Wittendorff, *supra* note 34.

¹²³ *Ibid.*

¹²⁴ *Ibid.*

adjustments that conflict with the arm's length principle and Article 9(2) is to provide taxpayers with a corresponding adjustment that accords with the arm's length principle¹²⁵. Thus, the purpose of both article 9(1) and (2) is to prevent legally caused economic double taxation. Factually caused economic double taxation may arise because the contracting states disagree on the facts applicable to a specific allocation norm applied by both states¹²⁶. The disagreement may, for instance, involve the question of whether the transfer price in fact adheres to the arm's length principle¹²⁷. A state may refuse to make a corresponding adjustment because he considers the transfer price to observe the arm's length principle¹²⁸. At treaty level, factually caused economic double taxation may be resolved by the MAP in Article 25 of the OECD Model Convention which supplements Article 9¹²⁹. If the competent authorities reach an agreement, Article 9 provides the legal basis for avoiding economic double taxation¹³⁰.

The OECD transfer pricing Guidelines aim at preventing factually caused economic double taxation by providing detailed rules and methods for the common application of the arm's length principle¹³¹.

5. Article 9 OECD Model Convention and Thin Capitalization rules

5.1. Thin Capitalization Rules

Because of the fundamentally different tax treatment of equity investments and loan financing, as mentioned above, in an international context and from a tax point of view, it may sometimes be more advantageous to a particular combination of company and contributor to arrange the financing of the company by ways of loans rather than by way of equity contribution¹³². Given this dynamic, it is easy to see that the investors in the company may

¹²⁵ Para. 5 and 6 *OECD MODEL: Commentary on Article 9* (2017).

¹²⁶ Wittendorff, *supra* note 34.

¹²⁷ *Ibid.*

¹²⁸ Para. 6 *OECD MODEL: Commentary on Article 9* (2017).

¹²⁹ Para. 11 *OECD MODEL: Commentary on Article 9* (2017) & Paras. 9-12 *OECD MODEL: Commentary on Article 25* (2017).

¹³⁰ If the primary adjustments proves to conflict with the arm's length principle, Article 9(1) will require the primary adjustment to be nullified. If, on the other hand, the outcome is that the primary adjustment adheres to the arm's length principle, Article 9(2) will require a corresponding adjustment to be made.

¹³¹ See para. 1 *OECD MODEL: Commentary on Article 9* (2017) & *OECD Guidelines, supra* n. 9, at Preface para. 15.

¹³² See Thin Cap Report, *supra* n. 21, at paras. 9-10.

decide to provide what is, in substance, equity capital in the form of debt financing, known as “hidden capitalization”¹³³. This tax-driven preference is a concern to the tax authorities for example, of the State of residence of the borrower as the deduction of important amounts of interest on the debt leads to an erosion of the tax base. In order to protect themselves against these disguising moves, States tend to enact, what is often described as, thin capitalization rules. Such rules focus essentially on debt financing provided by shareholders or related persons who are residents in a State other than the State of residence of the borrowing company¹³⁴. Whichever type of rules applies, the application of thin capitalization rules by the State of residence of the borrower results in economic double taxation each time that the State of residence of the lender is not prepared to give relief for the corporate taxes paid on the non-deductible interest in the State of residence of the borrower¹³⁵.

The application of domestic thin capitalization rules in a cross-border situation which is governed by a tax treaty raises the question whether such rules are consistent with the provision of tax treaties¹³⁶.

5.2. Article 9 OECD Model Convention: Scope

There can be little doubt that article 9 OECD Model Convention is relevant to the issue of thin capitalization¹³⁷. The aims of taxpayers practicing thin capitalization (i.e. claiming deduction of the highest possible amount of interest in a high tax jurisdiction and achieving taxation of interest at the lowest possible tax cost) conflicts with the object and purpose of

¹³³ See Thin Cap Report, *supra* n. 21, at para. 10.

¹³⁴ De Broe, *supra* n. 24; See DE: ECJ, 12 Dec. 2002, Case C-324-00, *Lankhorst-Hohorst*, ECR I-11779, ECJ Case Law IBFD, which have held that thin capitalization rules that apply only to financing provided by non-residents shareholders infringe EC-Treaty.

¹³⁵ Thin capitalization rules vary from jurisdiction to jurisdiction and their effects also vary. As mentioned on section 1.3.2., given the scope of this work and the research question posed, we will not expand on this issue. De Broe, *supra* n. 24.

¹³⁶ De Broe, *supra* n. 24.

¹³⁷ Concurring with this position, see De Broe, *supra* n. 24, J. A. Nitikman, *The interaction of Canada's thin capitalization rule and the Canada-United States tax treaty* vol. 26 (International Tax Journal 1, 2000); Fernandes, *supra* n. 22; Against this position, some domestic courts, have ruled that Article 9 (1) does not apply to thin capitalization rules, see FR: CE, 30 Dec. 2003, no. 233894, *Andritz Sprout Bauer & CA*: FCA, 18 May 1999, A-659-97, *Specialty Manufacturing Ltd. v. Her Majesty the Queen*, Tax Treaty Case Law IBFD, on appeal from CA: TC, 25 Aug. 1997, 97 DTC 1511 (T.C.C.), *Specialty Manufacturing Ltd. v. Her Majesty the Queen*, Tax Treaty Case Law IBFD. Concurring with this position see, Wittendorff, *supra* note 34 and Wittendorff, *supra* n. 51.

article 9 (1) OECD Model Convention¹³⁸. According to the OECD, article 9 (1) is relevant both for purposes of determining whether the interest is charged is at arm's length rate and for purposes of determining whether a *prima facie* loan be regarded as debt or should be regarded as equity¹³⁹.

Bearing in mind that article 9(1) OECD Model Convention is restrictive rather than illustrative, as defended above (see section 4.1.), which uses the arm's length principle as the yardstick, take the following example¹⁴⁰: Country A applies transfer pricing rules. On the basis of these rules, an amount of interest is not allowed as a deduction, whereas the transactions are in fact at arm's length. Does article 9 apply in these circumstances? It seems quite straightforward that if article 9 did not apply, states would be free to adjust profits where this is clearly not intended by the drafter of the OECD Model Convention¹⁴¹. If a deviation from the arm's length principle by thin capitalization rules would occur, it would necessarily lead to unsolved economic double taxation¹⁴². In other words, if the initial adjustment made to the taxable profits of the associated enterprise, which was imposed by thin capitalization rules, was not made on the basis of the arm's length principle, the other State would be under no obligation to make a downward adjustment of the taxable profits of the affiliated company¹⁴³.

An interesting question can also be raised by the following example¹⁴⁴: Country A applies earning stripping rules that limit the deduction of interest to 30% of the fiscal EBITDA, in so far as the excess is payable to non-resident lenders. No distinction is made between group interest and third-party interest. In the example, the amount of interest is 100, whereas the arm's length amount would be 80, and the non-deductible amount is 25, under the earnings stripping rules. This question will be further discussed on this thesis (see section below 6.2.).

¹³⁸ De Broe, *supra* n. 24. At the time of the Carrol Report (1933), it was already identified the excessive debt financing as a manner by which profits could be diverted from one country to another – See Carrol Report, *supra* n. 39, at paras. 6, 621, 680, 681 and 715.

¹³⁹ See para. 3 *OECD MODEL: Commentary on Article 9* (2017); Thin Cap Report, *supra* n. 21, at para 48-49.

¹⁴⁰ See O. Marres, in *International Tax Law: New Challenges to and from Constitutional and Legal Pluralism* vol. 14, Interest Deduction Limitations: When To Apply Articles 9 and 24(4) of the OECD Model (G. Maisto, P. Pistone & D. Weber eds., IBFD, 2016), Online Books IBFD.

¹⁴¹ No re-writing of the accounts of associated enterprises is authorized if the transactions between such enterprises have taken place on normal open market commercial terms – See para. 2 *OECD MODEL: Commentary on Article 9* (2017).

¹⁴² S. Fernandes, *Arm's Length Principle and the Issue of Thin Capitalization*, (Revista Direito Tributário Internacional Atual, Instituto Brasileiro de Direito Tributario, 2017).

¹⁴³ *Ibid.*

¹⁴⁴ Marres, *supra* n. 140.

5.3. The Consequences of Article 9 OECD Model Convention for Thin Capitalization Rules

There is no doubt that the application of domestic rules that adjust the actual interest rate to an arm's length rate are permitted under article 9(1) and corresponding para. 3(a) of the commentaries, which is based on paras 49 and 84(c) of the 1986 Thin Cap report¹⁴⁵. Hence, the application of domestic thin capitalization rules can only be given effect under tax treaties insofar that the disallowed interest or the interest which has been recharacterized as a dividend and which is included in taxable profit of the borrower does not exceed the profit which would have accrued to the borrower had the lender and the borrower been operating under arm's length conditions¹⁴⁶.

The second consequence which directly follows from the first one is that to determine whether the financial relations agreed between two associated enterprises are those made or imposed between independent third parties, a subject of reference is needed¹⁴⁷. The OECD suggests that the subject of reference is the independent bank benchmark¹⁴⁸. The application of this benchmark, as the OECD explains, implies enquiring whether considering the borrower's financial and economic condition, an independent bank would be prepared to provide such a high amount of debt capital or, in the case of additional debt capital funding, whether in the relevant circumstances an independent bank would lend to protect his original investment, or, on the contrary would decide to cut his losses¹⁴⁹. Such subject of reference must be used to determine whether the interest charged is at a rate that applies in the open market as well as to determine whether an ostensible loan is true debt or disguised equity¹⁵⁰. In other words, the idea of this benchmark is to determine by reference, *inter alia*, to the risks involved and the profit

¹⁴⁵ See Thin Cap Report, *supra* n. 21; G. Kofler, in *Klaus Vogel on Double Taxation Conventions*, 4th ed. (E. Reimer & A. Rust eds., Kluwer 2015).

¹⁴⁶ De Broe, *supra* n. 24 and Kofler, *supra* n. 145.

¹⁴⁷ *Ibid.*

¹⁴⁸ See Thin Cap Report, *supra* n. 21, at para. 76.

¹⁴⁹ *Ibid.*

¹⁵⁰ De Broe, *supra* n. 24.

potential of the debtor, whether a third party banker would have provided such funds as a loan or, instead, as equity capital¹⁵¹.

6. The Interest Limitation Rule

6.1. The OECD best practice approach – Comprehensive Interest Barriers

6.1.1. Policy Objectives

One of the focus points of the BEPS work carried out by the OECD was the possibility of MNEs using interest expenses to erode the tax base¹⁵². In particular, the OECD identified three basic scenarios where the risks related with the deductibility of interest by MNEs may arise: (i) by allocating third party debt to high tax countries, (ii) by using intra-group loans to generate more interest expenses than the MNE's actual third-party interest expenses and (iii) by using third party or intra-group financing to fund tax-exempt assets¹⁵³. In order to address the mentioned risks, Action 4 of the BEPS Action Plan regarding the limitation of base erosion involving interest deductions and other financial payments called for recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense¹⁵⁴.

In this respect, the OECD best practice approach “is based on a fixed ratio rule” which limits an entity's net deductions for interest and payments economically equivalent to interest to a percentage of interest earnings before interest, taxes, depreciation and amortization (EBITDA)¹⁵⁵. As a minimum this should apply to entities in multinational groups. To ensure

¹⁵¹ See Thin Cap Report, *supra* n. 21, at para. 76. Fernandes, *supra* n.22. De Broe, *supra* n. 24. However, the OECD warns for a too rigid reliance on the independent financier, because a parent company has a better understanding of the profit potential of its own subsidiary than a independent bank looking from the outside. As a result, a fact and circumstances-test and use evidence of transactions between independent parties in a reasonable manner are consistent with the arm's length principle laid down in Art. 9 (1) OECD Model – See De Broe, *supra* n. 24 & Fernandes, *supra* n. 22.

¹⁵² BEPS Action 4, *supra* n. 28, at p. 13.

¹⁵³ *Ibid.*

¹⁵⁴ *Ibid.*

¹⁵⁵ As noted by the OECD in the Action 4 final report released in October 2015 and subsequently reiterated in the 2016 updated Action 4 report.

While the OECD have a clear preference on a fixed ratio rule, it does not exclude the recourse to other benchmarks, such as an assets ratio or a group ratio. They acknowledge in fact that using asset values to measure the economic

that countries apply a fixed ratio that is low enough to tackle BEPS, while recognizing that not all countries are in the same position the recommended approach includes a corridor of possible ratios of between 10% and 30%”¹⁵⁶. The report also includes factors which countries should consider in setting their fixed ratio within this corridor. The approach can be supplemented by a worldwide group ratio rule which allows an entity to exceed this limit in certain circumstances¹⁵⁷.

As noted in the OECD BEPS reports on Action 4, the use of earnings-based rules presents several advantages such as an expected clear correlation between earnings and taxable income and that the earnings, as such, ought to be a useful indicator of an entity’s ability to meet its obligations to pay interest¹⁵⁸. Thus, the earnings are considered as the right benchmark to use in measuring the amount of debt an entity is able to borrow from related and unrelated parties¹⁵⁹. Another benefit is that earnings-based rules are more difficult to circumvent with tax planning strategies¹⁶⁰. The reason for that is because it is only through the increase of its earnings (and therefore of its taxable income in a certain country) that an entity may increase its net interest deductions¹⁶¹. From this, the OECD takes the view that the introduction of Comprehensive Interest Barriers is the best practice approach for the countries to be able to align interest deductions with taxable economic activity¹⁶². Still, the OECD acknowledges certain deficiencies or risks with the proposed best practice, to address these issues they came up with mechanics to correct the result of such rules¹⁶³. Yet, the said mechanics remain fully optional, and it is at the full discretion of the countries to implement them or not¹⁶⁴.

It is important to stand out that with this recommendation the OECD is giving a clear signal to all different countries around the world that earnings should be used as the preferred measure to address artificial practices and profit shifting, at least, in the field of deduction of

activity within a group may be more stable and predictable than an earnings ratio, which is more volatile. Still, the OECD also points out major drawbacks connected with the recognition and valuation of the assets. – BEPS Action 4, *supra* n. 28, at paras. 76, 79 and 80.

¹⁵⁶ BEPS Action 4, *supra* n. 28, at paras. 76, 79 and 80.

¹⁵⁷ *Ibid.*

¹⁵⁸ BEPS Action 4, *supra* n. 28, at para. 73.

¹⁵⁹ *Ibid.*

¹⁶⁰ BEPS Action 4, *supra* n. 28, at para. 74.

¹⁶¹ *Ibid.*

¹⁶² BEPS Action 4, *supra* n. 28, at p. 14.

¹⁶³ For example, BEPS Action 4, *supra* n. 28, at paras. 76 and 115.

¹⁶⁴ BEPS Action 4, *supra* n. 28, at paras. 156-158 and 161.

interest expenses¹⁶⁵. Moreover such best practice is indirectly setting aside the application of the long-standing arm's length principle and of a full benchmarking analysis of the entity by reference to the independent bank to attribute the fair/arm's length amount of profits of the different entities of a MNE¹⁶⁶. Even though, the arm's length test rules can still be applied on top of the OECD Comprehensive Interest Barriers¹⁶⁷. This means that the latter rules can be complemented by arm's length test rules, for example in determining the adequate interest rate before applying the OECD Comprehensive Interest Barriers¹⁶⁸.

6.1.2. Consequences

Any interest (and similar financial payments) paid by a group entity to any third parties, related parties or group entities is tax-deductible up to a certain fixed earnings ratio or up to the group ratio, if applicable¹⁶⁹. Any interest expenses that exceed the said fixed earnings ratio or the group ratio would be permanently disallowed and would be added back to the accounting result and taxable income for the year of the relevant entity and taxed in the hands of the debtor at the applicable standard rate¹⁷⁰.

As a result, the outcome of the proposed OECD Comprehensive Interest Barriers would be to create economic double taxation of interest on a world scale because a certain portion of the interest expenses would not be deductible in the hands of the debtor, whilst the corresponding interest income would normally be taxed in the hands of the creditor¹⁷¹.

¹⁶⁵ Fernandes, *supra* n. 22; It is important to note that the EU followed the OECD recommendation pursuant to the adoption of the ATAD by the Council on 20 June 2016.

¹⁶⁶ Fernandes, *supra* n. 22; The OECD on previous draft reports didn't even consider the arm's length test in the consultation process carried out under BEPS action 4. The arm's length test to limit the deductibility of interest payments was considered as burdensome to apply for both taxpayer and tax administration, and may still prove ineffective. – See OECD, *Public Discussion Draft BEPS' Action 4 – Interest Deductions and Other Financial Payments* paras. 21 and 22 (OECD Publishing 2014).

¹⁶⁷ BEPS Action 4, *supra* n. 28, at paras. 12, 59 and 205.

¹⁶⁸ Fernandes, *supra* n. 22.

¹⁶⁹ BEPS Action 4, *supra* n. 28, at paras. 23 and 24.

¹⁷⁰ BEPS Action 4, *supra* n. 28, at para. 85

¹⁷¹ BEPS Action 4, *supra* n. 28, at para. 159; Fernandes, *supra* n. 22.

6.2. Assessment of the Comprehensive Interest Barriers against the arm's length standard set by Article 9 of the OECD Model Convention

The question now is, with regard to the arm's length standard under Article 9 (1) OECD Model convention, whether Comprehensive Interest Barriers may be compatible with the arm's length principle.

Taking back the example given on this thesis (see *supra* section 5.2.), the answer on this matter depends on the position taken in relation to the nature of the Comprehensive Interest Barriers. One school of thought suggests that they ought to be considered as a general rule concerning the determination of taxable profits¹⁷², and for that reason they are not covered by the scope of Article 9. The other side of the coin takes the view that Comprehensive Interest Barriers are an anti-abuse rule¹⁷³. For the sake of this study the two positions will not be scrutinized in detail, but instead used to show their different consequences for the question raised in this section.

The first school of thought believes that the adjustment of 25, under the earnings stripping rule, is not in violation of article 9, since the adjustment clearly is not aimed at making the profits of the enterprise conform to arm's length profits, which is evidenced by the fact that the measure also applies to transactions between third parties and cannot therefore be considered a transfer pricing adjustment¹⁷⁴. Moreover, *Marres*, argue that the material scope of article 9 is confined to cases where a profit adjustment is made because conditions are made or imposed that differ from conditions agreed to between independent enterprises¹⁷⁵. If so, the domestic measure is a profit allocation rule that must meet the arm's length standard and that in principle gives rise to a corresponding adjustment¹⁷⁶. If not, the domestic measure is a tax base computation rule that in principle must be applied without discrimination as to the state of residence of the payee¹⁷⁷.

¹⁷²See for example, A. Linn, *Germany*, IFA Cahiers de droit fiscal international, vol. 95a, *Tax treaties and tax avoidance: application of anti-avoidance provisions* (Sdu Fiscale & Financiële Uitgevers 2010), Online Books IBFD & Marres, *supra* n. 140.

¹⁷³ See for example, H. J. Ault, & B. J. Arnold, et al., *Comparative income taxation: a structural analysis* 3th ed., (Kluwer Law International, 2010).

¹⁷⁴ *Ibid.*

¹⁷⁵ De Broe, *supra* n. 24.

¹⁷⁶ Marres, *supra* n. 140.

¹⁷⁷ *Ibid.*

Fernandes, on the other side, defends that any kind of Comprehensive Interest Barriers which work as mechanical blind cap limiting the debt financing of associated enterprises are in breach of the arm's length principles. Moreover, the author in question, submits that “Although ostensibly combating artificial financial arrangements imposed between related parties (...) the countries introducing these rules (...) are, in fact, trying to create an artificial source of revenue for the domestic budget of the country applying that kind of rule”. To expand on this matter, the author will analyze some arguments that sustain this latter view.

To begin with, the OECD Thin Capitalization Report (1986), clearly states that domestic thin capitalization rules may work on the basis of a fixed ratio, yet to them being compatible with the arm's length standard such rules have to give the chance to the taxpayer to provide evidence to the contrary¹⁷⁸. Well, from this, countries failing to do that are in breach of the arm's length test as set out in Article 9 (1)¹⁷⁹.

Moreover, as already evidenced in this thesis (see section 6.1.2.), one of the main consequences of the application of Comprehensive Interest Barriers is that if the interest expenses claimed by the taxpayer exceed the interest barrier set by the rules of a certain country, the taxing authorities of that country will re-write the accounts to increase the taxable profits of the relevant taxpayer by the amount of the excessive non-allowable interest (i.e. adjustment of the taxable income resulting from the commercial accounts of the entity by adding back the amount of (deemed) excessive interest payments)¹⁸⁰. To add, even when the terms of the transactions were agreed on normal open market commercial terms, the amount of (deemed) excessive interest payments will still be regarded as excessive by the relevant domestic rules¹⁸¹. This is all because the arm's length principle does not have access to the world of Comprehensive Interest Barriers, apart from countries that provide the taxpayers with an arm's length escape test, as mentioned in the paragraph above. This may seem kind of odd to the reader, when looking back to section 5.3. on this study, one of the consequences of Article 9 to Thin Cap rules is that those domestic rules are allowed but only in so far as they do “not have the effect of increasing the taxable profits of the relevant domestic enterprise to more than the

¹⁷⁸ Thin Cap Report, *supra* n. 21, at para. 79.

¹⁷⁹ From a study carried out analyzing of the selected Comprehensive Interest Barriers from Australia, Italy, United Kingdom and New Zealand, only Australia gives the opportunity to provide this evidence – See *Fernandes, supra* n. 22.

¹⁸⁰ *Fernandes, supra* n. 22.

¹⁸¹ *Ibid.*

arm's length profit"¹⁸². Well, from this, it is safe for the author to conclude that the adjustment made in accordance with the Comprehensive Interest Barriers is not in line with Article 9 and the arm's length principle related thereto.

As discussed earlier in this thesis the arm's length principle, works as a backstop to avoid a MNE freely and arbitrarily allocating its income and expenses across the different countries in which it operates. The underlying idea is if the "income and expenses cake" of the MNE is not correctly distributed, by resorting to the arm's length principle it is possible to correct the distribution of the MNEs income and expenses cake to promote an equitable inter-nation tax base allocation¹⁸³. Hence, the arm's length principle does not function in an arbitrary manner, instead its intrinsic feature is the "fair share", among the different countries concerned¹⁸⁴.

As noted in the BEPS Action 4 reports the OECD, on the one hand, has endorsed the Comprehensive Interest Barriers by stating that such rules restrict the ability of an entity to deduct interest expense based on an objective measure of its economic activity, but, on the other hand, has also admitted that such rules does not take into account the fact that groups operating in different sectors may require different amounts of leverage, and even within a sector some groups are more highly leveraged for non-tax reasons¹⁸⁵. Hence, Comprehensive Interest Barriers do not try to achieve any internationally agreed "fair share" principle or to secure an equitable inter-nation tax base allocation¹⁸⁶. Even though the countries adopting Comprehensive Interest Barriers or the international institutions recommending their adoption claim that these rules have to be introduced to secure the fair taxable base of a MNE (i.e. to avoid the erosion of the MNE's taxable base by deductible interest payments), what they do in practice is to determine on the basis of a unilateral formula provided by the domestic tax law what their "fair share" from a certain MNE should be¹⁸⁷. Thus, in the case of Comprehensive Interest Barriers, there is no evidence that the "income and expenses cake" of the MNE was initially incorrectly distributed, and there is therefore no evidence that the countries applying those rules did not get their real fair share from a certain MNE¹⁸⁸.

¹⁸² See para 3(c) *OECD MODEL: Commentary on Article 9* (2017).

¹⁸³ Fernandes, *supra* n. 22.

¹⁸⁴ *Ibid.*

¹⁸⁵ BEPS Action 4, *supra* n. 28, at para. 72 and 86.

¹⁸⁶ Fernandes, *supra* n. 22.

¹⁸⁷ *Ibid.*

¹⁸⁸ *Ibid.*

7. The proposed changes to Commentaries on Article 9 OECD Model Convention

7.1. Paragraph 3.1. - What is the Fuss About?

7.1.1. What has changed

As first, we note that the ongoing works on the Discussion Draft are mainly aimed at clarifying the application of Article 9 of the OECD Model Convention, especially as it relates to domestic laws on interest deductibility, including laws aimed at preventing tax avoidance described in Action 4 of the OECD's base erosion and profit shifting (BEPS) project. In doing so, the Discussion Draft specifies that the work at stake is "closely linked" to the Transfer Pricing Guidance on Financial Transactions.

To put it in a nutshell, the proposed changes to the Commentary on Article 9 of the OECD Model Convention would specify the following¹⁸⁹:

1. The Contracting State making a determination on the extent to which a financing transaction is regarded as a loan, or an equity contribution would do so taking into account factors in its domestic laws (including its judicial doctrine) or in the OECD Transfer Pricing Guidelines.
2. Once a controlled transaction has been priced in accordance with the arm's length principle, the proposed Commentary would provide that the domestic law of a Contracting State is to determine whether and how such profits should be taxed. The proposed changes would stipulate that the conditions for the deductibility of expenses are a matter to be determined by domestic law, subject to the provisions of the OECD Model and, in particular, paragraph 4 of Article 24
3. Hence, when domestic law limits the deductibility of otherwise arm's length payments that would not be considered to result in economic double taxation for purposes of paragraph 2 of Article 9 of the OECD Model and therefore a corresponding adjustment would not have to be made.

¹⁸⁹ EY, *OECD releases consultation document with proposed changes to Commentaries to OECD Model Tax Convention on Article 9 (Associated Enterprises) and related articles*, 13 Apr 2021.

For the purpose of this thesis, we will only give impetus to the last two points mentioned above (new para. 3.1 read in conjunction with new para. 6.1).

7.1.2. The Proposed Changes Scrutinized

Now, the new para. 3.1. states “once the profits of the two enterprises have been allocated in accordance with the arm’s length principle, it is for the domestic law of each Contracting State to determine whether and how such profits should be taxed (...)”. From the perspective of the author, it seems that the OECD taking the position, as other commentators¹⁹⁰ (see section 6.2.), that Article 9 is not relevant to the issue of whether elements of the profits of a company are taxable or deductible, but only to the issue of whether these elements are indeed attributable to the company¹⁹¹. This view is supported by the requirement for the other contracting state to make a corresponding adjustment: the idea of article 9 is that the total profit of a group of associated companies is attributed to these companies in conformity with the arm’s length standard while avoiding economic double taxation¹⁹². Thus, in principle, interest deduction restrictions are not governed by article 9 since they are not made due to the fact that the interest expenses are not attributable to the taxpayer and do not require a corresponding adjustment¹⁹³.

The also new para. 6.1., which directly concerns the new para. 3.1. here in analysis, is linked with the issue of economic double taxation. It is relevant to say that in regard to economic double taxation of interest disallowed by thin capitalization rules the OECD Commentary addresses this point but only when the disallowed interest is recharacterized as a dividend payment by the source country¹⁹⁴. In this respect, under certain conditions the country of residence of the creditor company has to grant relief for the economic double taxation of such interest as if the payment was in fact a dividend¹⁹⁵. In regard the Comprehensive Interest Barriers, they do not recharacterize the disallowed interest payments as dividends and therefore there is no treaty obligation for the creditor company’s country of residence to grant relief for

¹⁹⁰ Marres, *supra* n. 140. Linn, *supra* n. 172.

¹⁹¹ Marres, *supra* n. 140; De Broe, *supra* n. 24.

¹⁹² *Ibid.*

¹⁹³ Marres, *supra* n. 140; Wittendorff, *supra* n. 34.

¹⁹⁴ See Para 67 *OECD MODEL: Commentary on Article 23 B* (2017).

¹⁹⁵ See para. 68 *OECD MODEL: Commentary on Article 23 B* (2017).

the economic double taxation¹⁹⁶. In addition, because the OECD best practice approach sets aside the arm's length principle benchmark, but instead uses a unilateral domestic standard for revenue apportionment, which, varies widely among countries that adopt them, there is no treaty obligation for the creditor's country of residence to provide relief for the economic double taxation. Furthermore, the access to the MAP to solve this problem is, in principle, excluded because it does not concern a different interpretation or application of the arm's length principle¹⁹⁷.

As already recognized (see section 6.1.1.), the OECD BEPS Action 4 report is fully aware of this matter and has indeed addressed the issue by outlining mechanics that countries could implement to correct, up to a certain extent, the outcome of the implementation of such Comprehensive Interest Barriers¹⁹⁸. But, again, these mitigating measures are of the full discretion of the countries to implement them (or not), and even when implemented, they may still be limited in terms of time and/or value by the countries who implement the said mechanics¹⁹⁹.

7.1.3. The impact (or not) of the proposed new commentary

There is no doubt that the OECD in the discussion draft has handled, with distinction if we may say it, all the buzz around the Comprehensive Interest Barriers recommended in the final report on BEPS Action 4 and the interaction of Article 9 OECD Model Convention with those rules. It is not to forget that the OECD mantra prays for clarity and uniformity in the international tax world, providing guidance with respect to transfer pricing matters and forestall disputes that might arise in unclear areas²⁰⁰.

On the other hand, if Comprehensive Interest Barriers already suffered of innumerable flaws (see above section 6.2.), especially in relation to the arm's length principle, it is not by making article 9 OECD Model Convention "more in line" with them, that the issues will magically disappear or seem more translucent throughout the eyes of the international taxation

¹⁹⁶ R. BÖhi, & P. Hongler, *Interest deductibility: the implementation of BEPS Action 4* (International Fiscal Association, London Congress, 2019); Fernandes, *supra* n. 22.

¹⁹⁷ Fernandes, *supra* n. 22.

¹⁹⁸ BEPS Action 4, *supra* n. 28, at paras. 159 and 161.

¹⁹⁹ BEPS Action 4, *supra* n. 28, at para. 165.

²⁰⁰ See Introduction *OECD MODEL* (2017).

community. On the contrary, the OECD with this proposed changes are reasserting their work on BEPS action 4.

The new para. 3.1. clarifies the difference between determining the arm's length price and determining the taxable income. The new wording, in the author's opinion, gives leeway to legitimize a practice that leads to double taxation by oversteering the arm's length principle. The highlight on domestic law provisions creates the potential for more countries to place greater emphasis on domestic law to make adjustments which the double tax treaty will have little or no application.

If the new changes eventually come forward, we may say that a kind of domino effect is expected. To explain the above statement, in the author's view Comprehensive Interest Barriers foster and advocate the competition for the tax base. As already mentioned, the basis for the adjustment of the taxable profits under the OECD best practice approach is not the arm's length principle. Instead they determine the estimated accurate taxable profits of the relevant entity in accordance with a purely domestic standard. In fact, the main objective of the Comprehensive Interest Barriers is that by applying fixed ratios or caps to limit the tax-deductibility of interest payments, it ensures, that a portion of an entity's profits remain subject to tax in that country²⁰¹. Although the common aim of the OECD, and of the different countries, is to prevent the erosion of the tax base, this rules go beyond the framework of typical thin capitalization rules. Comprehensive interest barriers do not amount to achieve an equitable inter-nation tax base allocation because of the disconnection with the arm's length principle. Hence, in fact it allows the countries to tax as much as they can by reference of mechanical and protective caps and thereby expand their taxing rights. For that reason, States all over the world may be tempt to tighten their domestic rules, in order to enhance their economic situation, by getting more additional tax revenue to meet their budget and/or to reduce their deficit, without taking into account the other countries' fair claims or allowing the tax-deduction of economically justified interest expenses²⁰². With all that, we would also be witnesses of an exponential increase of unsolved economic double taxation of interest (i.e. permanent

²⁰¹ BEPS Action 4, *supra* n. 28, at para. 85.

²⁰² The amount of non-allowable interest will still be regarded as excessive by the relevant domestic rules, even when the terms of the disallowed transactions were agreed on normal open market commercial terms (i.e. on an arm's length basis). The reason for that is because the arm's length principle is alien to the Comprehensive Interest Barriers, and, as stated earlier on this thesis, normally countries don't have a rule that still provide for an arm's length escape test (see section 6.2.).

disallowance of interest expense in the hands of the borrower, whereas the lender is normally taxed on the corresponding interest income). Again, there is no common understanding among contracting countries of the amount at which the interest deductibility should be restricted, because the OECD have developed absolutely different formulas to compute the said amount with the arm's length principle being alien to all of them.

In a perfect international taxation world, the design of Comprehensive Interest Barriers would remain bound to the arm's length principle, but this would have to be the subject of a completely new master thesis study.

Final Conclusions

- (1) Transfer pricing is in the cross hairs of tax policy as it relates to the competing objectives of three parties: the revenue-maximizing objective of the domestic tax authority, the revenue-maximizing objective of the foreign tax authority, and the tax-minimizing objective of the taxpayer.
- (2) Literature on corporate taxation accumulates remarkable evidence that MNEs adjust the transfer pricing on transactions with related parties, thus, to transfer taxable profits from high-tax to low-tax countries. In this regard, the OECD guidelines on transfer pricing, approach the baseline standard of transfer pricing extensively accepted among countries, which establishes the arm's length principle as the fundamental parameter for appropriate valuation of intra-firm transactions.
- (3) The first original version of Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations provided guidance on the application of the arm's length principle for tax purposes on transactions between associated enterprises. The aim was to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein, while limiting the risks of economic double taxation that may result from a dispute between two countries on the determination of the arm's length remuneration for their cross-border transactions with associated enterprises.
- (4) Despite the broad application of OECD transfer pricing guidelines as a baseline standard, countries maintain unilateral rules to prevent transfer pricing manipulation. Although, transfer pricing rules have demonstrated to have positive impact on preventing income shifting, some evidence show that MNE still manage loopholes and weaknesses in domestic transfer pricing regulations to distort intra-firm prices.
- (5) The OECD Base Erosion and Profit Shifting (BEPS) Action Plan proposes a thorough review of current transfer pricing guidelines. The main objective is to

adapt the current guidelines for contemporary unprecedented arrangements, thus to mitigate breaches that still allow transfer pricing abuse.

- (6)** Article 9(1) has the purpose of protecting associated enterprises against economic double taxation but also to achieve an equitable allocation of taxing rights between states.
- (7)** Article 9(1) ensures that the domestic rules, in respect of transactions regarding business income between associated enterprises, i.e. income adjustments, comply with the arm's length principle with the objective of mitigating economic double taxation.
- (8)** The purpose of both article 9(1) and (2) is to prevent legally caused economic double taxation.
- (9)** Because of the fundamentally different tax treatment of equity investments and loan financing, in an international context it may sometimes, from the tax point of view, be more advantageous to a particular combination of company and contributor to arrange the financing of the company by ways of loans rather than by way of equity contribution.
- (10)** Article 9 OECD Model Convention is relevant to the issue of thin capitalization. The aims of taxpayers practicing thin capitalization (i.e. claiming deduction of the highest possible amount of interest in a high tax jurisdiction and achieving taxation of interest at the lowest possible tax cost) conflicts with the object and purpose of article 9 (1) OECD Model Convention.
- (11)** The application of domestic thin capitalization rules can only be given effect under tax treaties insofar that the disallowed interest or the interest which has been recharacterized as a dividend and which is included in taxable profit of the borrower does not exceed the profit which would have accrued to the borrower had the lender and the borrower been operating under arm's length conditions.
- (12)** One of the focus points of the BEPS work carried out by the OECD was the possibility of MNEs using interest expenses to erode the tax base.

- (13)** the OECD best practice approach is based on a fixed ratio rule which limits an entity's net deductions for interest and payments economically equivalent to interest to a percentage of interest earnings before interest, taxes, depreciation and amortization (EBITDA).
- (14)** Any interest (and similar financial payments) paid by a group entity to any third parties, related parties or group entities is tax-deductible up to a certain fixed earnings ratio or up to the group ratio, if applicable. Any interest expenses that exceed the said fixed earnings ratio or the group ratio would be permanently disallowed and would be added back to the accounting result and taxable income for the year of the relevant entity and taxed in the hands of the debtor at the applicable standard rate.
- (15)** Such best practice is indirectly setting aside the application of the long-standing arm's length principle.
- (16)** To the question if Comprehensive Interest Barriers are compatible with the arm's length standard set by Article 9 OECD Model, the answer depends on the position taken on the nature of the said rules.
- (17)** The OECD came up with proposed commentaries changes on Article 9 OECD Model mainly aimed at clarifying the application of that article, especially as it relates to domestic laws on interest deductibility.
- (18)** The OECD in the discussion draft has handled with distinction all the buzz around the Comprehensive Interest Barriers recommended in the final report on BEPS Action 4 and the interaction of Article 9 OECD Model Convention with those rules.
- (19)** The new para. 3.1. clarifies the difference between determining the arm's length price and determining the taxable income.
- (20)** The new wording gives leeway to legitimize a practice that leads to double taxation by oversteering the arm's length principle.
- (21)** The highlight on domestic law provisions creates the potential for more countries to place greater emphasis on domestic law to make adjustments which the double tax treaty will have little or no application.

- (22) Comprehensive Interest Barriers promote and endorse the competition for the tax base.
- (23) Although the common aim of the OECD, and of the different countries, is to prevent the erosion of the tax base, this rules go beyond the framework of typical thin capitalization rules. Comprehensive interest barriers do not amount to achieve an equitable inter-nation tax base allocation because of the disconnection with the arm's length principle.

Bibliographic references

AULT, H. J. and Arnold, B.J. [et al.], *Comparative income taxation: a structural analysis*, Third edition, Kluwer Law International, 2010.

ARNOLD, B.J., *The Relationship Between Restrictions on the Deduction of Interest Under Canadian Law and Canadian Tax Treaties*, at pp. 1051-1076 (Canadian Tax Journal, 2019).

BAISTROCCHI, E., *The Transfer Pricing Problems: A Global Proposal for Simplification* vol. 59, no. 4, at pp. 941-979 (The Tax Lawyer, 2006).

BEER, S., Loeprick, J., *Profit shifting: drivers of transfer (mis)pricing and the potential of countermeasures* vol. 22, at pp. 426-451 (International Tax Public Finance, 2015)

BEUSELINCK, C., Deloof, M. & Vanstraelen, A., *Cross-jurisdictional income shifting and tax enforcement: evidence from public versus private multinationals* vol. 20, at pp. 710-746 (Review of Accounting Studie, 2015)

BÖHI, R. and Hongler, P., *Interest deductibility: the implementation of BEPS Action 4* (International Fiscal Association, London Congress, 2019).

CARROLL, M.B., *Taxation of Foreign and National Enterprises, Methods of Allocating Taxable Income* (League of Nations, 1932).

CARROLL, M.B., *Taxation of Foreign and National Enterprises, Methods of Allocating Taxable Income* vol. IV (League of Nations, 1933).

CLAUSING, K.A., *Tax-motivated transfer pricing and US intrafirm trade prices* vol. 87, at pp. 2207-2223 (Journal of Public Economics, 2003).

CRISTEA, A.D. Cristea & Nguyen, D.X., *Transfer Pricing by Multinational Firms: New Evidence from Foreign Firm Ownerships* vol. 8, at pp.170-202 (American Economic Journal: Economic Policy, 2016).

COATES, W. H. *League of Nations Report on Double Taxation Submitted to the Financial Committee by Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp* vol. 87, no. 1, at pp. 99–102 (Journal of the Royal Statistical Society, 1924).

COMMISSION Staff Working Paper: Company Taxation in the Internal Market, SEC (2001) 1681.

DAVIES, R.B., et al, *Knocking on Tax Haven's Door: Multinational firms and Transfer Pricing* vol. 100, at pp. 120-134 (The Review of Economic and Statistics, MIT Press, 2018).

DAVIS, R. T., *Tax and Social Context: Legal Fictions and Tax* vol. 4, no. 1, at pp. 31-42 (American Legal Fictions Symposium, Savannah L. Rev. 31, 2017).

DE BROE, L., *International Tax Planning & Prevention of Abuse* (IBFD Doctoral Series, 2008)

DISCHINGER, M., Knoll, B. & Riedel, N. *The role of headquarters in multinational profit shifting strategies* vol. 21, at pp. 248-271 (International Tax and Public Finance, 2014).

DOS REIS, D.N.T.F., *The tension between Transfer Pricing and Customs Valuation* (repository ISEG, Instituto Superior de Economia e Gestão, 2012).

EDEN, L. and Byrnes, W., *Transfer pricing and state aid: The unintended consequences of advance pricing agreements* at pp. 9-25 (Transnational Corporations, 2018).

European Parliamentary Research Service, *Multinational enterprises, value creation and taxation: Key issues and policy developments*, (Ioannis Zachariadis, Members' Research Service, PE 637.971, July 2019).

EY, *OECD releases consultation document with proposed changes to Commentaries to OECD Model Tax Convention on Article 9 (Associated Enterprises) and related articles*, 13 Apr 2021.

FERNANDES, S.M., *Arm's Length Principle and the Issue of Thin Capitalization* at pp. 209-237 (Revista Direito Tributário Internacional Atual, 2017).

FERNANDES, S.M., *International Double Taxation of Interest: Assessing Recent Developments in Thin Capitalization Regimes* (IBFD Doctoral Series, 2019).

FREIDLANDER, L. & Wilkie, S., *Policy Forum: The History of Tax Treaty Provisions – And Why It Is Important To Know About It* vol. 54, no. 4, at pp. 907-921 (Canadian Tax Journal, 2006).

GIRAUD, A., and Sylvain, P. *Tax Rulings and State Aid Qualification: Should Reality Matter?* vol. 16, no. 2, at pp. 233-242 (European State Aid Law Quarterly, 2017).

HINES, J.R., *Lessons from Behavioral Responses to International Taxation* vol. 52, no. 2, at pp. 305-322 (National Tax Journal, The University Chicago Press, 1999).

HORNER, F.M., *International Cooperation and Understanding: What's New About The OECD Transfer Pricing Guidelines* at pp. 577-595 (University of Miami Law Review, 1996).

HÖHN E., *The Tax Treatment of interest in international economic transactions: General Report* vol. LXVIIa (IFA Cahiers de Droit Fiscal International, Kluwer, 1982).

JOGARAJAN, S., *Prelude to the International Tax Treaty Network: 1815-1914 Early Tax Treaties and the Conditions for Action* vol. 31, no. 4, at pp. 679–707 (Oxford Journal of Legal Studies, Oxford University Press, 2011).

KNOLL, B. and Riedel, N., *Transfer Pricing Laws* at pp. 22-26 (CESifo DICE Report, 2014).

KOBETSKY, M., *International Taxation of Permanent Establishments Principles and Policy* at pp. 106-151 (Cambridge University Press, 2011).

KOFLER, G., in *Klaus Vogel on Double Taxation Conventions* 4th ed., at pp. 11-15 (E. Reimer & A. Rust eds., Kluwer 2015).

KOFLER, G. and Verlinden, I., *Unlimited Adjustments: Some Reflections on Transfer Pricing, General Anti-Avoidance and Controlled Foreign Company Rules, and the “Saving Clause”* at pp. 269-281 (Bulletin for International Taxation, IBFD, 2020).

LEHNER, M., *Article 9 Associated Companies* at pp. 387-409.

LINN, A., *Tax treaties and tax avoidance: application of anti-avoidance provisions: German National Report*, in IFA Cahiers de Droit Fiscal International, Vol. 95a, at pp. 333-354 (Deventer: Kluwer, 2010).

LIU, L., et al., *International Transfer Pricing and Tax Avoidance: Evidence from Linked Trade-Tax Statistics in the UK* vol. 110, at pp. 1-vii (International Finance Discussion Paper No. 1214, 2017).

LOHSE, T., Riedel, N., & Spengel, C., *The Increasing Importance of Transfer Pricing Regulations – A Worldwide Overview* Working Paper 12/27 (Oxford University Centre for Business Taxation, 2012).

LOHSE, T., & Riedel, N., *Do Transfer Pricing Laws Limit International Income Shifting? Evidence from European Multinationals* Working Paper No. 4404 (CESifo, 2013).

MCKINLEY, J. et al., *Transfer pricing and its effect on financial reporting* (Journal of Accountancy, 2013).

MARRES, O., *Interest Deduction Limitations: When To Apply Articles 9 and 24(4) of the OECD Model?* vol. 14, at pp. 39-51 (EC and International Tax Law Series, IBFD, 2016).

MILADINOVIC, A. and Petruzzi, R., *The Recent Decision of the European Commission on Fiscal State Aid: An Analysis from a Transfer Pricing Perspective* at pp. 243-252 (International Transfer Pricing Journal, 2019).

NITIKMAN, J.A., *The interaction of Canada's thin capitalization rule and the Canada-United States tax treaty* vol. 26, at pp. 20-64 (International Tax Journal, 2000).

OECD Report, *R(4). Thin Capitalization*, adopted by the OECD Council on 26 November 1986, in Model Tax Convention on Income and on Capital 2014 (Full Version), OECD Publishing (OECD 1987).

OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators* (OECD 1995), International Organizations' Documentation IBFD.

OECD, *Measuring Globalization: OECD Handbook on Economic Globalization Indicators* (OECD 2005), International Organizations' Documentation IBFD.

OECD, *Public Discussion Draft BEPS' Action 4 – Interest Deductions and Other Financial Payments* (OECD Publishing 2014).

OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports: OECD/G20 Base Erosion and Profit Shifting Project* (OECD, 2015).

OECD, *Explanatory Statement: OECD/G20 Base Erosion and Profit Shifting Project* (OECD Publishing, 2015).

OECD, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2016 Update: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project* (OECD Publishing, 2017).

OECD, *Model Tax Convention on Income and on Capital* (18 December 2017), Models IBFD.

OECD, *Multinational enterprises in the global economy: Heavily debated but hardly measured* (OECD, 2018), International Organizations' Documentation IBFD.

OECD, *Proposed Changes to Commentaries in the OECD Model Tax Convention on Article 9 and on Related Articles: Public consultation document* (OECD 2021), International Organizations' Documentation IBFD.

OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators* (OECD 2022), International Organizations' Documentation IBFD.

RATHKE, A.A.T, *Studies on transfer pricing systems and profit shifting: impact of the international regulation on the shifting behavior of Brazilian firms* vol. 32, no. 85 (R. Cont. Fin., USP, São Paulo, 2021).

SAVITSKIY, A., *The first Tax Treaties: In Search of Origins* vol. 49, Issue 6 & 7, at pp. 569-585 (Intertax, Kluwer Law International BV, 2021).

STEINDL, M., and Solilová, V. *Tax Treaty Policy on Article 9 of the OECD Model Scrutinized* at pp. 128-136 (Bulletin for International Taxation, IBFD, 2013).

TAYLOR, C.J., *Twilight of the Neanderthals, or are bilateral double taxation treaty networks sustainable* vol. 34, at pp. 268-312 (Melbourn University Law Review, 2010).

THOMAS, C., *Customary International Law and State Taxation of Corporate Income: The case for the Separate Accounting Method* at pp. 99-136 (Cornel Law Faculty Publications, 1996).

TREIDLER, O., *The Arm's Length Principle In the Times of BEPS* (University of Wuerzburg, 2016).

WITTENDORF, J., *The Object of Art. 9(1) of the OECD Model Convention: Commercial or Financial Relations* vol. 17, no. 3, pp. 200-212 (International Transfer Pricing Journal, *IBFD* 2010).

WITTENDORF, J., *Transfer Pricing and the Arm's Length Principle in International Tax Law* (Wolters Kluwer 2010).