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Unlimited Adjustments: Some Reflections on Transfer Pricing, General Anti-Avoidance and Controlled Foreign Company Rules, and the "Saving Clause"

In light of Actions 8-10 of the OECD/G20 BEPS Project, this article considers the interaction and increasing pressure points between transfer pricing and general anti-avoidance and controlled foreign company rules, and the effect of article 9 of the OECD Model in light of the saving clause in article 1(3).

1. Introduction

At the Interdisciplinary Conference on Tax Treaty Interpretation after BEPS held in Lausanne on 20 December 2019, the authors gave a joint presentation on numerous issues entitled "Interpreting Article 9 OECD Model Tax Convention in the Light of BEPS Actions 8-10". In the lively debate and discussions during the breaks, two issues emerged that the authors want to address in the following contribution. The first relates to the relationship between a transfer pricing inquiry after Actions 8-10 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project and general anti-avoidance rules (GAARs) or specific anti-avoidance rules (SAARs) and the practical effect on what "toolboxes" are available to taxpayers and tax administrations. The second addresses the more theoretical question of the treaty context of transfer pricing, i.e. what article 9 of the OECD Model[1] "does" and what leeway the domestic legislature has in addressing international profit allocation in light of existing double taxation conventions.

2. Transfer Pricing, GAARs, Controlled Foreign Company Rules and Actions 8-10 of the OECD/G20 BEPS Project – Solution or Problem?

2.1. The context

Dealing with transfer pricing requires a comprehensive consideration of the arm's length principle (ALP), which is something all conscientious practitioners should do. Recently, this topic has been the subject of a defence of the standard.[2] The ALP has been in place for decades and it is not our intention to go over its entire history.[3] The original intent of transfer pricing legislation was anti-avoidance. Abuse was the driver behind the ALP when Mitchell B. Carroll[4] was writing in the 1930s in the absence of unitary taxation. However, these days abuse appears to be at the heart of a heated debate where, for some, there seems to be little difference between tax policy and tax politics. One cannot but agree that this blurred distinction is a worry. At a purely technical level, with regard to transfer pricing, allegations of increasing complexity and the challenge of "getting things through the comparability sieve" may not be totally unfounded. Nevertheless, ultimately, common sense goes a long way, and is something one can only hope international tax practitioners are not short of.

Applying the ALP is not an exact science. It requires a certain level of judgement, which should not take away from the merits of the principle itself. By providing for broadly equal tax treatment, it avoids the distortion of organizational decisions and the competition between multinational enterprises (MNEs) and domestic ones.[5] This may or may not lead to undesirable results, depending on whose side the person making the assessment is. Scholars have been honing their thoughts on this topic for a few years by saying, for example, that the margin of appreciation that the ALP leaves tax administrations is also used by states to improve their own competitive-

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1. Most recently, the *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Treaties & Models IBFD.
2. O. Treidler, *The Arm's Length Principle Works Just Fine (Most of the Time)*, 96 Tax Notes Intl. 12, p. 1121 et seq. (23 Dec. 2019). There are also the "8+1 papers" of Prof. L. Eden that are all available on her LinkedIn profile, with the third paper being of particular interest: *The Arm's Length Standard Is Not the Problem*, available at https://lnkd.in/eNSDeUK. This is a core article, which argues that BEPS problems were not caused by the ALP, but rather by loopholes and discontinuities in the international tax system, most of which have been addressed by the OECD/G20 BEPS Project.
3. R. Collier & J. Andrus, *Transfer Pricing and the Arm's Length Principle After BEPS* (Oxford University Press 2017) and L.E. Schoueri, *Arm's Length: Beyond the Guidelines of the OECD: "It is better to be roughly right than precisely wrong."(John Maynard Keynes*), 69 Bull. Intl. Taxn. 12 (2015), Journal Articles & Papers IBFD.
4. M.B. Carroll, *Taxation of Foreign and National Enterprises (Volume IV): Methods of Allocating Taxable Income*, League of Nations Document No. C.425(b).M.217(b).1933.II.A. (1933), p. 60.
5. *See*, for example, W. Schön, *Neutrality and Territoriality – Competing or Converging Concepts in European Tax Law?*, 69 Bull. Intl. Taxn. 4/5 (2015), Journal Articles & Papers IBFD.

ness or the global competitiveness of their businesses.[6] It should be added that transfer pricing has become an instrument for inviting inbound intra-group cross-border investment, (unfair) tax competition and even illegal State aid. The political interest thereby stimulated does not come as a surprise when capital import neutrality (CIN) and/or capital export neutrality (CEN) come under pressure. One could even take this to a more extreme dimension by arguing that a too lenient application of the ALP by a country supports artificial outbound profit shifting and, therefore, the granting of an illegal export subsidy. That would certainly be an interesting direction to take on an already somewhat bumpy road. What are referred to in common parlance as trade wars must be included in the equation and could be an interesting addition to the well-filled plate of the World Trade Organization (WTO). This is also a good moment to bring controlled foreign companies (CFC) legislation into the debate. CFC legislation is an instrument suitable to countering harmful tax regimes in other jurisdictions. Some (particularly capital-exporting) European countries, such as France, Germany and the United Kingdom, introduced their CFC legislation in the aftermath of the 1962 enactment of the US Subpart F legislation. Many countries followed afterwards.[7] Countries that do not include CFC rules in their legal order tend to bring about a similar effect by applying the general rules of tax avoidance and beneficial ownership, or other look through approaches. This is a good time to reflect on where we are and on what to expect in the not too distant future, particularly as we are on the verge of collecting the first feedback on the entry into force of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the BEPS Multilateral Instrument or MLI)[8] and what its principal purpose test (PPT) entails.

2.2. What is the fuss about?

CFC rules have a long history, going back almost 60 years to when the United States made them part of its international tax system. Most developed countries followed. Scholars speak of a "remarkable"[9] spread. CFC rules create a particular headache, as one needs to distinguish between what is in vulgar terms called "good" active income and "bad" passive income.[10] The EU Anti-Tax Avoidance Directive (ATAD) (2016/1164),[11] for example, envisages a carve-out of "substantive economic activity supported by staff, equipment, assets and premises as evidenced by relevant facts and circumstances". The second option under the ATAD (2016/1164) considers whether the arrangement had a tax avoidance purpose. This option targets "non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage".[12] The CFC would not have owned the assets or would not have undertaken the risks that generate all or part of its income if it had not been controlled by a company "where the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income".[13] This option relies on both a subjective element, i.e. what the taxpayer's purpose was, and an objective one, i.e. to what extent the CFC is reliant on the assets and/or employees of other group members to carry out its activities. Obviously, the attempt of the ATAD (2016/1164) to distinguish "bad" from "good" income has to be seen in light of the jurisprudence of the Court of Justice of the European Union (ECJ) on abuse, which limits the justification for treating cross-border situations worse than domestic ones to "wholly artificial" arrangements.[14]

There has been a wide adoption of GAARs and scholars have warned policymakers regarding the lack of legal certainty.[15] As the ATAD (2016/1164) illustrates, countries are increasingly required to implement various anti-avoidance measures, including CFC rules, which makes the issue much broader than just a CFC matter. The crux of the issue, therefore, is whether Actions 8-10 of the OECD/G20 BEPS Project exacerbate the risk that contractual arrangements, as a main allocation criterion, have been exchanged for value creation as the relevant paradigm in international tax law and what this means when dealing with transfer pricing. DEMPE, an acronym that was not known a decade ago, is often viewed as the culprit. What is meant by development, enhancement, maintenance, protection and exploitation may be controversial, as it is anything but easy to interpret this term unambiguously, especially when one moves away from deploying a healthy level of fact-specific judgement. For the more cynical, this raises the question of whether the OECD is relying on an unspecified concept of economic substance for which the concept of value creation is being used as a proxy. Such a negative tone does not come entirely as a surprise when flipping through the recent literature. The OECD/G20 BEPS Project, in general, and Actions 8-10, in particular, served the praiseworthy cause of improving or mod-

6. P.J. Wattel, *Stateless Income, State Aid and the (Which?) Arm's Length Principle*, 44 Intertax 11, pp. 791-801 (2016).
7. W. Schön, *Tax Competition in Europe – the Legal Perspective*, 9 EC Tax Rev. 2, pp. 90-104 (2000).
8. *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (7 June 2017), Treaties & Models IBFD [hereinafter the Multilateral Instrument or MLI].
9. B.J. Arnold, *The Evolution of Controlled Foreign Corporation Rules and Beyond*, 73 Bull. Intl. Taxn. 12 (2019), Journal Articles & Papers IBFD.
10. D.W. Blum, *The Proposal for a Global Minimum Tax: Comeback of residence taxation in the digital era?: Comment on can GILTI + BEAT = GLOBE?*, 47 Intertax 5, p. 517 (Jan. 2019).
11. Council Directive (EU) 2016/1164 of 12 July 2016 Laying Down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, art. 7(2) OJ L193, p. 1 (2016), Primary Sources IBFD [hereinafter the EU Anti-Tax Avoidance Directive or ATAD (2016/1164)].
12. It should be noted that similar language is to be found in the GAAR in the ATAD (2016/1164), based on which "a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage... are not genuine having regard to all relevant facts and circumstances" (art. 6 ATAD 2016/1164). Arrangements are non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.
13. M. Herzfeld, *Can GILTI + BEAT = GLOBE?*, 47 Intertax 5, p. 508 (2019).
14. UK: ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Case Law IBFD.
15. *See* Blum, *supra* n. 10, in referring to M. Lang, *BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties*, 74 Tax Notes Intl. 7, p. 655 (19 May 2015).

ernizing the application of the ALP through the alignment of profit allocation with value creation. The OECD/G20 BEPS Project has been criticized as it: (i) increases complexity; (ii) fails to align value earned and functions performed by MNEs; (iii) is unsuccessful in preventing less than single taxation; (iv) does not significantly stabilize the transfer pricing system; and (v) does not promote fairness, as tax revenues are still skewed towards low-tax countries that lack substance. Consequently, one may question whether it truly helps to make the rules of the game better.[16]

2.3. Do Actions 8-10 of the OECD/G20 BEPS Project attain their goal?

2.3.1. Value creation

The first question to ask is whether value creation is a robust technical concept or merely a politically driven concept. 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.[17] It has been a useful political device under the OECD/G20 BEPS Action Plan[18] in excluding tax havens from claiming jurisdiction over a firm's profits and has served as a "negative source rule". 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. Moreover, it is skewed towards "brains" as opposed to "hands".[19] The logic of value creation inevitably assigns 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 high-income countries, i.e. they reap the credit of cooperation.[20]

2.3.2. Are more anti-avoidance rules needed?

A fundamental question is whether Actions 8-10 of the OECD/G20 BEPS Project could establish a new normative functional, i.e. DEMPE-formula-based, standard for MNEs to transfer profits to low-tax jurisdictions, provided that value is created there.[21] It reinforces the alignment of taxing rights with the place of economic activities, but the concept of value creation does not prevent profits from ending up in low-tax jurisdictions, despite the improvements made in respect of the directional purpose and the effect of existing transfer pricing approaches. There is no room for contractual arrangements without legal substance in terms of functions, assets and risks in line with the capacity of the parties to credibly oversee such risks, i.e. having the expertise and being empowered to do so. There is academic work that has proposed the incorporation of some form of anti-avoidance test into article 9 of the OECD Model or further analysis of whether the commercial rationality test could be an option for that purpose.[22] Value creation in the context of Actions 8-10 and within the framework of article 9(1) of the OECD Model implies a redefinition of source, but with legal substance. The legal source requires the economic substance of value creation to align taxation with income-generating activities. In the context of Actions 8-10, value creation serves to allocate profits, on the one hand, and counter potential tax avoidance, on the other. It was the OECD's premise that the concept of value creation would remedy the inherited flaws of the international tax regime that originated in the 1920s (and has not changed materially since then). Scholars argue that, given that this premise is wrong, the substantial renovation of the international tax rules in connection with the ALP as claimed by the OECD is likely to fail.[23] Value creation, as we now know, only serves to justify the transferring of profits in terms of DEMPE[24] functions.

2.4. CFC legislation in detail

2.4.1. In general

When dealing with allocating taxing rights over various jurisdictions, the supply side of value creation reigns. The international consensus on the allocation of taxing rights between source and residence countries forms the context for CFC rules as established by the work of the League of Nations in the 1920s.[25] The basics[26] remained stable until the launch of the OECD work on the digitalization of the economy and come down to three fundamental principles: (1) countries have the right to tax on the basis of (i) the source, i.e. the income derived, earned or arising in a country, and (ii) the residence of the taxpayer, i.e. its close personal and economic connections to a country; (2) the source country has the first right to tax; and (3) the residence country has the right to tax worldwide income but must provide relief from the international double taxation of foreign source income subject to tax in another country.

16. W.J. Seeger, *Richard Collier and Joseph Andrus: Transfer Pricing and the Arm's Length Principle After BEPS*, 54 Bus. Econ. 3, pp. 182-184 (2019), commented on by Treidler, supra n. 2, at p. 1126.
17. W. Schön, *One Answer to Why and How to Tax the Digitalized Economy*, Max Planck Institute for Tax Law and Public Finance, Working Paper 2019-10 p. 5 (June 2019).
18. OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD 2013), Primary Sources IBFD.
19. Schön, *supra* n. 17, at pp. 6-7.
20. A. Christians, *Taxing According to Value Creation*, 90 Tax Notes Intl. 13, pp. 1379-1383 (18 June 2018).
21. M.S. Screpante, *Rethinking the Arm's Length Principle and Its Impact on the IP Licence Model after OECD/G20 BEPS Actions 8-10: Nothing Changed But the Change?*, 11 World Tax J. 3., sec. 7. (2019), Journal Articles & Papers IBFD.
22. Id.
23. H.J. Ault, W. Schön & S.E. Shay, *Base Erosion and Profit Shifting: A Roadmap for Reform*, 68 Bull. Intl. Taxn. 6/7 (2014), Journal Articles & Papers IBFD.
24. For an assessment of the practical aspects of applying DEMPEs, *see* I. Verlinden, S. De Baets & V. Parmessar, *Grappling with DEMPEs in the Trenches: Trying to Give It the Meaning It Deserves*, 47 Intertax 12, pp. 1042-1056 (2019).
25. League of Nations, *Double Taxation and Tax Evasion, Report presented by the Committee of Technical Experts on Double Taxation and Tax Evasion*, C.216.M.85, April 1927, II, p. 32.
26. For a more detailed overview, *see* Arnold, *supra* n. 9, at sec. 2.

Four subsidiary principles supplement those three fundamental ones: (1) source countries are entitled to tax certain passive investment income, generally dividends and interest; (2) source countries should tax most business profits earned by a non-resident if the latter has a substantial economic involvement there, i.e. a permanent establishment (PE); (3) source countries should not discriminate against non-residents carrying on business in their countries, against resident corporations owned or controlled by non-residents or against resident corporations making deductible payments to non-residents; and (4) residence countries should treat foreign subsidiaries of resident corporations as separate taxable entities. This principle has been steadily eroded since the United States adopted its Subpart F rules in 1962.[27] One can understand why the topic is of concern to so many countries. An MNE should be able to use CFCs to engage in legitimate offshore business activities. CFC rules are intended to protect a country's domestic tax base by eliminating any benefit from the diversion of tainted income to CFCs. The fundamental purpose of CFC rules reflects the tension and balance between CEN, under which a resident of a country should be subject to the same tax on foreign-source income as on a domestic source income, and CIN, under which a resident of a country should be subject to the same tax on business income earned in another country as other taxpayers carrying on business in that country. Under CEN, a country would apply its CFC rules to all CFC income, whereas under CIN, a country would not apply CFC rules at all, as it would not tax any foreign-source income, i.e. it would adhere to a territorial system.[28]

2.4.2. Relevance from a transfer pricing perspective

An important consideration when designing the scope of CFC rules is that their use can serve as a backstop to transfer pricing rules.[29] There are obviously fundamental differences between the two sets of rules. Transfer pricing focuses on transactions between entities defined by a form of economic solidarity, whereas CFC rules focus on CFC income irrespective of whether the income is generated in a context of dependence. CFC rules envisage a carve-out for income genuinely derived from business activities, whereas transfer pricing rules can still apply in such circumstances: for example, when prices are proven excessive. Transfer pricing adjustments are keyed to open market, i.e. separate entity, benchmarks, which is conceptually unconnected to the constitutive norm for base determination. In this respect, Kane (2013) refers to CFC and transfer pricing rules as a "particular pair of bedfellows", adding that CFC rules operating as a backstop to transfer pricing rules is an instance of redundancy. Using CFC rules to address pricing "irregularities" would overshoot the mark, as the inclusion of an amount is not keyed to the non-arm's-length amount of profit.[30] It should also be noted that transfer pricing rules do not eliminate tax avoidance resulting from passive income accumulation in a CFC generated by an asset transfer at arm's length to a CFC.[31]

2.4.3. The ATAD (2016/1164) and Action 3 of the OECD/G20 BEPS Project

CFC rules do support transfer pricing rules if the controlling entity's tax base is eroded. Under article 7(2) of the ATAD (2016/1164), a taxpayer should increase its tax base by the non-distributed income of the CFC arising from non-genuine arrangements put in place to obtain a tax advantage. The non-genuine character entails that the CFC would not own the assets or assume the risks giving rise to all, or part, of its income if it were not controlled by a company where the significant people functions that are relevant to those assets and risks are carried out and are instrumental in generating the controlled company's income.[32]

The work on Action 3 of the OECD/G20 BEPS Project provides for a minimum standard of CFC rules. For the OECD, the primary objective of CFC rules is not to complement transfer pricing rules. In themselves, transfer pricing rules do not eliminate the need for CFC rules. Rather, the latter aim to tax income that is easily "portable" to low-tax jurisdictions, irrespective of whether the income results from transacting with related parties or whether it is obtained by honouring the ALP.

It is particularly interesting to bring the notion of value creation into the equation and, more concretely, the alignment of primary taxing rights therewith. An example could be a "cash-box company", which is equity funded and has little or no DEMPE functionality. Under a mainstream investor analysis, as is well known in financial economics, a "rich company" can outsource brainpower to a third party while still obtaining the bulk of the profits of that brainpower because the reward for risk (preference) can be very large. However, between related parties, such a result would be impossible to realize, as under Actions 8-10 of the OECD/G20 BEPS Project only a risk-free rate of return can be allocated at arm's length to the cash-box entity. Majdowski and Bronzewska (2018) conclude that according to the OECD, CFC rules should target income that was obtained at arm's length but assigned to an entity in a low-tax jurisdiction, i.e. equal de facto to the surplus of income over what would have been established between unrelated parties but limited to the risk-free income – thus the minimal income that was obtained contrary to the properly implemented TP regulations.[33] The draft of OECD BEPS Action 3 considered whether theoretically CFC regulations could significantly replace TP reg-

27. Id.
28. Id., at sec. 3.1.
29. Id.
30. M.A. Kane, *Milking Versus Parking: Transfer Pricing and CFC Rules Under the Internal Revenue Code*, 66 Tax L. Rev. 4, p. 487 et seq. (2013) (comment drafted in connection with the international taxation panel of the NYU-UCLA symposium celebrating the 100th anniversary of US: Internal Revenue Code (IRC), available at https://www.law.nyu.edu/sites/default/files/ECM_PRO_073859.pdf.
31. F. Majdowski & K. Bronzewska, *Revolutionary Changes to the Arm's Length Principle under the OECD BEPS Project: Have CFC Rules Become Redundant?*, 46 Intertax 3, p. 212 (2018).
32. Id., at p. 216.
33. Id., referring to Y. Brauner, *Transfer Pricing in BEPS: First Round – Business Interests Win (But, Not in Knock-Out)*, 43 Intertax 1, p. 74 (2015).

ulations, concluding that this could be achieved under a full-inclusion mechanism, meaning that the entire CFC income would be assigned to the controlling entity without taking out income from a genuine business activity. Related parties would lose any desire to engage in tax arbitrage, as any tax benefits would be removed by the taxation of the income in the hands of the controlling entity.

2.5. PPT under the MLI as deus ex machina?

This contribution is limited to commenting on whether Actions 8-10 of the OECD/G20 BEPS Project have attained their objective when dealing with transfer pricing. When touching on value creation, there are reasons to be somewhat sceptical. What does DEMPE exactly mean? How easy is it to exclude any bias, at all? One of the most colourful comments at the 2017 IFA Congress in Rio de Janeiro was made by Vann: when discussing the future of transfer pricing, he referred to the "DEMPE dumps". This article does not deal with this issue specifically, but in an era of very fast digital transformation, exhibiting human-like intelligence is no longer the sole preserve of humans. Technically, the personification of equipment is not plausible,[34] despite the fact that capital-intensive equipment becomes "intelligent" via a trial and error approach, i.e. by using algorithms rather than deploying entrepreneurial and emotional skills. The DEMPE concept risks becoming hopelessly outdated before even being properly tested in the courts, and value creation is therefore rooted in an unsustainable set of principles. One could only fear that this opens the door to allegations involving a taxpayer's principal purpose when engaging in intercompany transactions.

2.6. Interim conclusions

Transfer pricing legislation morphed from an anti-avoidance mechanism almost a century ago into its current form as a way of allocating a "fair" share of profits. The ALP is at the centre of this issue, in the sense that MNEs applying the ALP cannot be absolved from allegations of illegitimate behaviour. By advancing value creation as the prevalent paradigm, Actions 8-10 of the OECD/G20 BEPS Project were intended to better align taxation with the economic activities generating the profits. For pessimists, value creation is an unspecific concept of economic substance that is used as a proxy. A DEMPE analysis may or may not be sufficiently convincing to substantiate that a party can derive value from those people skilled and empowered to oversee credibly entrepreneurial risk in the "right" location(s). Consequently, not only the legitimacy, but also the legality of a contractual arrangement may be challenged more easily by tax authorities. There is a clear risk that the "viral" spread of GAARs proves hard to stop and proliferates further, such that tax authorities are tempted to choose between the transfer pricing route and the GAAR route in a tax audit as they see fit. There should be no such optionality without robust technical foundation. Rapid technological transformations, such as human-like intelligence no longer being the preserve of physical persons, place increasing pressure on the DEMPE concepts. One can only hope that what will prevail in practice are transfer pricing rules that adhere to a thorough comparability analysis. This situation would mean starting with a profound consideration of the value chain from a business perspective. Transfer pricing is not an exact science. In other words, "It is better to be roughly right than precisely wrong"...[35]

3. Article 9 of the OECD Model, the Saving Clause and Unchained Legislature

3.1. In general

One of the clear missions of the OECD is to establish and defend the ALP for international profit allocation between associated enterprises. Starting with the OECD Report on Transfer Pricing and Multinational Enterprises[36] through the Transfer Pricing Guidelines (1996)[37] and the Final Report on Actions 8-10 of the OECD/G20 BEPS Project[38] to the more than 600 pages of the Transfer Pricing Guidelines (2017),[39] it has developed and refined its approach to the ALP, in respect of which article 9 of the OECD Model is the "authoritative statement".[40] From a policy perspective, the OECD has also been active in providing input on domestic transfer pricing developments[41] and recently put great effort into trying to align Brazilian law with the OECD's arm's length standard (ALS).[42] Indeed, to "ensure that double taxation resulting from the application of transfer pricing rules is relieved", the OECD thinks that it is:

> desirable for countries and jurisdictions to develop a network of bilateral tax treaties containing Article 9 to align their domestic transfer pricing legislation with the relevant internationally agreed principles.[43]

However, despite these intensive policy efforts on the part of the OECD, it is not entirely clear what article 9 of the OECD Model "does" from a legal perspective, if it places legal restrictions on how contracting states may allocate profits between associated enterprises, and if states can

34. Although also addressed at the 2001 IFA Congress in San Francisco under the heading Taxation of Income Derived from Electronic Commerce.

35. *See* Schoueri, *supra* n. 3.
36. OECD, *Report of the OECD Committee on Fiscal Affairs on Transfer Pricing and Multinational Enterprises* (OECD 1979), Primary Sources IBFD.
37. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 1996), Primary Sources IBFD.
38. The OECD has noted that "the goals set by the BEPS Action Plan in relation to the development of transfer pricing rules have been achieved without the need to develop special measures outside the arm's length principle". (*See* OECD, *Actions 8-10 Final Report 2015 – Aligning Transfer Pricing Outcomes with Value Creation* p. 12 (OECD 2015), Primary Sources IBFD.
39. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2017), Primary Sources IBFD [hereinafter Transfer Pricing Guidelines (2017)].
40. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 9*, para. 1 (21 Nov. 2017), Treaties & Models IBFD.
41. *See*, for example, OECD, *Task Force Report on Intercompany Transfer Pricing Regulations under US Section 482 Temporary and Proposed Regulations* (OECD 1993), Primary Sources IBFD.
42. OECD/Receita Federal do Brasil (RFB), *Transfer Pricing in Brazil: Towards Convergence with the OECD Standard* (OECD/RFB 2019) [hereinafter Transfer Pricing in Brazil].
43. Id., at para. 83.

escape such limitations by including a saving clause, i.e. article 1(3) of the OECD Model and article 11 of the MLI, in the tax treaties that they conclude.

3.2. Article 9 of the OECD Model: "permissive" or "restrictive" or both?

Article 9(1) of the OECD Model is not a classic distributive rule; rather, it deals with the quantification of business profits in transactions between associated enterprises, i.e. two separate but related taxpayers each resident in a different contracting state. Therefore, it resembles what article 7(2) regulates for the different components of a single cross-border enterprise. However, the purpose and effect of article 9(1) of the OECD Model is surprisingly unclear, as contracting states would be "free to operate their domestic legislation to increase the tax on their domestic companies even if Article 9 OECD were entirely omitted"[44], as long as the non-discrimination provisions of article 24 are observed.[45]

Article 9(1) of the OECD Model is generally not a legal basis for upward adjustments independent of domestic law,[46] nor does it give rise to a treaty obligation for a contracting state to make a primary transfer pricing adjustment, even if the conditions of article 9 are fulfilled.[47] Both are expressed by the wording of that article ("may"). Moreover, ascribing an anti-tax avoidance purpose to article 9 of the OECD Model,[48] i.e. an objective that is frequently attributed to domestic transfer pricing rules,[49] is unnecessary,[50] as, in any event, contracting states would be free to quantify business profits under domestic law, even in the complete absence of article 9.[51] Furthermore, in order to give legal meaning to article 9(1) of the OECD Model, it could be argued that it serves as a "door opener" for corresponding adjustments under article 9(2). While this is certainly true, "to argue that paragraph 2 does the real 'work' of article 9 and that paragraph 1 is merely prefatory" does not hold historically, as the former provision was included in the OECD Draft (1963),[52] whereas the latter was only introduced in the OECD Model (1977).[53] Finally, article 9(1) of the OECD Model clearly serves as a benchmark – together with articles 11(6) and 12(4) – in determining whether domestic rules restricting deductions for payments to persons resident in the other contracting state conform with the prohibition of discrimination in article 24(4) ("Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 4 of Article 12, apply...")[54] and, possibly, article 24(5).[55] However, it appears to be quite a stretch to conclude that the normative value of article 9(1) of the OECD Model is exhausted by that relationship,[56] especially, as, from a historical perspective, the OECD Draft (1963) already contained article 9(1), but not what is now article 24(4) of the OECD Model (2017).

What, then, does article 9 of the OECD Model really do? This debate is generally summarized as asking whether article 9(1) of the OECD Model "is held to be 'restrictive' or merely 'illustrative' in its scope".[57] The minority view is that article 9(1) of the OECD Model, while permitting the adjustment of profits up to the arm's length amount, does

44. *See* para. 7 FC/WP 7 on "Apportionment of Profits", FC/WP7(70)1 (2 June 1970), and para. 57 4th Report of Working Group No. 7, CFA/WP1(72)4 (21 Feb. 1972). *See also*, for example, the decision of the German *Bundesfinanzhof* (Federal Tax Court, BFH) in DE: BFH, 9 Nov. 2005, BFH I R 27/03, Case Law IBFD and J. Wittendorff, *Transfer Pricing and the Arm's Length Principle in International Tax Law* p. 147 (Wolters Kluwer 2010).
45. J. Wittendorff, *The Transactional Ghost of Article 9(1) of the OECD Model*, 63 Bull. Intl. Taxn. 3, sec. 5.1. (2009), Journal Articles & Papers IBFD and *supra* n. 44.
46. *See*, for example, DE: BFH, 12 Mar. 1980, I R 186/76; DE: BFH, 21 Jan. 1981, BFH I R 153/77, Case Law IBFD; the decision of the French *Conseil d'État* (Supreme Administrative Court, CE) in FR: CE, 14 Mar. 1984, Decisions No. 34,430-36,880, *Eyquem S.A.*, 36 *Droit Fiscal* 45-46 (1984), p. 1352, Case Law IBFD and 25 *Eur. Taxn.* p. 143 (1985), IBFD; DE: BFH, 11 Oct. 2012, I R 75/11, Case Law IBFD; DE: BFH, 17 Dec. 2014, I R 23/13; DE: BFH, 24 June 2015, I R 29/14; and the decision of the Federal Court of Australia (FCA) in AU: FCA, 23 Oct. 2015, *Chevron Australia Holdings Pty Ltd v. Commissioner of Taxation*, (2015) FCA 1092, paras. 51-62, Case Law IBFD. *See also*, for example, J. Wittendorff, *supra* n. 44, at pp. 190-193 and A. Bullen, *Arm's Length Transaction Structures – Recognizing and Restructuring Controlled Transactions in Transfer Pricing* sec. 3.1.2.3., p. 70 (IBFD 2011), Books IBFD, each with further references.
47. *See* Wittendorff, *supra* n. 45, at sec. 5.1. and *supra* n. 44, at p. 196; and Bullen, *supra* n. 46, at secs. 3.1.2.3. and 15.5.2., pp. 71 and 358.
48. *See*, for example, L. Pogorelova, *Transfer Pricing and Anti-abuse Rules*, 37 Intertax 12, p. 685 (2009). *See also* L. De Broe, *International Tax Planning and Prevention of Abuse* sec. 2.1.1., p. 77 (IBFD 2008), Books IBFD. Contra, *see*, for example, Wittendorff, *supra* n. 44, at pp. 147-148.
49. For instance, courts in the United States have held that IRC sec. 482 was designed to prevent tax avoidance or income distortion by shifting profits from one business to another (*see* the decision of the US Court of Appeals (CAFC) in US: CAFC, Fourth Circuit, 31 Jan. 1967, *Charles Town, Inc. v. Commissioner of Inland Revenue*, 372 F.2d 415), to prevent artificial income shifting between controlled taxpayers (US: CAFC, Fifth Circuit, 23 July 1979, *Robert M.Brittingham v. Commissioner of Inland Revenue*, 598 F.2d 1375, Case Law IBFD) and to prevent evasion by improper financial account manipulation, arbitrary profit shifting, and to reflect true tax liability. (*See* the decision of the US Court of Claims (USCFC) in US: USCFC, 17 Oct. 1979, *E.I. Du Pont de Nemours & Co. v. US*, 221 Ct. Cl. 333, 608 F.2d 445.).
50. *See* OECD, *Transfer Pricing Guidelines* (2017), *supra* n. 39, at para. 1.2. and Wittendorff, *supra* n. 44.
51. It should also be noted that the application of art. 9(1) *OECD Model* (2017) is not conditioned on an enterprise's wilful attempt to adopt a policy of tax avoidance, and that, conversely, the presence of a tax motive or purpose does not, in itself, warrant a conclusion that a transaction is not at arm's length (*see also* OECD, *Transfer Pricing Guidelines* (2017), *supra* n. 39, at para. 9.38).
52. *OECD Draft Tax Convention on Income and on Capital* (30 July 1963), Treaties & Models IBFD.
53. *OECD Model Tax Convention on Income and on Capital* (11 Apr. 1977), Treaties & Models IBFD. *See also* B.D. Lepard, *Is the United States Obligated to Drive on the Right? A Multidisciplinary Inquiry into the Normative Authority of Contemporary International Law Using the Arm's Length Standard as a Case Study*, 10 Duke J. Comp. & Intl. L. p. 133 (1999).
54. *See* para. 74 *OECD Model: Commentary on Article 24* (2017) and OECD, *Thin Capitalisation Report (adopted by the OECD Council on 26 November 1986)* para. 66 (OECD 1987), Primary Sources IBFD [hereinafter Thin Capitalisation Report (1987)], published in OECD, Thin Capitalisation: Taxation of Entertainers, Artistes and Sportsmen, Issues in International Taxation No. 2 (OECD 1987). *See also* Wittendorff, *supra* n. 44, at p. 148.
55. Even though art. 24(5) *OECD Model* (2017) does not contain similar opening language to art. 24(4), the OECD supposes that, in any event, "adjustments which are compatible with these provisions could not be considered to violate the provisions of paragraph 5." (*See* para. 79 *OECD Model: Commentary on Article 24* (2017).). For further discussion, *see* G. Kofler & J. Wittendorff, in *Klaus Vogel on Double Taxation Conventions*, art. 9 m.nos. 44-45 (E. Reimer & A. Rust eds., Kluwer 2015).
56. For the discussion of a different perspective, *see* P.A. Harris, *Article 10: Dividends* sec. 2.1.2.3.1., fn. 133 Global Tax Treaty Commentaries, Global Topics IBFD.
57. *See* paragraph 50 of OECD, *Thin Capitalisation Report* (1987), *supra* n. 54.

not prohibit the taxation of a higher amount in appropriate circumstances or the use of a different allocation standard.[58] The majority view, held by many in modern case law[59] and legal scholarship,[60] as well as numerous tax administrations,[61] considers that a treaty provision similar to article 9(1) of the OECD Model requires the contracting states to use its specific allocation norm, and, therefore, prohibits an adjustment of the profits to any amount exceeding the arm's length profit. We share the latter view for a number of reasons.

First, when considering the treaty rules corresponding to article 9 of the OECD Model, it should be noted that tax treaties generally restrict, rather than generate, domestic taxing rights. Nevertheless, it is sometimes argued that the wording of article 9 of the OECD Model *may* indicate that it is merely permissive[62] and, therefore, not much more than a programmatic statement. That, however, might only be half of the argument. Many treaty provisions are permissive and restrictive at the same time. Take, for example, article 7 of the OECD Model, which:

> provides that in certain circumstances the Contracting State may tax the business profits (which is permissive), but only so much of the business profits as is attributable to the permanent establishment (which involves a prohibition or limitation).[63]

As with article 7 of the OECD Model, which establishes the scope within which a contracting state's legislature may impose tax on a foreign enterprise, article 9 determines the amount taxable between associated enterprises, i.e. it "authorises the application of domestic rules", but only "in the circumstances defined by that Article".[64] Accordingly, "may" must be read as "may only", and not as "shall".[65] This interpretation also avoids depriving article 9 of the OECD Model and its definition of scope and legal consequences of any normative value. A mere "illustrative" or "permissive" understanding would make article 9(1) of the OECD Model largely superfluous.[66] This situation is also why, in the authors' view, little can be derived from the "fundamental principle that a tax treaty does not restrict a country's right to tax its own residents unless it does so

58. L.M. Kauder, *The Unspecific Federal Tax Policy of Arm's Length: A Comment on the Continuing Vitality of Formulary Apportionment at the Federal Level*, 60 Tax Notes, p. 1149 (23 Aug. 1993); J. Sasseville, *A Tax Treaty Perspective: Special Issues*, in *Tax Treaties and Domestic Law* sec. 3.5., p. 53 (G. Maisto ed., IBFD 2006), Books IBFD; and B.J. Arnold, *The Relationship Between Restrictions on the Deduction of Interest Under Canadian Law and Canadian Tax Treaties*, 67 Can. Tax J. 4, pp. 1071-1074 (2019), acknowledging, however, "the overwhelming weight of case law and scholarly authority to the contrary".

59. *See*, for example, BR: Brazilian Administrative Taxpayers' Council, No. 103-21.859/2005, as discussed by I. Calich & J.D. Rolim, *Tax Treaty Disputes in Brazil*, in *A Global Analysis of Tax Treaty Disputes* pp. 876-877 (E. Baistrocchi ed., Cambridge University Press 2017); I R 75/11 (2012), *supra* n. 46; I R 23/13 (2014), *supra* n. 46; DE: BHF, 24 Mar. 2015, I B 103/13; and I R 29/14 (2015), *supra* n. 46. Implicitly, *see also*, for example, the decision of the US Supreme Court (USSC) in US: USSC, 27 June 1983, *Container Corporation of America v. Franchise Tax Board of California*, 463 U.S. 159, Case Law IBFD, in noting that US tax treaties "require" the US Federal Government to adopt some form of "arm's length analysis". It should be noted that the BHF, while upholding the restrictive effect of art. 9(1) *OECD Model* (2017), in principle, has recently held that adjustments, such as the neutralization of a tax-effective write-off of a receivable, are not barred by art. 9. (*See* DE: BHF, 27 Feb. 2019, I R 51/17, I R 73/16, and I R 81/17, explicitly overruling, for example, I R 29/14 (2015), *supra* n. 46 and I R 23/13 (2014), *supra* n. 46, where it held that only pricing adjustments are not barred by that article; for analysis of this change in German case law *see* S. Rasch, in *DBA-Kommentar* (*Treaty Commentary*) art. 9 m.no. 34-38/5 (D. Gosch et al. eds., NWB 2019).

60. *See*, for example, G. Maisto, *General Report*, in *Transfer Pricing in the Absence of Comparable Market Prices*, International Fiscal Association (IFA), Cahiers de Droit Fiscal International vol. 77a, ch. IV, sec. 1. (Kluwer 1992); M. Lang, *Unterkapitalisierung* (Thin capitalization), in *Aktuelle Entwicklungen im Internationalen Steuerrecht* pp. 131-133 (W. Gassner, M. Lang & E. Lechner eds., Linde 1994); C. Thomas, *Customary International Law and State Taxation of Corporate Income: The Case for the Separate Accounting Method*, 14 Berkeley J. Intl. L., pp. 130-131 (1996); F.M. Horner, *International Cooperation and Understanding: What's New About the OECD's Transfer Pricing Guidelines*, 13 Tax Notes Intl. 13, pp. 1065-1075 (1996) and 50 U. Miami L. Rev. 3, pp. 578-579 (1996); K. Vogel, *Klaus Vogel on Double Taxation Conventions* 3rd edn. art. 9 m.no. 16-17 (Kluwer Law International 1997); G.M.M. Michielse, *Treaty Aspects of Thin Capitalization*, 51 Bull. Intl. Fiscal Docn. 12, pp. 568-569 (1997), IBFD; J.A. Nitikman, *The Interaction of Canada's Thin Capitalization Rule and the Canada-United States Tax Treaty*, 26 *Intl. Tax J.* 1, pp. 43-44 (2000); F.C. de Hosson, *Codification of the Arm's Length Principle in the Netherlands Corporate Income Tax Act*, 30 *Intertax* 5, pp. 192-193 (2002); D. Gosch, *Wechselbezügliches zwischen internationalen und nationalen Gewinnkorrekturvorschriften*, in *Gestaltung und Abwehr im Steuerrecht, Festschrift für Klaus Korn* p. 396 (D. Carlé et al. eds., Stollfuß 2005); De Broe, *supra* n. 48, at p. 513; Wittendorff, *supra* n. 44, at pp. 195-199; Bullen, *supra* n. 46, at sec. 3.2, pp. 68-72; A. Fross, *Earnings Stripping and Thin Cap Rules: Maintaining an Arm's Length Distance*, 53 Eur. Taxn. 10, sec. 3.4. (2013), Journal Articles & Papers IBFD; A. Eigelshoven. in *DBA* (*Tax Treaties*) 6th edn., art. 9 m.no. 18-20 (K. Vogel & M. Lehner eds., C.H. Beck 2015); J. Becker, *The Relation of Article 9 Paragraph 1 German Double Taxation Treaties to Domestic Tax Law and the Consequences for Current Value Depreciation under Section 1 Paragraph 1: Foreign Tax Act*, 43 Intertax 10, pp. 590-591 (2015); Schoueri, *supra* n. 3; M. Weiss, *The Impact of Article 9 of the OECD Model on German Taxation*, 56 Eur. Taxn. 2/3 (2016), Journal Articles & Papers IBFD; O.C.R. Marres, *Interest Deduction Limitations: When to Apply Articles 9 and 24(4) of the OECD Model*, 56 Eur. Taxn. 1, sec. 2. (2016), Journal Articles & Papers IBFD, also ch. 3, in *Non-Discrimination in Tax Treaties: Selected Issues from a Global Perspective* sec. 3.2.2.1., pp. 40-41 (D. Weber & P. Pistone eds., IBFD 2016), Books IBFD); G. Kofler, Die 'Sperrwirkung' des Art 9 OECD-MA, 1 Transfer Pricing Intl. 2, pp. 70-77 (2017); H. Schaumburg & N. Häck, in *Internationales Steuerrecht* (International Taxation) 4th edn., m.no. 19.292-19.295 (H. Schaumburg ed., Otto Schmidt 2017); Kofler & Wittendorff, *supra* n. 55, at art. 9 m.no. 8-16; Rasch, *supra* n. 59, at art. 9 m.no. 32-48; J. Englisch & J. Becker, *International Effective Minimum Taxation – The GLOBE Proposal*, 11 World Tax J. 4, sec. 5.2.2. (2019), Journal Articles & Papers IBFD; and E. Baistrocchi, *Article 9: Associated Enterprises*, sec. 6.2.5.1., Global Tax Treaty Commentaries, Global Topics IBFD. For an intermediate approach, according to which art. 9(1) *OECD Model* (2017) contains a "persuasive obligation, rather than a binding obligation or mere authoritative permission, to use not only an arm's length standard but also a transaction-based arm's length method", *see* Lepard, *supra* n. 53, at pp. 128-147.

61. *See*, for example, AU: Australian Taxation Ruling 94/14 of 31 May 1994, paras. 18 and 184-186 ("treaty provisions will prevail"); AT: Austrian Transfer Pricing Guidelines of 28 October 2010, BMF-010221/2522-IV/4/2010, para. 6 ("*Sperrwirkung*", i.e. "barrier effect"); and DE: German Administrative Principles – Business Restructurings of 13 October 2010, BMF IV B 5 – S 1341/08/10003 para. 1.2.3. (English translation published in U. Andresen, *Principles for the Audit of the Allocation of Income between Related Persons in Cases of Cross-Border Transfers of Business Functions (Administration Principles – Business Restructurings): Federal Ministry of Finance*, 18 Intl. Transfer Pricing J. 1 (2011), Journal Articles & Papers IBFD ("*begrenzen*", i.e. "restrict").

62. *See* J. Sasseville, *supra* n. 58, at sec. 3.5., p. 53, who argues that the word "may" in art. 9(1) *OECD Model* (1977) implies that the provision is merely permissive.

63. AU: FCA, 19 Apr. 2007, *GE Capital Finance Pty Ltd. v. Commissioner of Taxation*, (2007) FCA 558, para. 36, Case Law IBFD.

64. Para. 72 *OECD Model: Commentary on Article* 1 (2017).

65. It may be noted in passing that the use of the term "shall", as was the case, for example, in the *London Model* (1946), would imply an obligation for contracting states to exercise the authority under art. 9(1) *OECD Model* (2017). *See also* Bullen, *supra* n. 46, at sec. 3.1.2.3., p. 71.

66. Kofler & Wittendorff, *supra* n. 55, at art. 9 m.no. 12 et seq. with further references.

explicitly",[67] as a sound interpretation of article 9(1) of the OECD Model results in exactly such an explicit restriction – unless, of course, a tax treaty contains a saving clause (*see* section 3.3.).

Second, the Commentary on Article 9 of the OECD Model appears to support the majority view of a restrictive scope by noting that:

> [n]o re-writing of the accounts of associated enterprises is authorised if the transactions between such enterprises have taken place on normal open market commercial terms (on an arm's length basis).[68]

Moreover, and specifically with regard to thin capitalization rules, the OECD Commentary on Article 9 takes the position that the application of such rules "should normally not have the effect of increasing the taxable profits of the relevant domestic enterprise to more than the arm's length profit",[69] and that article 9(1) of the OECD Model:

> does not prevent the application of national rules on thin capitalization insofar (but only insofar) as their effect is to assimilate the profits of the borrower to an amount corresponding to the profits that would have accrued in an arm's length situation.[70]

Furthermore, numerous statements throughout the OECD Commentary on Article 9,[71] the OECD Transfer Pricing Guidelines[72] and other OECD reports[73] and documents[74] indicate a restrictive rather than a merely permissive understanding. Nevertheless, it should be noted that the historical OECD material is not unequivocal:[75] for instance, a 1970 Report by a two-country working group viewed article 9 of the OECD Model as "merely permissive" and concluded "the Article serves a useful purpose as a statement of what the Contracting Parties to a Double Taxation Convention have in mind".[76] The OECD Commentary on Article 9 (2017) also indicates a certain lack of consensus between the OECD member countries on the allocation norm.[77]

Third, under a merely permissive reading, the purpose of article 9 of the OECD Model to eliminate economic double taxation would be undermined, as article 9(2) requires a corresponding adjustment only if the other state "considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm's length".[78] Consequently, if article 9(1) of the OECD Model does not restrict a contracting state only to arm's length adjustments, the unpalatable result would be that the appropriate tax base in each jurisdiction would not be secured and that economic double taxation could persist systematically within the framework of article 9.[79]

Fourth, the only way to assure that business profits are only taxed in the contracting state in which the profits originate economically is by requiring both contracting states to use firm adjustment criteria such as those set out in article 9(1) of the OECD Model.[80] Both article 7 (with regard to a PE) and article 9 (in respect of an associated enterprise) of the OECD Model contain rules on the determination of attributable profits based on the ALP. These articles, together with their historical development,[81] the

67. Arnold, *supra* n. 58, p. 1073. However, one should also note that this appears to be a rather newly discovered and expressed general principle in the *OECD Model: Commentaries* (*see* para. 8 *OECD Model: Commentary on Article 1* (2017)) that is also reflected in the saving clause of art. 1(3)*OECD Model* (2017), as it was previously only mentioned with regard to the taxation of resident partners of a foreign hybrid entity (*see also OECD Model Tax Convention on Income and on Capital: Commentary on Article 1*, para. 6.1. (26 July 2014), Treaties & Models IBFD). Accordingly, it is doubtful, how general that principle really is or was if a tax treaty does or did not contain a saving clause.
68. *OECD Model: Commentary on Article 9* para. 2 (2017).
69. *See OECD Model: Commentary on Article 9* para. 3(c) (2017); and OECD, *Thin Capitalisation Report* (1987), *supra* n. 54, at para. 50.
70. *See* para. 3(a) *OECD Model: Commentary on Article 9* (2017) and OECD, *Thin Capitalisation Report* (1987), *supra* n. 54, at para. 84(c).
71. *See*, for example, para. 72 *OECD Model: Commentary on Article 1* (2017) ("Article 9 specifically authorises the application of domestic rules in the circumstances defined by that Article") and paras. 74 and 79, *OECD Model: Commentary on Article 24* (2017) ("compatible").
72. *See* OECD, *Transfer Pricing Guidelines* (2017), *supra* n. 39, at para. 1.7 ("authorised").
73. *See*, for example, OECD, *Thin Capitalisation Report* (1987), *supra* n. 54, at paras. 29-30, 50 and 84.
74. *See*, for example, OECD/G20 Inclusive Framework on BEPS, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy* p. 19 (OECD 2019) (pointing at exploring "[t]he necessity to change any other treaty provision, such as Article 9, to allow market jurisdictions to exercise taxing rights over the measure of profits allocated to them under the new nexus and profit allocation rules") and OECD/RFB, *Transfer Pricing in Brazil*, *supra* n. 42, at para. 82 ("When countries or jurisdictions sign bilateral tax treaties containing Article 9 of the OECD MTC (or an equivalent article), that article will usually be interpreted in accordance with the OECD Guidelines, setting the boundaries for the application of the transfer pricing rules in the domestic legislation of the contracting states in relation to transactions that are covered by the provisions of Article 9.").
75. For a detailed analysis, *see* Lepard, *supra* n. 53, at pp. 128-147.
76. *See* para. 7 FC/WP 7 on "Apportionment of Profits", FC/WP7(70)1 (2 June 1970) and para. 57 4th Report of Working Group No. 7, CFA/WP1(72)4 (21 Feb. 1972) (reminding "Members that during its earlier discussions it was generally agreed that Article 9 as it stands is purely permissive" and that "Contracting States are equally free to operate their own domestic rules increasing the tax on, or otherwise penalising, their own companies. The Working Group therefore agrees with the Belgian delegation that Article 9 as it is drafted at present merely confirms the rights which States may have to make upward adjustments.").
77. *See* para. 4 *OECD Model: Commentary on Article 9* (2017): "A number of countries interpret the Article in such a way that it by no means bars the adjustment of profits under national law under conditions that differ from those of the Article and that it has the function of raising the arm's length principle at treaty level". *See also* OECD, *Report on Double Taxation Conventions and the Use of Base Companies* (adopted by the Council of the OECD on 27 November 1986) para. 30 (OECD 1986) and, on the nature of this disagreement specifically, OECD, *Thin Capitalisation Report* (1987), *supra* n. 54, at paras. 29-30 and 50. *See also* Wittendorff, *supra* n. 44, at p. 194.
78. *See* para. 6 *OECD Model: Commentary on Article 9* (2017). This portion of the *OECD Model* (2017) is sometimes taken as an argument that art. 9(1) is not restrictive at all (*see* Arnold, *supra* n. 58, at p. 1072), but a more intuitive reading appears to be that reasonable states can disagree on what an arm's length price is.
79. *See*, for example, Michielse, *supra* n. 60, at p. 569 (1997), IBFD; and Bullen, *supra* n. 46, p. 70. In this direction, *see also* OECD, *Thin Capitalisation Report* (1987), *supra* n. 54, at para. 50.
80. For instance, Schaumburg & Häck, *supra* n. 60, at m.no. 19.292-19.295. *See also* P. Baker, *Double Taxation Conventions* 3rd edn., art. 9 m.no. 9B.14 (Sweet & Maxwell 1997), in noting that the true scope of art. 9(1) *OECD Model* (2017) may be that "it limits the treaty protection provided by Articles 7 and 8 to those profits which an enterprise would derive if no special conditions existed with regard to associated enterprises. Article 9(1) does not, therefore, of itself provide any authorization for the adjustment of profits between associated enterprises, nor does it restrict domestic legislation, except in so far as the application of that domestic legislation conflicts with Articles 7 and 8 (as applied together with Article 9)".
81. *See also*, for example, Wittendorff, *supra* n. 44, at p. 197.

commentaries on articles 7 and 9 of the OECD Model[82] and the subsequent introduction of article 9(2) of the OECD Model (1977), confirm that the legal effect of articles 7(2) and 9(1) must be the same.[83] The function of article 9(1) of the OECD Model, therefore, is to limit adjustments to the level of profits that would have accrued under conditions between independent enterprises. Accordingly, the allocation norm in the OECD Model is the separate entity approach with the ALP in respect of transactions between associated enterprises.[84] Consequently, profit adjustments to any amount exceeding an arm's length profit are prohibited by article 9 of the OECD Model.

Fifth, the mutual agreement procedure (MAP) under article 25 of the OECD Model:

> provides machinery to enable competent authorities to consult with each other with a view to resolving, in the context of transfer pricing problems, not only problems of juridical double taxation but also those of economic double taxation, and especially those resulting from the inclusion of profits of associated enterprises under paragraph 1 of Article 9.[85]

The Commentary on Article 25 of the OECD Model states that:

> the taxation in the State of the payer – in case of a special relationship between the payer and the beneficial owner – of the excess part of interest and royalties, under the provisions of Article 9, paragraph 6 of Article 11 or paragraph 4 of Article 12,

are among the most common cases.[86] However, article 25 of the OECD Model requires that "taxation [is] not in accordance with the provisions of this Convention". If, however, article 9(1) of the OECD Model had no restrictive force, how could a primary adjustment beyond arm's length ever "not [be] in accordance" with the tax treaty? The OECD's position on that very practical issue is rather vague, and the OECD Commentary on Article 25 – in discussing situations where a tax treaty does not contain article 9(2) of the OECD Model[87] – notes that:

> most member countries consider that economic double taxation resulting from adjustments made to profits by reason of transfer pricing is not in accordance with – at least – the spirit of the convention and falls within the scope of the mutual agreement procedure set up under Article 25.[88]

Sixth, and finally, a potential argument by implication made for a merely permissive reading of article 9(1) of the OECD Model is likewise not convincing. It is sometimes argued that a restrictive understanding would make CFC rules or interest barrier rules inapplicable, and that states would never have agreed to such consequences. As for CFC rules – for example, those based on Action 3 of the OECD/G20 BEPS Project – it appears to be clear that, just as with article 7 of the OECD Model, income inclusion under such provisions is not a quantification exercise under article 9 that tries to realize a balanced allocation of taxing rights, because it "does not reduce the profits of the enterprise of the other State and may not, therefore, be said to have been levied on such profits".[89] Similarly, the argument with regard to the potential effect on interest barrier rules based on earnings before interest, taxes, depreciation, and amortization, for example, according to Action 4 of the OECD/G20 BEPS Project or article 4 of the ATAD (2016/1164), assumes that article 9(1) of the OECD Model would prohibit any restriction of the deduction of arm's length payments.[90] However, this is not the case: as such interest barrier rules, just as other disallowances of deductions – for example, in respect of meals or entertainment expenses – do not depend on conditions different from those between independent enterprises, they do not result in an actual reduction of taxable profits in the other contracting state, or a claim to a larger share of "profits" from transactions with the other associated enterprise. As a result, they are not even aimed at assimilating the profits to an amount corresponding to the profits in an arm's length situation.[91] Accordingly, it seems to us that those arguments by implication are largely without merit.

3.3. Is the restrictive force of article 9 of the OECD Model negated by a saving clause?

Action 6 of the OECD/G20 BEPS Project dealt with various forms of treaty abuse[92] and lead to the inclusion of a "saving clause" in the OECD Model, in the form of a new article 1(3), which is reflected in article 11 of the MLI.[93] As noted by the OECD, the majority of treaty provisions are intended merely "to restrict the right of a Contracting State to tax the residents of the other Contracting State",

82. *See* para. 16 *OECD Model: Commentary on Article 7* (2017), in noting the second part of art. 7 *OECD Model* (2017): "fiction corresponds to the arm's length principle which is also applicable, under the provisions of Article 9, for the purpose of adjusting the profits of associated enterprises".
83. *See*, for example, Nitikman, *supra* n. 60, at p. 47; Wittendorff, *supra* n. 44, at p. 197; Bullen, *supra* n. 46, a pp. 70-71; Fross, *supra* n. 60, at sec. 3.3.; and Schaumburg & Häck, *supra* n. 60, at m.no. 19.294. For a contrary position, *see* B.J. Arnold, *supra* n. 58, at p. 1073, who acknowledges that "this is a reasonable argument in terms of treaty policy" but also argues that "the wording of article 9(1) does not justify a restrictive interpretation as clearly as the wording of article 7 does".
84. *See* paras. 1 and 2 *OECD Model: Commentary on Article 9* (2017).
85. Para. 10 *OECD Model: Commentary on Article 25* (2017).
86. Id., at para. 9.
87. However, following the OECD/G20 BEPS Project, it is a politically agreed "minimum standard" that states will ensure that access to a MAP is provided for transfer pricing cases regardless of whether the tax treaty contains a provision modelled on art. 9(2) *OECD Model* (2017) (*see also* element 1.1 of the minimum standard in OECD, *Action 14 Final Report 2015 – Making Dispute Resolution Mechanisms More Effective* pp. 13-14 paras. 10-12 (OECD 2015), Primary Sources IBFD [hereinafter *Action 14 Final Report* (2015)]. Moreover, it is considered best practice for states to include art. 9(2) *OECD Model* (2017) in their tax treaties (*see also* element 1 of the best practices in OECD, *Action 14 Final Report* (2015), *supra*, at p. 29 para. 43), thereby giving states "the possibility to provide for corresponding adjustments unilaterally in cases in which they find the objection of the taxpayer to be justified" (*see* OECD, *Action 14 Final Report* (2015), *supra*, at p. 29 para. 43). Art. 17 MLI provides a mechanism for the parties to implement this best practice.
88. Para. 11 *OECD Model: Commentary on Article 25* (2017).
89. Para. 14 *OECD Model: Commentary on Article 7* (2017). *See also* Englisch & Becker, *supra* n. 60, at sec. 5.1.
90. In that direction, *see* Arnold, *supra* n. 58, at p. 1074.
91. *See*, for example, Marres, *supra* n. 60, at sec. 2.2.; and Englisch & Becker, *supra* n. 60. *See also*, implicitly, OECD, *Action 4 Final Report 2015 – Limiting Base Erosion Involving Interest Deductions and Other Financial Payments* p. 38 para. 59 (OECD 2015), Primary Sources IBFD.
92. OECD, *Action 6 Final Report 2015 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (OECD 2015), Primary Sources IBFD [hereinafter Action 6 Final Report (2015)].
93. While a saving clause is a longstanding feature of US treaty policy (currently, *US Model Tax Convention on Income*, art. 1(4) (17 Feb. 2016), Treaties & Models IBFD), to which the OECD explicitly refers, few other countries had so far adopted it; *see*, for example, G. Kofler, *Some Reflections on the 'Saving Clause'*, 44 Intertax 8/9, pp. 574-575 (2016).

but not the right to tax its own residents, specifically in situations where two contracting states tax the same income on a residence basis, as they allocate that income to different taxpayers.[94] While the Commentary on Article 1 of the OECD Model (2017) rejected arguments that certain provisions could be interpreted as limiting a contracting state's right to tax its own residents in the context of partnerships and CFC rules,[95] the OECD has concluded that such a principle should be reflected as a general rule in the OECD Model itself.[96]

The saving clause in article 1(3) of the OECD Model preserves ("saves") the right of a contracting state to tax its residents, irrespective of any other provision of a tax treaty, unless it is "turned off" by one of the specific exceptions. The article reads as follows:

> 3. This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 3 of Article 7, paragraph 2 of Article 9 and Articles 19, 20, 23 [A] [B], 24, 25 and 28.

At face value, article 1(3) of the OECD Model is not limited to situations that raise tax-avoidance concerns, nor is it merely of a clarifying nature.[97] Read in light of the exceptions, the purpose of the saving clause "is to prevent the tax treaty from restricting residence taxation *in an unintended way*".[98] However, drafted as a general provision, it quasi-automatically addresses anti-abuse concerns specifically, where, based on a national anti-avoidance provision, the same income is effectively attributed to different taxpayers by the two contracting states. Accordingly, the intended focus is the protection of domestic CFC rules and the residence-based taxation of partners in hybrid entities.[99] While perhaps not immediately intended, two-taxpayer situations arise with regard to transfer pricing and arm's length adjustments under article 9(1) of the OECD Model, as this provision deals with residence-based profit taxation as between associated enterprises in both contracting states.

If one assumes that article 9(1) of the OECD Model has restrictive force (as we do – *see* section 3.2.), such a restriction on the quantity of the profits that domestic law can allocate and tax would be arguably irrelevant under a saving clause based on article 1(3). Such a situation would arise as each of the enterprises involved in a transfer pricing issue is a resident of its contracting state and each of those residence states is relieved from its obligation to comply with the ALP when it makes primary adjustments. The concept of taxation in article 1(3) of the OECD Model is broad enough to cover such an understanding. By not including article 9(1) of the OECD Model in the exceptions to the saving clause, contracting states would take the position that this paragraph is not intended to restrict a state's right to make transfer pricing adjustments to its resident companies, whether or not those adjustments comply with the ALP[100] or, for example, to use formulary apportionment instead, as long as they comply with the non-discrimination provisions of article 24, which are excepted from the saving clause. Legal scholarship[101] and courts have drawn that very conclusion. For instance, in *Container Corp.* (1983), which was a case concerning California's formulary apportionment system, the US Supreme Court noted that:

> although the United States is a party to a great number of tax treaties that require the Federal Government to adopt some form of "arm's-length" analysis in taxing the domestic income of multinational enterprises, that requirement is generally waived, according to the saving clause in (then) article 1(3) of the US Model (1981),[102] "with respect to the taxes imposed by each of the contracting nations on its own domestic corporations".[103]

Likewise, the US Court of Appeals for the Ninth Circuit reasoned in *Xilinx* (2009) that US domestic law "does not conflict with the tax treaty in these circumstances, because" – as under the saving clause in article 1(4) of the Ireland-United States Income Tax Treaty (1997)[104] – "the treaty expressly allows a contracting state to apply its domestic laws to its own citizens, even if those laws conflict with the treaty".[105]

As discussed elsewhere,[106] this outcome appears to be rather strange and – from the perspective of a restrictive

94. OECD, *Action 6 Final Report* (2015), *supra* n. 92, at p. 86 para. 61.
95. *See*, for example, paras 6.1 (taxation of resident partners of foreign partnerships) and 23 (CFC rules) *OECD Model: Commentary on Article 1* (2017).
96. OECD, *Action 6 Final Report* (2015), *supra* n. 92, at p. 86 para. 62.
97. Assume, for example, that a tax treaty contains a saving clause and the pre-2017 version of art. 8 of the OECD Model, which allocated the exclusive right to tax shipping or air transportation profits to the state in which the enterprise's place of effective management (PoEM) is located. Accordingly, in a case where the state of the enterprise's PoEM is different from the taxpayer's state of residence – for example, in the case of individuals or partnerships running a shipping or air transportation enterprise – the saving clause would "save" the latter's right to tax. This is possibly contra to para. 18 *OECD Model: Commentary on Article 1* (2017), according to which art. 1(3) *OECD Model* (2017) "confirms the general principle that the Convention does not restrict a Contracting State's right to tax its own residents except where this is intended and lists the provisions with respect to which that principle is not applicable". However, apparently this principle was not highlighted prior to the 2017 update of the *OECD Model: Commentaries*.
98. Sasseville, *supra* n. 58, at sec. 3.5., p. 50 [emphasis in the original].
99. *See*, for example, D. Gutmann & S. Austry, *Article 1 – Persons Covered* secs. 2.3.3. and 2.3.4., Global Tax Treaty Commentaries, Global Topics IBFD.
100. *See also* Sasseville, *supra* n. 58, at sec. 3.5., p. 53.
101. *See*, for that effect of a saving clause on art. 9(1) *OECD Model* (2017), for example, Sasseville, *supra* n. 58, at sec. 3.5., p. 53; J. Wittendorff, *supra* n. 44, at pp. 81-82; Kofler, *supra* n. 60, at pp. 75-77 and *supra* n. 93, at pp. 586-588; V. Chand, *Should States Opt for the Saving Clause In the Multilateral Instrument?*, 86 Tax Notes Intl. 8, pp. 691-692 (22 May 2017); B. Wells, *Get With the BEAT*, 158 Tax Notes, p. 1025 (19 Feb. 2018) and U. Houston L. Ctr. No. 2018-A-4; and Kofler & Wittendorff, *supra* n. 55, at art. 9 m.no. 15-16. Contra, *see* Englisch & Becker, *supra* n. 60 (arguing that the allocation of profits would not be covered by a saving clause). *See also* Lepard, *supra* n. 53, at pp. 143-146 (arguing that the ALS under art. 9(1) *OECD Model* (2017) has strong persuasive, but not necessarily decisive force, also in light of a saving clause).
102. *US Model Tax Convention on Income* (16 June 1981), Treaties & Models IBFD.
103. *Container Corp* (1983), *supra* n. 59, at p. 196, fn. 35.
104. *Convention between the Government of Ireland and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains* (28 July 1997) (as amended through 1999), Treaties & Models IBFD.
105. *See* US: CAFC, Ninth Circuit, 27 May 2009, *Xilinx, Inc. v. Commissioner*, 567 F.3d 482, Case Law IBFD (withdrawn on 13 January 2010, and – without reference to the saving clause – newly decided by the US: CAFC, Ninth Circuit, 22 Mar. 2010, *Xilinx, Inc. v. Commissioner*, 598 F.3d 1191, Case Law IBFD).
106. *See* Kofler, *supra* n. 93, at pp. 586-588.

understanding of article 9(1) of the OECD Model – it is hard to grasp why the OECD opens the door to potential deviations from the ALP. Accordingly, it would have been prudent to except also article 9(1) of the OECD Model, and not only article 9(2), from the saving clause.[107] In addition, the odd effects do not stop here. Similarly, the obligation to make a corresponding adjustment under article 9(2) of the OECD Model, which is excepted from the saving clause, is imposed on the other contracting state, but only if that state believes that the primary adjustment is justified in both principle and amount.[108] Such a situation seems unlikely to occur if the first adjusting state applies whatever standard it pleases – for example, formulary apportionment – without regard to any limits set by article 9(1) of the OECD Model.[109] Moreover, not excepting article 9(1) from the saving clause also appears to shift the interaction of various provisions in the OECD Model. For instance, compliance with article 9(1) of the OECD Model also implies compliance with the non-discrimination provisions of articles 24(4) and 24(5), for example, in the context of thin capitalization rules.[110] If, however, a contracting state deviates from article 9(1) of the OECD Model under the saving clause, such a deviation may be scrutinized under the non-discrimination provisions, all of which are excepted from the saving clause.[111]

Finally, one might even ask if double taxation arising from a deviation from the ALP in article 9(1) of the OECD Model may still open the door to a MAP or arbitration under article 25 of the OECD Model or the MLI, which requires that "the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention". These doubts arise because, arguably, taxation based on the saving clause is always "in accordance with the provisions" of a tax treaty,[112] so that taxpayers would always be excluded from finding relief through competent authority negotiations or arbitration. This would appear to be a strange result, as article 25 of the OECD Model itself is excepted from the saving clause, which might imply that a MAP should – at least in spirit – still be possible in cases of residence-based taxation, including transfer pricing adjustments, under a saving clause. However, at least in the European Union, it appears to be clear that taxpayers can at least take recourse to the Arbitration Convention (90/436)[113] with regard to transfer pricing disputes and, arguably, the Tax Dispute Resolution Directive (2017/1852),[114] which covers all tax disputes that arise from the interpretation and application of tax treaties.[115]

3.4. What follows?

Assuming a restrictive effect of article 9 of the OECD Model has potentially far-reaching consequences, as it would theoretically prohibit all adjustments that are based on considerations other than the appropriateness, i.e. an arm's length basis, of the conditions within the objective and subjective scope of article 9 of the OECD Model. One important effect of such restrictive force with regard to article 9(1) of the OECD Model is that pricing adjustments that are not based on considerations concerning appropriateness of pricing, but are instead based merely on formal grounds – for example, lack of clear and a priori agreements– are barred.[116] Many also argue that article 9 of the OECD Model would prohibit a state from introducing formulary apportionment as a mechanism to allocate profits.[117] Formulary apportionment is also rejected by the OECD as being "non-arm's length".[118]

However, the practical effect of the restrictive force of article 9 of the OECD Model should not be overstated, as – despite the static language of the provision since 1963 – the ALP has evolved dramatically, and, increasingly become standard-based over the past few decades, specifically following the OECD/G20 BEPS Project.[119] The

107. If contracting states are concerned about, for example, the interaction of their CFC regimes with the ALP, they should address such problems in their bilateral negotiations rather than through subjecting art. 9(1) *OECD Model* (2017) to a general saving clause.
108. With further references, *see* Kofler & Wittendorff, *supra* n. 55, at art. 9 m.no. 113.
109. Possibly more optimistic, *see* J. Schuch & N. Neubauer, *The Saving Clause: Article 1(3) of the OECD Model*, in *Base Erosion and Profit Shifting (BEPS)* p. 38 (M. Lang et al. eds., Linde 2016).
110. *See* Kofler & Wittendorff, *supra* n. 55, at art. 9 m.nos. 44-45.
111. *See also* L. De Broe & J. Luts, *BEPS Action 6: Tax Treaty Abuse*, 43 Intertax 2, p. 122 et seq. (2015).
112. *See*, for such an understanding in the context of a hybrid entity under the *Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains* (31 Dec. 1975), Treaties & Models IBFD, as decided by the UK Special Commissioners of Income Tax (UKSCIT) in UK: UKSCIT, 19 Nov. 2008, *Bayfine UK Products Bayfine UK v. Revenue & Customs*, [2008] UKSPC SPC00719, para. 55; and by the Court of Appeal of England and Wales (Civil Division) (EWCA Civ) in UK: EWCA Civ, 23 Mar. 2011, *Bayfine UK v. HM Revenue and Customs*, [2011] EWCA Civ 304, para. 41, Case Law IBFD.
113. Convention 90/436/EEC on the Elimination of Double Taxation in Connection with the Adjustment of Transfers of Profits Between Associated Undertakings, OJ L 225 (1990), p. 10, as amended, Primary Sources IBFD [hereinafter the Arbitration Convention (90/436)]. The Arbitration Convention (90/436) provides a process for the elimination of double taxation in transfer pricing cases by agreement between the contracting states, which procedure may include, if necessary, referring the matter to an independent advisory body, i.e. an arbitration panel. It is firmly based on the ALS as the principle for profit adjustments (*see* art. 4 Arbitration Convention (90/436) and *see also* the *Revised Code of Conduct for the Effective Implementation of the Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises*, pt. 6.1(a), OJ C 322 (2009), p. 1, Primary Sources IBFD), so that taxpayers can have recourse to that principle even if a contracting state's domestic law would go beyond it and would also be permitted to do so under a saving clause.
114. Council Directive (EU) 2017/1852 of 10 October 2017 on Tax Dispute Resolution Mechanisms in the European Union, OJ L 265 (2017), p. 1, Primary Sources IBFD.
115. *See*, for example, I. Richelle, *Dans les arcanes de la nouvelle directive sur le règlement des différends fiscaux, in L'Europe au présent ! – Liber Amicorum Melchior Wathelet* pp. 883-927 (J. Wildemeersch & P. Paschalidis eds., Bruylant 2018) and G. Kofler, EU Tax Dispute Resolution Directive: The Deathblow to Double Taxation in the European Union, 28 EC Tax Rev. 6, pp. 266-269 (2019).
116. I R 75/11 (2012), *supra* n. 46; I R 23/13 (2014), *supra* n. 46; I B 103/13 (2015), *supra* n. 59; and I R 29/14 (2015), *supra* n. 46; as confirmed by, for example, I R 51/17, I R 73/16, and I R 81/17 (2019), *supra* n. 59. For a detailed discussion of the prevailing opinion and the contrary positions, *see* Wittendorff, *supra* n. 44, at pp. 227-230 and G. Kofler, *supra* n. 60, p. 70 et seq.
117. For a detailed discussion of the various positions, *see* Lepard, *supra* n. 53, at pp. 128-147.
118. *See* OECD, *Transfer Pricing Guidelines* (2017), *supra* n. 39, at para. 1.16 et seq.
119. *See also* Baistrocchi, *supra* n. 60, at sec. 6.2.5.1.

ALP is frequently viewed as more "result-oriented, thereby meaning that the objective is parity in taxable income rather than parity in the method of allocation itself", i.e. it is not limited to comparable transactions.[120] Accordingly, the relevant standard focuses less on finding comparable transactions than on testing if "the actual transaction possesses the commercial rationality of arrangements that would be agreed between unrelated parties under comparable economic circumstances",[121] i.e. arm's length behaviour.[122] Examples of this evolution are the focus on DEMPE functions for intangible related returns,[123] risk allocation based on control over risk and capacity to bear risk[124] and the permissibility of ex-post evidence for the pricing of the transfer of hard-to-value intangibles.[125] We also envisage domestic courts struggling with what the effective contours of the "restriction" set by article 9 of the OECD Model really are. This increasingly uncertain scope of the ALP has resulted, for example, in Brazilian courts concluding that the heterodox Brazilian transfer pricing rules are in conformity with article 9 of the OECD Model.[126] Moreover, the German *Bundesfinanzhof* (Federal Tax Court), a spearhead for the restrictive force of article 9 of the OECD Model, has recently relaxed its case law by accepting that this provision does not prevent adjustments that are based on non-arm's length behaviour, i.e. "*dem Grunde nach*", such as granting an inter-company loan without collateralization, while the previous case law only permitted adjustments to the arm's length price, i.e. "*der Höhe nach*" – for example, to the amount of interest.[127]

That said, and depending on the domestic approach to article 9 of the OECD Model, the saving clause in article 1(3) would arguably remove all of the legal shackles on what a state can do under its domestic (transfer pricing) legislation and prevent litigation as to the compatibility of domestic rules with article 9. The saving clause may permit any and every deviation from the ALS in article 9(1) of the OECD Model, thereby making the avoidance of double taxation in that area even more complex. Consequently, while states would legally be free to do as they please, there is still the strong commitment of OECD member countries to follow the ALP in their domestic legislation, unless international consensus emerges to deviate from it in certain areas.[128] From a policy perspective, it should be noted that, in 1995, the OECD Council recommended that states should:

> follow, when reviewing, and if necessary, adjusting transfer pricing between associated enterprises for the purposes of determining taxable income, the Guidelines – considering the whole of the Guidelines and the interaction of the different chapters – for arriving at arm's length pricing for transactions between associated enterprises,[129]

and, in 2016, that they "follow the guidance set out in the Actions 8-10 Report and the Action 13 Report".[130] So, even if article 9 of the OECD Model's binding force to use (only) the ALP in respect of international profit allocation between associated enterprises might be "switched off" by a saving clause, there at least remains a political commitment by states that also aims at avoiding international economic double taxation in the transfer pricing area.

4. Conclusions

The legitimacy of how intercompany prices are set is at the heart of a mediatized multi-stakeholder debate. Accordingly, transfer pricing is fertile soil for a deeper dive from a joint academic and practitioner's perspective. Conceived as an anti-avoidance measure almost a century ago, the ALP evolved into a globally accepted allocation mechanism. It is also result-oriented, i.e. its objective is parity in taxable income rather than parity in the method of allocation itself. What, therefore, gives rise to the current writing on Actions 8-10 of the OECD/G20 BEPS Project in relation to article 9 of the OECD Model? It is interesting to note how countries have introduced domestic legislation and administrative guidance in line with the ideas created within the OECD, not to mention how courts have created jurisprudence on such fact-specific matters. The treaty context is relevant because article 9 of the OECD Model restricts the contracting states in how domestic taxing rights can be exercised, i.e. it establishes the allocation norm of the ALP as the outer edge of domestic taxation. It is understandable that the tax authorities have an interest in seeking support for arguing that most functionality and entrepreneurial risk assumption originates from within their borders. This situation is particularly difficult to quantify when parties are joined by some form

120. *See* US: CAFC, the Ninth Circuit, 7 June 2019, *Altera Corporation and Subsidiaries v. Commissioner of Internal Revenue*, 926 F.3d 1061, Case Law IBFD.
121. *See* OECD, *Transfer Pricing Guidelines* (2017), *supra* n. 39, at para. 1.123.
122. For a critical position on whether that approach is in accordance with the wording of art. 9 *OECD Model* (2017), *see*, for example, Rasch, *supra* n. 59, at art. 9 m.no. 42.
123. *See* OECD, *Transfer Pricing Guidelines* (2017), *supra* n. 39, at para. 6.34. For critical assessments in the light of the traditional ALS, *see also* Schoueri, *supra* n. 3, at sec. 2.3. and J.G. Ballentine, *Ownership, Control, and the Arm's-Length Standard*, 81 Tax Notes Intl. 12, pp. 1177-1180 (20 June 2016).
124. *See* OECD, *Transfer Pricing Guidelines* (2017), *supra* n. 39, at para. 1.56-1.106. For a critical approach, *see* J. Wittendorff, *OECD Misinterprets Controlled Transactions*, 78 Tax Notes Intl. 5, pp. 466-467 (May 4, 2015).
125. *See* OECD, *Transfer Pricing Guidelines* (2017), *supra* n. 39, at para. 6.188. Cf. the OECD, in 1993, noting that "[t]he use of hindsight in transfer pricing methodologies … is generally inconsistent with the arm's length standard". (*See* OECD, *Reports of the Task Force of the OECD Committee on Fiscal Affairs on US Transfer Pricing Proposed Regulations* – Part II: Intercompany Transfer Pricing Regulations under US Section 482 Temporary and Proposed Regulations, para. 3.17. OCDE/GD(93)131 (OECD 1993).)
126. *See* Brazilian Administrative Taxpayers' Council, No. 103-21.859/2005, as discussed by Calich & Rolim, *supra* n. 59.
127. *See* I R 51/17, I R 73/16, and I R 81/17 (2019), *supra* n. 59, explicitly overruling, for example, I R 29/14 (2015), *supra* n. 46 and I R 23/13 (2014), *supra* n. 46, where it held that only pricing adjustments are not barred by that article. For analysis of this change in German case law, *see also* Rasch, *supra* n. 59, at art. 9 m.no. 34-38/5.
128. *See*, for example, OECD/G20 Inclusive Framework on BEPS, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy* p. 19 (OECD 2019), pointing at exploring "[t]he necessity to change any other treaty provision, such as Article 9, to allow market jurisdictions to exercise taxing rights over the measure of profits allocated to them under the new nexus and profit allocation rules".
129. *See* Recommendation of the Council on the Determination of Transfer Pricing between Associated Enterprises, C(95)126/FINAL, as last amended by C(2017)37.
130. *See* Recommendation of the Council on Base Erosion and Profit Shifting Measures Related to Transfer Pricing, C(2016)79.

of legal and economic solidarity when transacting with each other. The genesis of the DEMPE concept is plausible, i.e. to facilitate an economic substance assessment centred on individuals having the expertise and empowerment to credibly oversee entrepreneurial risk. However, this concept may mean different things to different people and there is little reason to give the result the same praise as its noble intention. Tax uncertainty is what we see and the pressure is mounting. It is tempting for countries and tax authorities to: (i) give a preponderance of weight to potentially draconic domestic rights over a restrictive treaty framework; and/or (ii) avoid the hassle of a thorough assessment based on value chain analysis to move straight to anti-avoidance and/or CFC based "attacks" on transfer prices. However, there is no legal ground to do so. With regard to point (i), the restrictive force of article 9(1) of the OECD Model in respect of primary adjustments could potentially be "switched off" by a saving clause under article 1(3), while corresponding adjustments under article 9(2) are exempt from that clause, and, therefore, are still required, even in the presence of a saving clause. With regard to point (ii), more nuance is required than to argue simply that CFC legislation is a backstop to transfer pricing. Moreover, what some refer to as the viral spread of GAARs is definitely a worry, but should not open the door for field tax inspectors to jump to conclusions by way of the concept of anti-avoidance without the need for a thorough transfer pricing analysis. Such a course of action is unlikely to prevail before the courts. Unfortunately, it would result in a waste of valuable management time for all of the parties involved and give rise to opportunity costs at a time where thought instead needs to be put into how to make "the rules of the game" better.