The Potential of Multilateral Tax Treaties

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1. The rich literature supporting multilateralism

It is time for renewed multilateralism – a multilateralism that delivers for real people in real time.
UN Secretary-General Ban Ki-moon
November 5, 2009[1]

For the past half-century international tax scholars and policy makers have been actively debating whether nation states need to change their approach to international tax policy in the face of an increasingly integrated world. A relatively small number of big questions have motivated much of their work: Will investment be made in countries where it can reap the most productive returns or will economic efficiency be eroded because differences in tax rates and bases cause investors to invest in jurisdictions where their real economic returns are sub-optimal? How can countries, acting largely unilaterally, ensure that tax revenues are fairly allocated between two (or more) jurisdictions, each of which has a justifiable claim to tax the associated income, and how can they ensure that the responsibility to pay tax is fairly allocated among types of income (i.e. employment versus capital returns) and among types of investors (i.e. higher- and lower-income individuals)? Will differential approaches to international tax policy, and in particular the presence of tax havens and preferential tax regimes for some forms of investment, result in the explosion of tax evasion and avoidance opportunities, particularly for passive investments, to the detriment of government revenue collection? How can tax administrators ensure that tax is collected in at least one jurisdiction?

Scholars have debated these broad questions as well as the finer empirical and normative propositions that underlie them. At the root of these questions, however, is a debate about whether and how countries ought to design their tax systems given the increasing internationalization of trade and mobility. The collection of chapters in this book provides a snapshot of the scholarship grappling with these questions, rooted in the context of

1. "Working together, nations can tackle today's major challenges – Ban," *United Nations News Center* (5 November 2009), available at http://huwu.org/apps/news/story.asp?NewsID=32856&Cr=multilateralism&Cr1=#.

the tax treaties that provide some of the fundamental architecture of international tax systems.

Over the same period, the literature on multilateralism more generally has proliferated.[2] Scholars in many disciplines have devoted energies to making sense of the concept and tracking the tendencies towards or away from multilateralism in a wide range of contexts.[3] Broadly put, this diverse and extensive body of scholarship is preoccupied with discerning the parameters of and through which states in groups of three or more coordinate their national policies through ad hoc or more institutional arrangements.

Given that international tax law has not seen the trend towards formal legal multilateralism witnessed in other areas of legal regulation,[4] in section 2. this paper canvasses briefly some alternative possible approaches that governments could adopt if they were serious about better coordinating and possibly harmonizing international tax regimes. In section 3., the paper turns to explore in some detail the potential advantages to using tax treaties as a form of multilateral solution. In section 4., the paper evaluates the CARICOM multilateral double taxation treaty to see if in practice that treaty delivers on the predicted benefits of multilateralism including: whether it offers the potential to ensure that tax is collected in at least one state; whether some of the mechanisms to implement multilateralism would better integrate tax regimes; and whether multilateralism can promote tax fairness. The paper concludes by urging governments to pursue multilateral and collective solutions to international tax law design, alongside unilateral solutions to some of the policy dilemmas that arise in an integrated world,

2. For a discussion of the debates between and among universalists and multilateralists in international law see Blum, G., "Bilateralism, Multilateralism, and the Architecture of International Law", 49 *Harvard International Law Journal* 2 (2008), pp. 323-379.

3. See e.g. Bhagwati, J., *Regionalism and Multilateralism: An Overview*, Discussion Paper No. 693 (Columbia: Columbia University Department of Economics, 1992); Caporaso, J., "International Relations Theory and Multilateralism: The Search for Foundations", 46 *International Organization* 3 (1992), pp. 599-632; Bouchard, C. and J. Peterson, *Conceptualising Multilateralism*, Mercury Working Paper (Edinburgh: University of Edinburgh, 2009), available at http://typo3-8447.rrz.uni-koeln.de/fileadmin/user_upload/Bouchard_Peterson_Conceptualising_Multilateralism.pdf; Ruggie, J.G., "Multilateralism: The Anatomy of an Institution", 46 *International Organization* 3 (1992), p. 561; Keohane, R., "Multilateralism: An Agenda for Research", 45 *International Journal* 4 (1990), p. 731.

4. See Rixen, T., and I. Rohlfing, *The Political Economy of Bilateralism and Multilateralism: Institutional Choice in International Trade and Taxation*, TranState Working Papers No. 31 (Bremen: University of Bremen, 2005).

and to explore creative ways of designing collaborative tax instruments and agreements to ensure international tax laws remain robust.

2. Possible approaches to improving tax coordination: The road to multilateralism

There are a number of steps countries can take unilaterally to ensure that they collect an appropriate amount of tax from businesses operating in their jurisdictions. These unilaterally designed rules can be quite technical; however, the purpose of this part of the paper is simply to highlight a few of the kinds of rules that might be adopted, using Canada's rules as illustrative. After a review of some of these unilateral design possibilities, this section of the paper turns to a discussion of the possible multilateral solutions.

First, under the present law, corporations are deemed to be resident in Canada, and are taxed on their worldwide income, if they are incorporated in Canada or if their central management and control is in Canada.[5] These tests make it very simple for a corporation to become resident outside Canada. It would be relatively simple to substantially strengthen this test of corporate residency by making it a multi-factor test. A corporation might be held to be resident in Canada if it has a substantial economic nexus with Canada based upon a consideration of a number of connecting factors in addition to the two previously mentioned factors such as: whether the executive or day-to-day control is exercised in Canada; whether the majority of shareholders are resident in Canada; whether the controlling shareholders are resident in Canada; and whether the corporation has substantial business operations in Canada.[6] Corporations should not be able to avoid domestic taxation through the manipulation of formal, legal procedures.

Second, a substantial part of international trade takes place between affiliated corporations. In determining how much profit a Canadian subsidiary has earned in Canada, the present tax rules require it to compute its profits as if it were dealing with its affiliated overseas corporations at arm's length. Of course it is notoriously difficult to determine what the value of a

5. For a fuller discussion of the Canadian corporate residence rules see Brooks, K., Canada, in Maisto (ed.) *Residence of Companies Under Tax Treaties and EC Law*, EC and International Law Tax Series, Vol. 5 (Amsterdam: IBFD Publications, 2009).
6. See the suggestions made by Arnold, B., "A Tax Policy Perspective on Corporate Residence", 51 *Canadian Tax Journal* 4 (2003), pp. 1559-66, at 1562; and McIntyre, M., "Determining the Residence of Members of a Corporate Group", 51 *Canadian Tax Journal* 3 (2003), pp. 1567-1572.

transfer between related companies should be – particularly for unique and intangible goods and services – and it is widely understood that billions of dollars of corporate profits are in effect removed from the jurisdiction of the Canadian government through the manipulation of these so-called transfer prices. Numerous commentators have suggested that the Canadian government should use a formula based upon, for example, what percentage of the multinational's worldwide sales are in Canada or what percentage of its worldwide payroll is in Canada, and simply assume that that percentage of its worldwide profits were earned in Canada.[7] Such an approach would be much more difficult to manipulate and would provide a more appropriate calculation of profits attributable to Canada.

Third, and finally, Canada has tax treaties with a number of countries that have very favourable tax regimes for international businesses, such as Barbados. Under Canada's domestic tax law any business income earned in corporations resident in these jurisdictions can be repatriated to Canada tax-free. The Auditor-General has suggested on numerous occasions that the Canadian government should close this loophole,[8] which remains available for Canadian multinationals.[9] In fact, this loophole has been extended in the last 2 years as the government has moved to allow investors into countries with whom Canada enters into a tax information exchange agreement to receive the beneficial tax treatment for business profits afforded previously only to countries with which Canada had a comprehensive income tax treaty.[10] Canada entered into its first tax

7. The literature on the difficulties of transfer pricing and the advantages of a formulary approach, including concrete efforts to set out what factors should be considered, is voluminous. For a recent illustration, see Avi-Yonah, R., K. Clausing and M. Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split", University of Michigan Public Law Working Paper No. 138 (Michigan: University of Michigan, 2008), available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1317327.

8. See e.g. *Report of the Auditor General of Canada*, 1992, Chapter 2 - Other Audit Observations, "Tax arrangements for foreign affiliates are costing Canada hundreds of millions of dollars in lost tax revenues", Para. 2.28, available at http://www.oag-bvg.gc.ca/internet/English/parl_oag_199212_02_e_8055.html#0.2.L39QK2.V0OCQD.CS3YFE.F1; *Report of the Auditor General of Canada*, December 2002, Chapter 4 - Canada Customs and Revenue Agency - Taxing International Transactions of Canadian Residents, Para. 4.9, available at http://www.oag-bvg.gc.ca/internet/English/parl_oag_200212_11_e_12405.html#ch11hd3e.

9. See also the recommendations in Arnold, B.J., *Reforming Canada's International Tax System: Toward Coherence and Simplicity* (Toronto: Canadian Tax Foundation, 2009), Chapter 4.

10. A comprehensive treaty is a treaty that covers all kinds of income taxes, not just taxes on shipping profits, for example.

information exchange agreement with the Netherlands Antilles[11] in August 2009 and has announced that it is negotiating agreements with a long list of low-tax jurisdictions.[12] These exchange agreements may prove to be useful tools for obtaining information about recalcitrant taxpayers, but the trade off on taxing business profits earned in the jurisdiction is perhaps not worth the benefits.

The list of possible measures that Canada (or any country) could take to strengthen the taxation of multinational businesses operating in Canada is long. The point in highlighting a few unilateral measures is simply to underscore that even if states have to act unilaterally, they are not entirely impotent to preserve their corporate or business tax bases in the face of the forces of globalization.

Nevertheless, presumably many of the perceived pressures of globalization are related to any given country's sense that other countries are offering more competitive or attractive tax environments for international business. This sentiment leads countries to conclude that they, too, need to refine their tax systems (by reducing rates and limiting their tax base) in order to attract foreign investment and keep domestic investment at home. Therefore, it seems that protecting a country's national sovereignty might be better accomplished through multilateral or cooperative agreements.

There are at least four obvious advantages to tax cooperation.[13] The first two advantages are derived primarily because they result in reduced barriers to investment and assist in ensuring that investment is made in the jurisdiction where the best economic returns can be earned. First, if nations coordinate in setting their tax policies, barriers to business investment may be reduced. For example, in the absence of coordination, two countries might impose tax on the same income leading to disincentives for cross-border investment.

11. See http://www.fin.gc.ca/treaties-conventions/antilles-agree-eng.asp. For a review of the significance of this first treaty and the proposed subsequent ones see Boidman, N., "Canada's Two-Faced TIEAs – Netherland Antilles Trumps Bermuda", 55 *Tax Notes Int'l* 12 (2009), p. 1023.

12. These include Anguilla, Aruba, Bahamas, Bahrain, Bermuda, British Virgin Islands, Cayman Islands, Dominica, Gibraltar, Guernsey, Isle of Man, Jersey, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, San Marino, Turks and Caicos Islands. See http://www.fin.gc.ca/treaties-conventions/tieaaerf-nego-eng.asp.

13. Mintz, J. identifies three in "Globalization of the Corporate Income Tax", 56 *FinanzArchiv: Public Finance Analysis* 3/4 (1999), pp. 393-398.

Second, cooperation may reduce fiscal externalities. When nations set their tax policies based only on their own best interest, neutrality at an international level suffers. For example, it is appealing for a nation to tax foreign investors on the value of their income earned in the host country to fund domestic spending programs. This strategy permits the cost of those domestic programmes to be exported to non-resident investors. However, this practice inevitably affects the tax revenue that can be raised in the foreign jurisdiction. While this externality (tax exportation) makes the other jurisdiction worse off, a second fiscal externality, tax base flight may make that jurisdiction better off. In this case, the host nation raises its business tax rate to a sufficiently high level that business relocates to another nation. The result is increased revenues for the new host nation.

Other efforts at tax coordination seek to ensure that an appropriate amount of tax is collected. So, a third advantage to coordination among nations is that abusive tax arrangements might be reduced. For example, companies with the ability to locate in a variety of jurisdictions may be able to: 1) take advantage of the opportunity to deduct some expenses (double dip) in more than one jurisdiction; 2) price goods and services sold between related companies (transfer pricing) in a way that ensures that most of the profits are realized in low-tax jurisdictions; 3) funnel profits through multiple countries to achieve reduced withholding tax rates; or 4), conceal profits altogether by leaving profits in jurisdictions with bank secrecy laws or inadequate exchange of information obligations.

Fourth, and finally, compliance and administration costs might be reduced if tax systems were more harmonized. Every jurisdiction has different rules for calculating income, and different tax rates. If more of these calculation rules were the same, the time and expense of determining taxes owing would decrease.

Governments, policy makers and scholars have explored a variety of collaborative, coordinated and harmonized approaches to taxation in an effort to capture some or all of the above reviewed advantages.[14] For example,

14. Interest in increased cooperation between national governments in the tax area is far from new. See e.g. Tinbergen, J., A.J. Dolman and J. van Ettinger, *Reshaping the International Order: A Report to the Club of Rome* (New York: Dutton, 1976); Steinberg, E.B. and J.A. Yager, *New Means of Financing International Needs* (Washington: The Brookings Institution, 1978); Surr, J.V., "Intertax: Intergovernmental Cooperation in Taxation", 7 *Harvard International Law Journal* 2 (1966), p. 179; and Kingston, C.I., "The Coherence of International Taxation", 81 *Columbia Law Review* 6 (1981), pp. 1151-1289.

the formation of the European Union has resulted in a number of recent attempts to coordinate corporate tax regimes in Europe. These initiatives are driven in part by a desire to facilitate greater trade among EU countries, but also in part by concerns about preserving the corporate tax.[15] Similarly, the Organisation for Economic Cooperation and Development (OECD) has attempted to combat what they have termed "harmful tax competition", releasing a significant report in 1998, with subsequent follow-up reports and releases.[16] OECD member country concerns about tax evasion and fraud have manifested in a concerted effort to promote tax information exchange among countries, an effort that has received a good deal of political attention over the last couple of years.[17] Scholars and policy makers have explored the possibilities presented by an international tax organization that could propose and/or implement international tax policy,[18] the adoption of a

15. For EU initiatives, see for example discussions of the potential of a Common Consolidated Corporate Tax Base: European Commission (EC), *CCCTB: Possible Elements of a Technical Outline,* Working Document CCCTB\WP\057\doc, 26 July 2007, available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/CCCTBWP057_en.pdf; Avi-Yonah, R. and K. Clausing, "More Open Issues Regarding the Consolidated Corporate Tax Base in the European Union", 62 *Tax Law Review* 1 (2008), p. 119; Fuest, C., "The European Commission's proposal for a common consolidated tax base", 24 *Oxford Review of Economic Policy* 4 (2008), p. 720; Mintz, J. and J. Weiner, "Some Open Negotiation Issues Involving a Common Consolidated Corporate Tax Base in the European Union", 62 *Tax Law Review* 81 (2008), p. 81.

16. See OECD, *Harmful Tax Competition: An Emerging Global Issues* (Paris: OECD, 1998); OECD, *Towards a Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices* (Paris: OECD, 2000). See also the OECD's website tracking their activities on this issue: http://www.oecd.org/department/0,3355,en_2649_33745_1_1_1_1_1,00.html.

17. See e.g. OECD, "Finance Ministers Issue Statement on International Tax Fraud and Evasion" (23 June 2009) Doc. 2009-14279 Tax Analysts; OECD, "Overview of the OECD's Work on Countering International Tax Evasion: A Background Brief", (18 September 2009) Doc. 2009-20883 Tax Analysts.

18. See e.g. Avi-Yonah, R., "Commentary: Treating Tax Issues Through Trade Regimes", 26 *Brook. J. Int'l L.* 4 (2000-2001), p. 1683; Cockfield, A., "The Rise of the OECD as Informal 'World Tax Organization' through National Responses to E-Commerce Tax Challenges", 8 *Yale J. L. & Tech.* 59 (2006), p. 136; Horner, F., "Do We Need an International Tax Organization?", 24 *Tax Notes Int'l* 2 (2001), p. 179; McLure, C., "Globalization, Tax Rules and National Sovereignty", 55 *Bulletin for International Fiscal Documentation* 8 (2001), pp. 328-341; Pinto, D., "A Proposal to Create a World Tax Organisation", 9 *New Zealand Journal of Taxation Law and Policy* (2003), pp. 145-160; Spencer, D., "The UN a forum for global tax issues? (Part 2)", 17 *Journal of International Taxation* 3 (2006), pp. 30-44; Tanzi, V., Is there a Need for World Tax Organization?, in Razin/Sadka (eds.) *The Economics of Globalization* (New York: Cambridge University Press, 1999), p. 173; Vann, R., "A Model Tax Treaty for the Asian-Pacific Region? (Part II)", 45 *Bulletin for International Fiscal Documentation* 4 (1991), pp. 151-163 at 160-161. See Brauner, Y., "An International Tax Regime in Crystallization", 56 *Tax Law Review* 2 (2003), pp. 259-328 for an argument in favour of

consolidated tax base,[19] the application of consistent withholding tax rates, enhanced exchange of information, formulary apportionment[20] and a model tax code,[21] among other ideas aimed at promoting some form of coordination of harmonization.

In addition to these alternatives, countries could use tax treaties as a means of better coordinating or harmonizing their tax regimes. Canada has close to 100 bilateral tax treaties with foreign countries. As usually articulated, the fundamental purpose of these bilateral tax treaties is to facilitate cross-border trade, investment and other activities by removing the possibility of double taxation for multinationals operating in both countries. However, an equally important purpose should be to ensure that international income is taxed at least once and to prevent tax evasion. Canada's tax treaties could be strengthened in several ways to achieve these objectives by providing for more information exchanges, facilitating the simultaneous audits of multinational corporations and so on.

While changes to bilateral tax treaties may help to facilitate trade and prevent avoidance and evasion, the remainder of this paper pursues the possibilities presented by a move from bilateral to multilateral tax treaties, exploring the argument that the potential advantages of coordination and harmonization are better captured if more countries are at the treaty-negotiating table.

3. The advantages of multilateral tax treaties

The beginnings of modern efforts to coordinate tax regimes between multiple nations using multilateral tax treaties can be traced to the work of

an incrementally harmonized world tax regime. See also the proposal in United Nations, *Report of the High Level Panel on Financing for Development*, available at http://www.un.org/reports/financing/full_report.pdf.

19. See e.g. Weiner, J., "Approaching an EU Common Consolidated Tax Base", 46 *Tax Notes Int'l* 6 (2007), p. 647.

20. See e.g. Bird, R., "The Interjurisdictional Allocation of Income and the Unitary Taxation Debate", 3 *Australian Tax Forum* (1986), p. 333; Musgrave, P., "Tax Base Shares: the Unitary versus Separate Entity Approaches", 21 *Canadian Tax Foundation* (1979), p. 445.

21. See e.g. Hussey, W. and D. Lubick, *Basic World Tax Code and Commentary: a project sponsored by the Harvard University International Tax Program* (Arlington, Virginia: Tax Analysts, 1996); Arnold, B., "International Aspects of the Basic world Tax Code and Commentary", 7 *Tax Notes Int'l* (1993), p. 260; Krever, R., "Drafting Tax Legislation: Some Lessons from the Basic World Tax Code", 12 *Tax Notes Int'l* (1996), p. 915.

the League of Nations around the time of the First World War.[22] Motivated by concerns expressed by the International Chamber of Commerce, the focus of the League of Nations work in the early 1920s was on the eradication or reduction of double taxation that might arise as a consequence of the application of two or more national tax systems to a particular stream of income. The League commissioned a well-known report authored by four economists to explore alternative approaches to resolve international double taxation.[23] The result of that report, and the subsequent pressures from different member states, was that the League embraced double taxation treaties, rather than multilateral tax treaties, which were also on their agenda for consideration.

Tax scholars who have written about multilateral tax treaties are often talking about different things. Some scholars have written about a worldwide multilateral treaty that would replace the current system of bilateral agreements;[24] others have advocated a multilateral treaty or agreement that would address one or two very specific aspects of international taxation that could be signed onto by governments with an interest in becoming part of that treaty;[25] still others have debated the merits of multilateral tax treaties

22. See Lang, M. and J. Schuch, "Europe on its way to a Multilateral Tax Treaty", 9 *EC Tax Review* 1 (2000), pp. 39-43 at 39; Loukota, H., Multilateral Tax Treaty Versus Bilateral Treaty Network, in Lang et al. (eds.) *Multilateral Tax Treaties: New Developments in International Tax Law* (London: Kluwer Law International, 1998), Chapter 5, pp. 86-87.

23. Bruins, W., L. Einaudi, E. Seligman and Sir J. Stamp, *Report on Double Taxation Submitted to the Financial Committee*, League of Nations Doc. No. E.F.S. 73/F. 19 (Geneva: League of Nations, 1923).

24. See e.g. Loukota, in Lang et al. (eds.) *Multilateral Tax Treaties: New Developments in International Tax Law* (1998), Chapter 5, pp. 86-87. Thuronyi, V., "International Tax Cooperation and a Multilateral Treaty", 26 *Brook. J. Int'l L.* 4 (2000-2001), p. 1641.

25. See e.g. Dunlop, J., "Taxing the International Athlete: Working Toward Free Trade in the Americas Through a Multilateral Tax Treaty", 27 *Northwestern Journal of International Law & Business* 1 (2006), pp. 227-253; Graetz, M., "A Multilateral Solution for the Income Tax Treatment of Interest Expenses", Yale Law & Economics Research Paper No. 371 (New Haven: Yale Law School, 2008), available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1259847; Oliver, D., "Tax Treaties and the Market State", 56 *Tax Law Review* 4 (2003), pp. 587-608; McIntyre, M., "Options for Greater International Coordination and Cooperation in the Tax Treaty Area", in 56 *Bulletin for International Fiscal Documentation* 6 (2002), pp. 250-253; Arnold, B., J. Sasseville and E. Zolt, "Summary of the Proceedings of an Invitational Seminar on Tax Treaties in the 21st Century", 50 *Canadian Tax Journal* 1 (2002), pp. 65-144 at 99; Reinhold, R., "Some Things that Multilateral Tax Treaties Might Usefully Do", 57 *Tax Lawyer* 3 (2003-2004), p. 661. As a concrete illustration of this kind of treaty see the OECD and Council of Europe's *Multinational Convention on Mutual Administrative Assistance on*

that could be signed by regional or trading blocks.[26] This paper focuses on the possibilities presented by this last kind of multilateral tax treaty.

A number of tax scholars have either considered the advantages of multilateral tax treaties or noted the disadvantages of bilateral treaties (that might be ameliorated with multilateral agreement).[27] Those advantages are reviewed in this part of the paper. A number of the advantages identified in the literature are based on the ability of multilateral treaties to better facilitate trade; other advantages focus on the potential for greater enforcement; and a final category of advantages are based on gains to administration. While facilitating trade, and more especially enabling better enforcement, are laudable goals in the face of increased globalization, with the potential for tax competition to erode business tax revenues significantly, this part of the paper ends by exploring whether multilateral tax treaties could serve a useful role in protecting tax bases and rates.

3.1. Advantages in facilitating trade

Addressing triangular cases: Bilateral tax treaties are quite effective where activities are carried on in only two jurisdictions. They become less effective where a multinational carries on activities in more than those two states. For example, it is a challenge for tax administrations to determine how to best tax a company that has income from a source in one state, earned by a permanent establishment in a second state, and where the business has its head office (or residence) in a third state.[28] Triangular cases also arise for individual actors. For example, an individual may be resident in one country, engaged in a work project in a second country, and sent to a third country on a short-term basis. Similarly, multilateral treaties are more effective

Tax Matters, CETS No.: 127 (Strasbourg: Council of Europe, 1998), available at http://conventions.coe.int/Treaty/EN/Treaties/Html/127.htm.

26. See e.g. Lang and Schuch, *EC Tax Review* (2000), pp. 39-43; Mattsson, N., "Multilateral Tax Treaties: A Model for The Future?", 28 *Intertax* 8/9 (2000), pp. 301-308; Vann, 45 *Bulletin for International Fiscal Documentation* 4 (1991), pp. 151-163 at 160-161.

27. See e.g. Taylor, C.J., "Twilight of the Neanderthals or are Bi-lateral Double Tax Treaty Networks Sustainable?" (Paper presented at the Australasian Tax Teachers Association Conference in Christchurch, New Zealand, January 2009); Thuronyi, 26 *Brook. J. Int'l L.* (2000-2001), p. 1641. Not everyone thinks that multilateral treaties are the appropriate focus for harmonization efforts. See e.g. Ault, H., "The Importance of International Cooperation in Forging Tax Policy", 26 *Brook. J. Int'l L.* 4 (2000-2001), p. 1693.

28. See OECD, Triangular Cases, in OECD (ed.) *Model Tax Convention: Four Related Studies* (Paris: OECD, 1992), p. 28.

at dealing with cases where, for example, an individual or company might be found to be resident in more than two jurisdictions, or income may be held to have multiple sources. Multilateral treaties can resolve these kinds of triangular fact situations in equitable ways.

Expanding treaty networks: Many middle- and low-income countries (1) have underfinanced tax administrations and have therefore been unable to develop significant tax treaty networks; (2) have faced discrimination by high-income country negotiators and therefore have been unable to negotiate extensive tax treaty networks; or (3) have realized the capital-exporting bias of the OECD and to a lesser extent United Nations (UN) model double taxation treaties and have opted not to enter into tax treaties based on those models. These countries are arguably insufficiently covered by tax treaties and would potentially benefit from multilateral treaties onto which they could sign.

3.2. Advantages in preventing or reducing evasion and avoidance

Facilitating exchange of information: One of the most difficult challenges in administering tax systems is obtaining information about the international transactions and investments of domestic taxpayers. It is relatively straightforward for tax administrators to get information about a taxpayer's domestic activities since usually domestic law enables administrators to compel evidence from third parties and the taxpayer him or herself. In contrast, where a taxpayer's investments are held in secret in another jurisdiction, the tax administration has no real mechanism to compel the other jurisdiction to provide it with information about the taxpayer's investments. As a consequence, information exchange has become one of the hot topics of international taxation.

Bilateral tax treaties generally include a provision that enables the states, which are parties to the treaty, to exchange information for tax purposes under certain conditions. For states with many bilateral tax treaties (or tax information exchange agreements) the major challenges of information exchange may be limited to tax havens that refuse to enter into information exchanges or tax administration resource constraints. However, many middle- and low-income countries, for example, have been unable to command a vast network of tax treaties and may find their ability to obtain taxpayer information is quite limited.

Multilateral tax treaties could ameliorate some of the limits on information exchange. For example, a multilateral treaty could require multiple governments to work together in an audit of a group of companies that carry on activities in several of those jurisdictions. In addition, they might enable countries to share tax information, which they have received from other countries outside the multilateral treaty network.

Reducing treaty shopping: Taxpayers commonly use treaty networks in an effort to secure the most tax-advantaged routes for their investment. For example, if a taxpayer in Country A wants to invest in Country B, but Country B imposes a 10% withholding tax rate, the taxpayer in Country A may invest in Country B through a vehicle in Country C if the rate of withholding in the tax treaty between Countries B and C is less than 10%. It is almost impossible to police this kind of treaty shopping; however, if Countries A, B, and C were all members of a multilateral tax treaty with the same rates of withholding, then there would be no incentive for the investor to divert investment through a third country.

Advancing fair approaches to tax issues that cannot be adequately resolved by only one or two states: A range of technical international tax design issues are difficult for one state to adequately address on its own. Transfer pricing and interest deductibility are two illustrative areas where adequate international tax design is difficult if not impossible for one state alone to manage.[29] Disputes about transfer pricing have become a major preoccupation of tax scholars and administrators. Under the model bilateral tax treaties and the domestic tax legislation of most high-income countries, multinational companies are charged with determining an “arm’s-length” price for goods and services exchanged within the corporate group. Tax administrators have a notoriously difficult time determining what goods and services are in fact being transferred between related companies, settling on an arm’s-length price and enforcing an audit on a company that does business in multiple jurisdictions. In addition, transfer pricing audits are hugely expensive for both tax administrators and multinationals.

As noted above, many scholars have endorsed some form of formulary apportionment whereby the profits of a multinational are allocated among the jurisdictions where that corporation has activities based on some objective factors. Although two treaty partners could agree to a form of formulary apportionment as part of their negotiation of a bilateral tax

29. Other difficult issues include conflicting depreciation practices and the treatment of cross-border mergers and acquisitions.

treaty, none have done so. It is possible that countries entering into a multilateral tax agreement might feel less constrained by the model tax treaties and dominant bilateral practices and might consider whether some form of formulary apportionment might be acceptable for multinationals doing business in the countries who are party to the agreement.[30]

Interest deductibility poses similar challenges. A parent company located in Country A may carry on business through a vehicle located in Country B. For the purposes of Country B's law, the vehicle may be classified as a corporation, entitled to be treated as a separate taxpayer. For the purposes of Country A's law, the vehicle may be classified as a flow-through entity, therefore not distinct from the "parent" in Country A. If the entity in Country B borrows some funds and makes deductible interest payments, that entity may receive a deduction in Country B as well as in Country A for the same interest payments. This kind of arrangement, expressed in its simplest form here, is referred to as a "double dip" because two interest deductions have been claimed for one interest payment. While the two countries could conceivably come to some agreement between them about the allocation of the interest deduction, no pair of countries has done so. Instead, countries often cite the ability of businesses in other jurisdictions to enter into similar arrangements as a justification for failing to take action. If, however, several countries were at the negotiating table, it is possible that they could find some mutually agreeable solution to the allocation of interest (and other) expenses.

3.3. Administrative advantages

Reducing interpretive inconsistencies: One of the challenges of a network of bilateral treaties can be that different jurisdictions take different interpretive positions on similar or identical clauses. As a result, some commentators have criticized bilateral treaties as leading to excessive time spent on interpretive issues that may result in a lack of common understanding about similar or identical text.[31] One proposed solution to this problem is the adoption of a multilateral treaty with an international body charged with

30. See, for example, the proposal made by McDaniel, P., "Formulary Taxation in the North American Free Trade Zone", 49 *Tax Law Review* 4 (1995), p. 691.
31. See e.g. Thuronyi, 26 *Brook. J. Int'l L.* (2000-2001), p. 1641.