
Sieb Kingma
Inclusive Global Tax Governance in the Post-BEPS Era
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Inclusive Global Tax Governance in the Post-BEPS Era

Why this book?
After the 2008 global financial crisis, the international tax policy landscape drastically changed. The OECD was able to exploit the political pressure on the G20 to develop a timely response to the crisis and, together, these organizations took the lead in the much-needed income tax reform process that is still ongoing. Income tax rules are not only under great pressure internationally because big multinationals and rich individuals are able to avoid and evade paying taxes, but also because developing countries did not have a voice in the establishment of international tax norms and rules. Accordingly, the effectiveness and legitimacy of the international tax regime can be questioned. Inclusive Global Tax Governance in the Post-BEPS Era addresses these issues by answering the question: Which institutional changes should be made to global tax governance to achieve an effective and legitimate international tax regime? In order to answer this research question, Inclusive Global Tax Governance in the Post-BEPS Era adopts a two-step approach. As a first step, the effectiveness and legitimacy of the international tax regime are evaluated in order to determine which changes to international tax relations are necessary to make the international tax regime more effective and legitimate. As a second step, the current global tax governance model is evaluated by analysing the institutional arrangements of the European Union, G20, OECD, United Nations and International Monetary Fund, and by carrying out a case study into the BEPS reform process. The findings of these two steps are brought together to put forward recommendations for an improved global tax governance model that is fit to achieve an effective and legitimate international tax regime. Inclusive Global Tax Governance in the Post-BEPS Era takes an interdisciplinary approach, connecting the fields of international tax law and international relations. Not only are concepts from international relations, such as sovereignty and the international regime, applied to international taxation, but theories of international relations, such as neoliberal institutionalism and constructivism, are also applied to understand international income tax relations. This is done in an accessible way to make sure that persons not trained in political science are able to understand them.

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Chapter 1

Introduction to the Research

1.1. Introduction and central research question

At this very moment, the much needed reform of the international tax regime (ITR)[1] is ongoing. It is much needed because the norms and rules of the ITR, which were established in the 1920s under the auspices of the League of Nations, have not kept pace with developments in globalization and digitalization. According to the OECD, the norms and rules of the ITR even allow multinational enterprises to enter into arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place and should be taxed. These undesirable practices are referred to as "base erosion and profit shifting" (BEPS).[2] BEPS presents a serious risk to tax revenues, tax sovereignty and tax fairness.[3]

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1. This is not the first time it has been argued that an international tax regime (ITR) exists. In 1997, Avi-Yonah introduced the concept of the ITR based on two principles: the single tax principle and the benefits principle. *See* R.S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 Tax Law Review 3, p. 507 (1997). *See also* R.S. Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of US Treaty Policy*, 59 New York Law School Law Review 2, pp. 305-306 (2015). Avi-Yonah's concept is quite controversial; several authors have supported his view, while others have advocated the view that no ITR exists. *See* R.S. Avi-Yonah, *Tax Competition, Tax Arbitrage and the International Tax Regime*, 61 Bull. Intl. Taxn. 4, p. 130 (2007), Journal Articles & Papers IBFD. Although not everyone agrees that an international (income) tax regime exists, the author believes that an ITR does exist at the most basic level because of the extensive network of bilateral tax treaties (BTTs) that is largely similar in policy and language. Because he largely agrees with Avi-Yonah's concept, the concept of the ITR used in this research will build on Avi-Yonah's concept. However, unlike Avi-Yonah, the author's concept follows the basic structure of international relations theory's consensus definition of an international regime, as established by Krasner: "International regimes are defined as principles, norms, rules, and decision-making procedures around which actor expectations converge in a given issue-area. Principles are beliefs of fact, causation, and rectitude. Norms are standards of behavior defined in terms of rights and obligations. Rules are specific prescriptions or proscriptions for action. Decision-making procedures are prevailing practices for making and implementing collective choice."*See* S.D. Krasner, *Structural Causes and Regime Consequences: Regimes as Intervening Variables*, 36 International Organization 2, pp. 185-186 (1982). The details of the ITR are provided in section 1.2.2. of this chapter.

2. OECD, *Part 1 of a Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries* p. 3 (OECD 2014).

3. OECD, *Addressing Base Erosion and Profit Shifting* p. 5 (OECD 2013).

In addition to the perceived ineffectiveness of the norms and rules of the ITR, the legitimacy of these norms and rules can be questioned, because many states were not represented in the organizations that have set the norms and rules. In line with this, developing countries, civil society organizations (CSOs) and academics question the legitimacy of the OECD – an intergovernmental organization with limited membership – as the leading international standard-setter in tax matters.[4] This indicates that the current global tax governance model suffers from institutional shortcomings. This research addresses all of these matter – not only the perceived ineffectiveness and lack of legitimacy of the norms and rules of the ITR, but also the institutional shortcomings of the current global tax governance model.

The central research question of this dissertation is: Which institutional changes should be made to global tax governance to achieve an effective and legitimate ITR?

As the central research question clearly indicates, this research is primarily concerned with the governance aspects of an effective and legitimate ITR. It will focus on the institutional changes that should be made to the current global tax governance model, in particular to the two stages that lead to an international agreement, being the agenda-setting and decision-making processes.[5] It will set out institutional preconditions that global tax

4. Magalhães, for instance, argues that "a small group of rich countries dominate the field, imposing their will globally through non-binding mechanisms". *See* T.D. Magalhães, *What Is Really Wrong with Global Tax Governance and How to Properly Fix It*, 10 World Tax J. 4, sec. 1. (2018), Journal Articles & Papers IBFD. Others have made similar arguments. *See*, e.g. C. Peters, *On the Legitimacy of International Tax Law* (IBFD 2014), Books IBFD; I.J. Mosquera Valderrama, *Legitimacy and the Making of International Tax Law: The Challenges of Multilateralism*, 7 World Tax J. 3 (2015); S. Fung, *The Questionable Legitimacy of the OECD/G20 BEPS Project*, Erasmus Law Review 2, p. 76 (2017). Equally important is that a large part of the society of states and a number of academics and civil society organizations have called for a stronger UN tax body. *See*, e.g. Financial Transparency Coalition, *Every government that's supported a UN tax body, in one table* (28 Apr. 2017), available at https://financialtransparency.org/list-governments-supported-un-tax-body-one-table/ (accessed 22 Mar. 2019); R.S. Avi-Yonah & H. Xu, *Evaluating BEPS: A Reconsideration of the Benefits Principle and Proposal for UN Oversight*, 6 Harvard Business Law Review 2, p. 185 (2016); and Global Policy Watch, *10 Reasons Why an Intergovernmental UN Tax Body Will Benefit Everyone* (Global Policy Watch 2015), available at https://www.globalpolicywatch.org/blog/2015/06/17/10-reasons-why-an-intergovernmental-un-tax-body-will-benefit-everyone/ (accessed 11 Feb. 2019).

5. The international regulatory process comprises at least the following five main stages: (i) agenda-setting, in which it is decided as to which issues are placed on the regulatory agenda; (ii) negotiation, in which the agreement is negotiated, drafted and promulgated; (iii) implementation, in which the agreement is implemented by the relevant actor(s); (iv) monitoring compliance, in which it is verified as to whether the actors actually play by the rules they agreed to; and (v) enforcement, in which compliance is promoted, while

governance should fulfil in order to achieve an effective and legitimate ITR and will apply them to the current global tax governance model to determine which institutional changes should be made thereto. This research will not determine, however, what the specific tax norms and rules of such an ITR should look like.

To set out the institutional preconditions under which global tax governance can achieve an effective and legitimate ITR, the key evaluative criteria "effective" and "legitimate" will be used to evaluate the ITR. These key evaluative criteria deserve further explanation.

The Oxford English Dictionary defines the adjective "effective" as:
(1) "successful in producing a desired or intended result"; and
(2) "[attributive] existing in fact, though not formally acknowledged as such".

In this research, "effective" should be understood as it is defined under point (1) above. This interpretation is in line with the broad understanding of effectiveness in the context of the study of international regimes. Under this understanding, effectiveness has to do with the contributions that regimes make towards solving the problems that motivate actors to create them.[6] As the occurrence of BEPS indicates, the policy objectives of the ITR are no longer achieved. Accordingly, the effectiveness of the ITR can be questioned. This research will therefore evaluate the effectiveness of the ITR to determine which of its aspects should be reconsidered to achieve its desired or intended policy objectives. The details of the ITR are provided in section 1.2.2.

Legitimacy is, as Peters puts it, "a complex and multifaceted concept".[7] It should therefore be seen in its proper context. Historically, legitimacy has been used to question the "rightness" of rules and the way in which these rules are created.[8] This will form the basis of the inquiry into legitimacy, but

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non-compliance might be sanctioned. *See* K.W. Abbott & D. Snidal, *The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State*, in *The Politics of Global Regulation* p. 63 (W. Mattli & N. Woods eds., Princeton University Press 2009). *See also* T. Rixen, *Institutional Reform of Global Tax Governance: A Proposal*, in *Global Tax Governance: What is wrong with it and how to fix it* pp. 332-333 (P. Dietsch & T. Rixen eds., ECPR Press 2016).

6. M.A. Levy, O.R. Young & M. Zürn, *The Study of International Regimes*, 1 European Journal of International Relations 3, pp. 267 and 291 (1995).

7. Peters, *supra* n. 4, at sec. 1.3.3.

8. S.P. Mulligan, *The Uses of Legitimacy in International Relations*, 34 Millennium: Journal of International Studies 2, pp. 349 and 358-359 (2005).

it is translated into the international perspective as questioning the rightness of the norms and rules of the ITR and the way in which they are created.[9] In this context, it should be noted that this research focuses in particular on procedural legitimacy. This approach looks at the process of reaching an international agreement in order to determine whether the agreement can be considered legitimate.[10] The underlying premise is that if the process leading to an international agreement meets the standard of legitimacy, the agreement itself should be considered legitimate. The inquiry into legitimacy is therefore concerned with the question of whether the relevant actors have access to the forum in which international tax norms and rules are created or, more concretely, whether they are able to provide input on the forum's agenda-setting and decision-making processes.

To clarify the context of the inquiry into legitimacy, the work of Scharpf, which was further developed by Schmidt and Mosquera Valderrama, should be considered. Scharpf distinguishes two faces of democratic self-determination: (i) input-oriented democratic thought, or input legitimacy; and (ii) output-oriented democratic thought, or output legitimacy. Input legitimacy puts the focus on "government by the people", which indicates that political choices are legitimate if and because they reflect the "will of the people". Output legitimacy, on the other hand focuses, on "government for the people"', which indicates that political choices are legitimate if and because they effectively promote the common welfare of the people.[11]

Schmidt added "throughput legitimacy" as a third dimension to Scharpf's categorization. Throughput legitimacy looks at the efficacy, accountability and transparency of governance processes, along with their inclusiveness and openness to consultation with the people.[12] Mosquera Valderrama

9. This research is not the first to assess the legitimacy of international tax law. Three recent contributions are Peters' dissertation (*supra* n. 4) and the articles of Mosquera Valderrama (*supra* n. 4) and Fung (*supra* n. 4). Peters' dissertation aims to improve the legitimacy of international tax law in the changing state-society interaction (*see* para. 1.3.3.). Mosquera Valderrama's article assesses the input and output legitimacy of the OECD/G20 BEPS Project. Fung applies the three types of complaints that address the alleged "democratic" gap between national and international forms of law-making (i.e. horizontal, vertical and ideological) as established by Alvarez in respect of international taxation in order to assess the legitimacy of the OECD/G20 BEPS Project. *See* J.E. Alvarez, *Introducing the Themes*, 38 Victoria University of Wellington Law Review 2, pp. 159–165 (2007).

10. F.M. Barnard, *Democratic Legitimacy: Plural Values and Political Power* p. 27 (McGill-Queen's University Press 2001).

11. F. Scharpf, *Governing in Europe: Effective and Democratic?* p. 6 (Oxford University Press 1999).

12. V.A. Schmidt, *Democracy and Legitimacy in the European Union Revisited: Input, Output and "Throughput"*, 61 Political Studies 2, p. 2 (2013).

has applied the concepts of input and output legitimacy as established by Scharpf to international tax law-making in the OECD/G20 BEPS Project and has translated them into the society of states instead of states' societies.[13] In her understanding, "[i]nput legitimacy addresses the participation and representation of developing countries in setting the agenda and in the drafting of the content of the OECD/G20 BEPS initiative", while "[o]utput legitimacy addresses the search for collective solutions to deal with base erosion and profit shifting, including the mechanisms to realize these solutions, which differ between OECD member countries and non-OECD, i.e. developing, countries".[14] Throughput legitimacy is not applied by Mosquera Valderrama, but it would add another dimension to the analysis by focusing on the governance processes of the OECD/G20 BEPS Project and the participation of non-state actors therein.

Since the focus of this research is on the agenda-setting and decision-making processes in the setting of international tax standards, the inquiry into legitimacy predominantly involves assessing Mosquera Valderrama's translation of Scharpf's input legitimacy and Schmidt's throughput legitimacy. Because states still possess de jure tax sovereignty (which is the formal competence to set their own tax policies) and are, thus, responsible for tax legislation, the author agrees with Mosquera Valderrama's translation of Scharpf's input legitimacy addressed to the society of states. In line with her understanding, this research will assess input legitimacy by looking at the participation of all members of the society of states in the agenda-setting and decision-making processes in the setting of international tax standards. Additionally, this research will assess throughput legitimacy by evaluating tax governance processes in terms of their transparency and openness in relation to non-state actors.

As will be argued in section 1.2.2., the ITR is path-dependent. This indicates that it is highly unlikely that there will be a complete overhaul of the norms and rules of the ITR. However, because a large part of the society of states was not able to participate in the creation of these norms and rules, the standard of procedural legitimacy was not met. In order for the ITR to become acceptable for those that did not have a voice in its creation – and, thus, in order for it to become legitimate – these norms and rules should be evaluated from the perspective of these actors. As Mosquera Valderrama convincingly argues, a lack of input legitimacy could be, to some extent,

13. Mosquera Valderrama, *supra* n. 4; and I.J. Mosquera Valderrama, *Output Legitimacy Deficits and the Inclusive Framework of the OECD/G20 Base Erosion and Profit Shifting Initiative*, 72 Bull. Intl. Taxn. 3, p. 160 (2018), Journal Articles & Papers IBFD.
14. Mosquera Valderrama (2018), id.

permissible if output legitimacy exists.[15] Accordingly, this research will not only determine how the agenda-setting and decision-making processes in international tax matters should look from a procedural legitimacy perspective, but will also evaluate the legitimacy of the existing norms and rules of the ITR to determine which of its aspects should be reconsidered to improve its legitimacy.

As mentioned above, the key evaluative criteria of effectiveness and legitimacy will be used to set out the institutional preconditions that global tax governance should fulfil in order to achieve an effective and legitimate ITR. These institutional preconditions relate to the following questions:

– Who should participate in the creation of international income tax norms and rules?
– How should they cooperate?
– What should be on the agenda to achieve an effective and legitimate ITR?

The first two questions of institutional preconditions relate to the institutional aspects of the agenda-setting and decision-making processes. Since this research assesses both input and throughput legitimacy, it will not only determine the capacity within which states should participate in these processes, but also the capacity within which other actors should do so. In this context, it should be noted that participation could range from consultation to actual influence on decisions taken. The third question of institutional preconditions relates to the tax norms and rules of the ITR that should be reconsidered to address their perceived ineffectiveness and lack of legitimacy. The institutional preconditions will be set out in Part 2 of this research and applied to the current global tax governance model in Part 5 in order to answer the central research question. In between, the current global tax governance model will be analysed.

In the remainder of this chapter, first, the scene is set by introducing the key concepts of this research, being tax sovereignty, the international tax regime, the need for international governmental organizations and the globalization paradox of international tax cooperation (*see* section 1.2.). Second, the three key objectives of this research are formulated (*see* section 1.3.). Third, the research design is explained in more detail (*see* section 1.4.). Fourth and finally, the outline of this research is provided (*see* section 1.5.).

15. Id.

1.2. Setting the scene

Ultimately, the current issues of the ITR are the result of the fact that states have relied heavily on their de jure tax sovereignty. States have cooperated in the field of taxation, but only through sovereignty-preserving legal constructs.[16] The fact that states have relied so heavily on their tax sovereignty is not surprising, considering that taxes are the most important source of government revenue[17] and that tax policy can influence the overall demand in the economy, growth, stability of prices and employment levels.[18] A state's need for revenue has even been considered one of its central and defining features, and raising taxes has been considered its most basic task.[19] It has even been said that the modern state can be considered a tax state.[20] Because a state is able to collect tax revenue, it is considered sovereign.[21]

1.2.1. Tax sovereignty

Sovereignty is a central characteristic of modern states,[22] and it plays a central role in international relations as an organizing principle.[23] There is, however, no single definition of sovereignty, because its meaning depends on the context within which it is being used.[24] Although there is no single

16. T. Rixen, *From Double Tax Avoidance to Tax Competition: Explaining the Institutional Trajectory of International Tax Governance*, 18 Review of International Political Economy 2, pp.197 and 206 (2011).
17. There are exceptions, of course. In some oil-producing countries, for instance, oil accounts for the vast majority of government revenue. *See* J.M. Davis, R. Ossowski & A. Fedelino (eds.), *Fiscal Policy Formulation and Implementation in Oil-Producing Countries* (IMF 2003).
18. D.M. Ring, *What's at Stake in the Sovereignty Debate? International Tax and the Nation-State*, 49 Virginia Journal of International Law 1, pp. 155 and 167-170 (2008).
19. M. Stewart, *Introduction: New Research on Tax Law and Political Institutions*, 24 Law in Context: Tax Law and Political Institutions 1, p. 1 (2006).
20. J.A. Schumpeter, *The Crisis of the Tax State*, in *Joseph A Schumpeter: The Economics and Sociology of Capitalism* p. 108 (R. Swedberg ed., Princeton University Press 1991). *See also* P. Genschel, *Globalization and the Transformation of the Tax State*, 13 European Review 1, p. 53 (2005).
21. Genschel, id., at p. 60.
22. C.W. Morris, *An Essay on the Modern State* p. 172 (Cambridge University Press 1998).
23. T.J. Biersteker, *State, Sovereignty, and Territory*, in *Handbook of International Relations* p. 260 (2nd ed., W. Carlnaes, T. Risse & B.A. Simmons eds., SAGE Publication Ltd 2013).
24. Sovereignty has been commonly used in different ways. For example, there is (i) domestic sovereignty, which refers to the organization of state authority within the state and the level of effective control exercised by the state; (ii) interdependence sovereignty, which refers to the ability of the state to control trans-border movements; (iii)

definition of sovereignty, a clear distinction is made between the internal and external aspects of it. Internal sovereignty refers to the state having full autonomy within its own borders and the recognition of that authority by its residents. External sovereignty refers to independence from outside authorities and the recognition of that independence by these outside authorities.[25]

The concept of sovereignty has been applied several times in the context of taxation. Tax sovereignty is conceptualized differently, but it is closely related in the literature. According to Souza de Man, the concept of tax sovereignty implies that states are free to draft their tax legislation.[26] McLure, Jr defines tax sovereignty as "the ability of a nation to pursue whatever tax policy it chooses, unfettered by external influences".[27] According to Christians, tax sovereignty is "the idea that governments have a non-exclusive right to decide through political means whether and how to tax whatever activity occurs within their territories and whomever can be considered to be their 'people', and that they recognize a reciprocal right in all other States".[28] Genschel and Rixen describe tax sovereignty as "the exclusive right of national governments to make law (legal sovereignty), to administer and enforce tax law (administrative sovereignty), and to claim all tax revenue for the national budget (revenue sovereignty)".[29] For his doctoral thesis,

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internation sovereignty, which refers to the mutual recognition of states or other entities; (iv) Westphalian sovereignty, which refers to the exclusion of external actors from domestic authority configurations; and (v) international legal sovereignty, which refers to the status of states in the international community. *See* S.D. Krasner, *Compromising Westphalia*, 20 International Security 3, pp. 115 and 118-121 (1995); and P. Dietsch, *Rethinking Sovereignty in International Fiscal Policy*, 37 Review of International Studies 5, pp. 2107 and 2109-2111 (2011). *See also*, for an extensive overview of the history of the concept of sovereignty, M. Isenbaert, *EC Law and the Sovereignty of the Member States in Direct Taxation* ch. 2 (IBFD 2010), Books IBFD.

25. E.g. Morris, *supra* n. 22, at p. 172; and Biersteker, *supra* n. 23, at p. 261. Jeffery describes the internal and external dimension of sovereignty from a legal perspective, and, therefore, differently. The internal dimension is determined by the state's own internal constitutional arrangements, as well as the external dimension by the interaction of international law with national law. *See* R.J. Jeffery, *The Impact of State Sovereignty on Global Trade and International Taxation* p. 25 (Kluwer Law International 1999).

26. F. Souza de Man, *Taxation of Cross-Border Provision of Services in Double Tax Conventions between Developed and Developing Countries: A Proposal for New Guidelines* p. 27 (2013).

27. C.E. McLure, Jr, *Globalization, tax rules and national sovereignty*, 55 Bull. Intl. Taxn. 8, pp. 328-329 (2001), Journal Articles & Papers IBFD.

28. A. Christians, *Sovereignty, Taxation and Social Contract*, 18 Minnesota Journal of International Law 1, pp. 99 and 110-111 (2009).

29. P. Genschel & T. Rixen, *Settling and Unsettling the Transnational Legal Order of International Taxation*, in *Transnational Legal Orders* p. 156 (T.C. Halliday & G. Schaffer eds., Cambridge University Press 2015).

Rixen used a different concept of tax sovereignty, referring to it as the state's power to tax its territory, citizens and residents.[30] Building on these conceptions, the following broad conception of tax sovereignty has been established: tax sovereignty is the exclusive competence of a state to set its own tax policy. In this context, tax policy should be understood in the broadest possible sense: it does not only include the design of the state's tax system, its tax laws, the administration and enforcement of these tax laws and the claim to the revenue, but it also includes the competence of the state to decide with whom and in which manner to cooperate in the field of taxation.

The boundaries of the state's competence to tax have traditionally been based on geographical territorial connections. In general, the state only has the competence to tax when there is a subjective or an objective nexus between the taxpayer and the state: the state has the competence to tax all activities of its residents and/or citizens (so-called "residence jurisdiction") and the competence to tax non-residents regarding their activities that occur in its territory (so-called "source jurisdiction").

States still possess de jure tax sovereignty. They want their tax policies to remain tailored to their own interests because they view tax policy as an important component in pursuing socio-economic policy.[31] In accordance with rational choice theory,[32] Rixen argues that states are expected to use tax policy to maximize their national welfare.[33] When international trade and the movement of capital were restricted by trade barriers and capital controls, tax policy was mostly a national affair,[34] and states could effectively achieve their desired policy goals. Globalization, however, opened up the borders for outside authorities, such as other states, international

30. T. Rixen, *The Political Economy of International Tax Governance* p. 27 (Palgrave Macmillan 2008).
31. A.J. Cockfield, *The Rise of the OECD as Informal "World Tax Organization" Through National Responses to E-commerce Tax Challenges*, 8 Yale Journal of Law and Technology 1, pp. 136 and 180 (2006).
32. The "rational choice" theory starts from the premise that states are motivated by self-interest and act strategically to advance those interests. *See* I. Johnstone, *Law-Making by International Organizations: Perspectives from IL/IR Theory*, in *Interdisciplinary Perspectives on International Law and International Relations: The State of the Art* p. 276 (J.L. Dunoff & M.A. Pollack eds., Cambridge University Press 2013).
33. Rixen, *supra* n. 16, at p. 200.
34. Genschel, *supra* n. 20, at p. 54.

governmental organizations (IGOs),[35] international non-governmental organizations (NGOs)[36] and "informal" horizontal networks.[37] Because of economic integration and because of the establishment of international organizations, the idea of the state being completely independent from all external forces and in complete control domestically has been revealed to be a fiction.[38] Their de facto tax sovereignty – that is, the ability to effectively achieve their desired tax policy goals – has, thus, been weakened.[39]

1.2.2. The ITR

States have relied heavily on their de jure tax sovereignty, but this does not mean that they have not cooperated and coordinated at all in the field of taxation. Already in 1899, the first international tax agreement was concluded,[40] and in 1928, the first model tax convention was drawn up.[41] The cooperation and coordination efforts led to the establishment of an ITR. International income taxation, therefore, does not result in a situation of total (unregulated) tax competition (which implies a lack of tax coordination), but it is also not a situation of complete tax harmonization (which implies total tax coordination). The ITR is in between. It results in a situation of tax cooperation

35. International governmental organizations are organizations established by a treaty or other instrument governed by international law, possessing their own international legal personalities, with mainly state members. Although informal horizontal networks with governmental members do not fit this definition, the term "international governmental organizations" will be used in this research to refer to both "formal" international governmental organizations and "informal" horizontal networks with governmental members.

36. International non-governmental organizations (NGOs) are international organizations with non-governmental members. International NGOs can be divided into non-profit-oriented transnational organizations and profit-oriented transnational organizations (multinational enterprises, or MNEs). Strictly speaking, NGOs thus refer to both civil society organizations and MNEs, although the abbreviation "NGO" is ordinarily used to refer to civil society organizations. To avoid confusion, in this research, NGOs will be used to refer to both non-profit-oriented transnational organizations and profit-oriented transnational organizations. *See* V. Rittberger, B. Zangl & A. Kruck, *International Organization* pp. 7-9 (2nd ed., Palgrave Macmillan 2012).

37. Slaughter defines a network as "a pattern of regular and purposive relations among like government units working across the borders that divide countries from one another and that demarcate the 'domestic' from the 'international' sphere". Horizontal networks bring together national government officials in their respective issue areas. *See* A-M. Slaughter, *A New World Order* p. 14 (Princeton University Press 2004).

38. *See also* S.D. Krasner, *Sovereignty: Organized Hypocrisy* pp. 40-42 (Princeton University Press 1999); Isenbaert, *supra* n. 24, at pp. 54-58.

39. Rixen, *supra* n. 30, at p. 27; and Dietsch, *supra* n. 24, at p. 2109.

40. The first international tax agreement was concluded between Prussia and Austria-Hungary. *See* Rixen, *supra* n. 30, at p. 87.

41. The first model tax convention was drawn up by the League of Nations. *See*, for a historical overview of model tax conventions, id., at ch. 5.

whereby states work together for their mutual benefit and undertake greater coordination between tax policies, but they stop short of imposing obligations upon each other to operate identical tax systems.[42]

The ITR is limited in scope, since its guidelines focus almost exclusively on taxes on income and capital and ignore other direct and indirect taxes. It exists primarily because of the presence of over 3,000 bilateral tax treaties (BTTs). Even though all BTTs are concluded by different states after extensive negotiations, they are largely similar in policy and in wording,[43] as they are ordinarily based on non-binding model tax conventions, which are established by IGOs.[44] The ITR does not interfere with national tax laws. The rules are, in Rixen's words, "sovereignty-preserving in so far as they accept different national tax systems as givens".[45] The ITR aims at coordinating different tax systems, not harmonizing them:[46] BTTs only allocate the competence to tax to states; states can still apply their own national tax laws to their respective shares of the tax base.[47] Although the rules of the ITR have become more sophisticated and complex over time, the fundamental principles of the ITR have remained unchanged since the 1920s.[48] This perfectly exemplifies the strong path dependency[49] of the ITR.[50]

There have been several interpretations of the ITR in literature. The concept of the ITR here is built on three existing conceptions of it, which are first summarized below. The best-known interpretation of the ITR was

42. J. Owens, *Globalisation: Implications for Tax Policies*, 14 Fiscal Studies 21, pp. 39-44 (1993).
43. Ash and Marian made an empirical investigation to test the level of transnational consensus on the legal language controlling international tax matters. In order to do so, they built a database of 4,502 BTTs and 16 model tax conventions and used natural language processing to test the legal language convergence of these treaties. They found that there are clear trends towards convergence in legal language in treaties since the 1960s. *See* E. Ash & O.Y. Marian, *The Making of International Tax Law: Empirical Evidence from Natural Language Processing*, UC Irvine School of Law Research Paper No. 2019-02 (2019), available at https://ssrn.com/abstract=3314310 (accessed 29 Aug. 2019).
44. R.S. Avi-Yonah, *International Tax as International Law: An Analysis of the International Tax Regime* p. 3 (Cambridge University Press 2007).
45. Rixen, *supra* n. 30, at p. 150.
46. Id.
47. Rixen, *supra* n. 16, at p. 206.
48. Id., at pp. 207-208.
49. The concept of path dependency indicates that preceding steps in a particular direction induce further movement in the same direction. *See* P. Pierson, *Increasing Returns, Path Dependence, and the Study of Politics*, 94 The American Political Science Review 2, pp. 251-252 (2000).
50. *See also* R. Eccleston, *The Dynamics of Global Governance: The Financial Crisis, the OECD, and the Politics of International Tax Cooperation* p. 69 (Edward Elgar Publishing 2012).

introduced by Avi-Yonah in 1997 and was developed further over the years. Avi-Yonah argues that the domestic tax laws of various jurisdictions and their bilateral tax treaties form an ITR that is part of customary international law.[51] The single tax principle and the benefits principle are at the heart of this ITR.[52] The single tax principle implies that cross-border income should not be subject to tax more than once, but it also should not be taxed less than once at the rate determined by the benefits principle. The benefits principle allocates the right to tax active (business) income primarily to the source state, while the right to tax passive (investment) income is primarily allocated to the residence state.[53] Avi-Yonah's concept has been supported by several authors, while others have advocated the view that no ITR exists.[54] Whereas the benefits principle is broadly accepted, the single tax principle is quite controversial, because double non-taxation actually occurs. Avi-Yonah tries to convince sceptics by stating that the OECD and an increasing number of tax administrations believe in the single tax principle and seek to implement it in practice.[55] However, the fact that double non-taxation has been on the international tax agenda for a while does not necessarily make it part of the regime.[56] In this respect, the author thinks that Avi-Yonah's single tax principle does not do justice to tax sovereignty. He therefore proposes a slight alteration to Avi-Yonah's single tax principle: cross-border income should be subject to tax not more than once, but also not less than once at the rate determined by the state that may tax according to the benefits principle. Additionally, Avi-Yonah's two principles do not tell the whole story about the international tax regime, and therefore, some elements should be added.

51. Avi-Yonah, *supra* n. 44, at pp. 4-5.
52. From the regime theory of international relations theory, the benefits principle resembles a norm rather than a principle.
53. Avi-Yonah, *supra* n. 44, at p. 3.
54. Avi-Yonah presents an overview of the most prominent critics and supporters of his concept in id., at p. 1; and Avi-Yonah (2007), *supra* n. 1, at p. 130.
55. Avi-Yonah, *supra* n. 44, at p. 182.
56. Parada is also critical of the notion of double non-taxation in the context of the single tax principle. For his conceptual analysis of double non-taxation, *see* L. Parada, *Double Non-taxation and the Use of Hybrid Entities: An Alternative Approach in the New Era of BEPS* ch. 1 (Kluwer Law International 2018). De Melo Rigoni, on the other hand, argues that the ITR is now in its third stage and that the focus of the single tax principle has changed in each stage. In the ITR's first stage, which lasted from 1928 until 1997, the single tax principle focused on double taxation only. In the second stage, which lasted from 1998 until 2013, the single tax principle focused on the avoidance of double taxation and, formally, on the avoidance of double non-taxation as well. In the third stage, which started in 2013, the single tax principle focuses on the avoidance of both double taxation and double non-taxation. *See* J.M. De Melo Rigoni, *The International Tax Regime in the Twenty-First Century: The Emergence of a Third Stage*, 45 Intertax 3, p. 205 (2007).

Unlike Avi-Yonah, Ring and Broekhuijsen have applied international relations' regime theory to international taxation. According to Ring, it is inaccurate to use the term "regime" to describe all operations in the international tax arena. Some features of the international tax system constitute a regime, while others do not.[57] Ring has applied regime theory to what she calls the "avoidance of double taxation" regime. The principle is that international double income taxation is harmful and should be avoided. The norm is that residence countries yield primary tax jurisdiction to the source state, at least with respect to certain types of income. The rules include the details of the particular mechanisms by which the residence jurisdiction yields to the source jurisdiction, and the procedures include the process of bilateral specification through a negotiated treaty with reciprocal rules and obligations and the opportunity for review through the competent authority mechanism.[58]

Broekhuijsen has used regime theory to construct an analytical framework for analysing international tax relations in the context of the conclusion of a multilateral agreement for international taxation. His concept of the international tax regime is as follows:

- the principles are (i) national tax sovereignty; (ii) an idea of states' "fair shares", based on concepts such as source and residence; and (iii) a perception of the international tax environment as a competitive "market" for foreign direct investment (FDI);
- the norms can be found in the various model tax conventions, with the OECD Model Tax Convention (OECD Model)[59] and its Commentary being the dominant resource;
- the rules are the terms of bilateral treaties; and
- decision-making procedures are predominantly national and are added by mutual agreement procedure (MAP).[60]

Building on the three concepts of an ITR, this research creates its own concept of the international (income) tax regime:

- the principles are:
  - states still possess and try to preserve their de jure tax sovereignty. Accordingly, they are responsible for their domestic tax laws and the conclusion of tax treaties;

57. D. Ring, *International Tax Relations: Theory and Implications*, 60 Tax Law Review 2, pp. 83 and 115 (2007).
58. Id., at pp. 116-117.
59. *OECD Model Tax Convention on Income and on Capital* (23 Nov. 2017), Treaties & Models IBFD [hereinafter OECD Model (2017)].
60. D.M. Broekhuijsen, *A Multilateral Tax Treaty: Designing an Instrument to Modernise International Tax Law* pp. 64-65 (EM Meijers Institute 2017).

  - juridical double taxation is harmful and should be avoided; and
  - states should be able to use tax policy for competitive purposes, especially to attract FDI;
- the norms are:
  - states can only tax natural and legal persons when there is a personal or physical nexus between the state and the taxpayer;
  - states should avoid double taxation either unilaterally, bilaterally or multilaterally; and
  - states should base their treaties on the blueprint provided by model tax conventions, which includes the way in which the benefits principle should be applied or, put differently, the way in which taxing rights should be allocated;
- the specific rules can be found in domestic tax laws and tax treaties; and
- the decision-making procedures are predominantly national, while tax treaties are concluded between states on the basis of consensus.

1.2.3. The need for IGOs

Although states relied heavily on their tax sovereignty in the pre-BEPS era,[61] they needed IGOs for their cooperation and coordination efforts. Several IGOs have played a critical role in the development of the ITR. The League of Nations was the first IGO that produced output concerning the ITR by virtue of its 1928 Model Tax Convention.[62] After World War II, when the League of Nations was replaced by the United Nations as the world peace organization, the League of Nations expected the United Nations to take over its work in the field of taxation. The United Nations initially tried to do so by establishing a Financial and Fiscal Commission, made up of 15 national experts within the Economic and Social Council, but because the Financial and Fiscal Commission's meetings were heavily politicized and its members were unable to reach a compromise between the residence and source principles, it ceased to meet after 1954. It was not until 1968 that the United Nations created a new tax committee. By that time, the OECD – and its predecessor, the Organisation for European Economic Co-operation (OEEC) – had already taken up the work of the League of Nations in the

61. The "pre-BEPS era" refers to the period before the BEPS reform process started, which was the period before 2012. In 2012, the issue started to appear on the international tax agenda.
62. Although it has been argued that model tax conventions favour residence states, the allocation of taxing rights introduced by the League of Nations represented a compromise between source and residence states. *See* Ring, *supra* n. 57, at p. 121; and Rixen, *supra* n. 30, at ch. 5.

field of taxation.[63] The OECD played a crucial role in the development of the ITR, and it became the leading IGO in international tax matters.[64] The OECD is even described as "the major forum for international tax policy",[65] "the expert body for international tax affairs"[66] and an "informal 'world tax organisation'".[67]

Both the OECD and the United Nations have established their own model tax conventions. In addition to the provisions for the avoidance of double taxation of income and capital, both models contain a non-discrimination provision, a MAP and provisions to improve administrative cooperation in tax matters for the purpose of preventing tax evasion and avoidance. The first version of the OECD Model was published in 1963. The first version of the UN Model Double Taxation Convention between Developed and Developing Countries (UN Model) was published in 1980. The first UN Model was largely based on the OECD Model,[68] with a similar structure and terminology.[69] Compared to the OECD Model, the UN Model gives more weight to the source principle and, therefore, leans more towards the interests of developing countries.[70] As the UN Model is based on the OECD Model, the over 3,000 BTTs in force are all essentially based on the OECD Model, and the texts of these BTTs deviate very little from the text of the OECD Model.[71]

63. Rixen, *supra* n. 30, at p. 96.
64. R. Eccleston & R. Woodward, *Pathologies in International Policy Transfer: The Case of the OECD Tax Transparency Initiative*, 16 Journal of Comparative Policy Analysis: Research and Practice 3, pp. 216 and 219 (2014).
65. C.M. Radaelli, *Game Theory and Institutional Entrepreneurship: Transfer Pricing and the Search for Coordination in Internation Tax Policy*, 26 Policy Studies Journal 4, 603 and 605 (1998).
66. Eccleston & Woodward, *supra* n. 64, at p. 226.
67. Cockfield, *supra* n. 31, at p. 180.
68. M. Lennard, *The purpose and the current status of the United Nations tax work*, 14 Asia-Pac. Tax Bull. 1, pp. 23-24 (2008), Journal Articles & Papers IBFD.
69. V. Daurer, *Tax Treaties and Developing Countries* p. 62 (Kluwer Law International 2014).
70. *United Nations Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 2018), Treaties & Models IBFD [hereinafter UN Model (2017)]. To give an example, (i) art. 10(2) of the OECD Model (2017) limits source taxing rights on dividends to 5% or 15% of the gross amount of the dividends; (ii) art. 11(2) of the OECD Model (2017) limits source taxing rights on interests to 10% of the gross amount of the interest; and (iii) art. 12 of the OECD Model (2017) excludes the source country from taxing royalties at all. The corresponding articles of the UN Model (2017), on the other hand, do not contain fixed percentages for the source taxation of dividends and interest and allow source taxation in the case of royalties.
71. M. Bennett, *Part II: OECD as a Standard-Setting Organization: Questions Remain on Cultural Acceptance*, 67 Tax Executive 6, p. 22 (2015).

Whereas the OECD and the United Nations have influenced the actual design of international tax policy and tax rules in the pre-BEPS era up to the creation of soft law, the European Union has influenced its Member States to the extent of the creation of hard law in the form of secondary EU law. In the European Union, indirect taxes are harmonized extensively under EU law, while direct taxes are scarcely harmonized.[72] Most of the European Union's pre-BEPS output in the field of direct taxation – such as the Interest and Royalties Directive[73] and the Parent-Subsidiary Directive[74]– has been adopted with a view to eliminating the double taxation of companies.[75] As the adoption of secondary EU law in the field of taxation requires unanimity from the Council of the European Union, which is made up of one representative from each Member State at the ministerial level, even in the European Union, states cooperate in a sovereignty-preserving manner.

1.2.4. The globalization paradox of international tax cooperation

In the pre-BEPS era, the focus of the cooperation and coordination efforts in direct taxation was primarily on the avoidance of double taxation. This problem was overcome to a large extent, while other problems like (legal) tax avoidance and (illegal) tax evasion were put aside.[76] Accordingly, Avi-Yonah describes the existence of the current ITR as a "flawed miracle". It is a miracle because taxation is the last field that states are expected to reach consensus on, as international taxation is, to some extent, a zero-sum game.[77] However, the ITR is flawed because its norms and rules have become obsolete due to globalization and digitalization.[78] Because of BEPS arrangements, both the benefits and single tax principles are threatened: not only are profits shifted away from the jurisdictions where the activities creating those profits take place and should be taxed, but there are also profits that

72. R. Szudoczky, *The Sources of EU Law and Their Relationships: Lessons for the Field of Taxation* sec. 8.1. (IBFD 2014), Books IBFD.
73. Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, OJ L 157 (2003), Primary Sources IBFD.
74. Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 345 (2011), Primary Sources IBFD.
75. M. Schaper, *The Structure and Organization of EU Law in the Field of Direct Taxes* p. 293 (IBFD 2013), Books IBFD.
76. Rixen, *supra* n. 30, at p. 149.
77. One state's gain is the other's loss.
78. R.S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 Texas Law Review 6, pp. 1301 and 1303-1304 (1996).

are not taxed at all. Despite states' reliance on de jure tax sovereignty, their de facto tax sovereignty has, thus, been weakened.

The current problems of the ITR have not yet been resolved, since tax cooperation has been in a globalization paradox. States need international actors to solve collective problems that can only be addressed on a global scale; however, the centralization of decision-making power and coercive authority is considered to be both infeasible and undesirable.[79] Considering the issue of double taxation, states needed an IGO (first, the League of Nations, and later, the OEEC, OECD and United Nations) to resolve the issue of double taxation through the creation of a model tax convention. The rationale behind a model tax convention as a basis for concluding BTTs was that a single multilateral treaty would emerge if multiple treaties were built on a structurally similar model, producing uniformity in international tax law even without a supranational authority.[80] However, after almost a century of model tax conventions, this still did not happen.[81] This perfectly exemplifies the globalization paradox in which tax cooperation finds itself.

Hence, states remain the principal actors in the ITR.[82] In the absence of a legitimate authority ruling over the ITR (like a global tax organization), there are two ways to describe the current international institutional framework in the field of taxation. First, there is international anarchy, which is not synonymous with chaos and disorder, but used to describe a world order without a supranational authority and without effective norms and rules. Second, there is global governance, which is about how actors work together to maintain order and achieve collective goals in the absence of a legitimate authority.[83] As the current international institutional framework in the field of income taxation does not entirely lack organization (there are IGOs involved in tax matters, and, at the most basic level, an ITR exists), global tax governance is the best way to describe it.

79. *See*, for the concept of the globalization paradox, Slaughter, *supra* n. 37, at p. 8.
80. A. Christians, *Networks, Norms, and National Tax Policy*, 9 Washington University Global Studies Law Review 1, p. 13 (2010).
81. Although Ash & Marian, *supra* n. 43 observe a clear convergence in the legal language in tax treaties, tax treaties still differ. Additionally, the practice is still that states negotiate and conclude the terms of their tax treaties bilaterally, not multilaterally.
82. *See also* J.E. Dougherty & R.L. Pfaltzgraff, Jr, *Contending Theories of International Relations: A Comprehensive Survey* p. 545 (5th ed., Longman 2001); and N. Bisley, *Rethinking Globalization* p. 64 (Palgrave Macmillan 2007).
83. V. Rittberger et al., *International Organization* p. 230 (3rd ed., Red Globe Press 2019).

At the turn of the 21st century, the focus of the cooperation and coordination efforts in international taxation started to shift. The focus was no longer on the avoidance of double taxation alone, but IGOs started to address the issue of harmful tax competition – whatever this term may refer to – as well. The initiatives of the IGOs enjoyed mixed success. Mandated by the G7 in 1996,[84] the OECD published the report "Harmful Tax Competition: An Emerging Issue" in 1998,[85] which marked the start of the OECD's campaign against harmful tax competition. However, because the support of OECD member countries for the campaign had declined and outside opponents had started a campaign against it, its scope had narrowed to enhancing information exchange by 2003.[86] In the European Union, the issue of harmful tax competition was addressed in 1997 with the Code of Conduct for Business Taxation.[87] By virtue of the Code of Conduct for Business Taxation, the EU Member States made a commitment not to introduce new tax measures that are harmful within the meaning of the Code and to re-examine their existing laws and established practices, having regard to the principles of and the review process outlined in the Code.[88] Nevertheless, the Code of Conduct is not a hard law instrument, but merely a political agreement.[89]

After the 2008 financial crisis, the dynamics of cooperation and coordination in international taxation really changed. The OECD was able to exploit the political pressure on the G20 to develop a timely response to the crisis,[90] and, consequently, developments regarding tax transparency and the exchange of information for tax purposes followed rapidly. It was not until 2012 that the first IGO presented its action plan for a fundamental reform of the substantive norms and rules of the ITR. The European Commission was the first to release an action plan to strengthen the fight against tax fraud and tax evasion, released on 6 December 2012.[91] Nonetheless, the OECD,

84. G7, *Economic Communiqué: Making a Success of Globalization for the Benefit of All*, point 16 (28 June 1996).
85. OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD 1998).
86. Eccleston, *supra* n. 50, at ch. 3.
87. M. Nouwen, *The Gathering Momentum of International and Supranational Action against Aggressive Tax Planning and Harmful Tax Competition: The State of Play of Recent Work of the OECD and European Union*, 53 Eur. Taxn. 10, sec. 3.2.1. (2013), Journal Articles & Papers IBFD.
88. *See* the conclusions of the ECOFIN Council meeting on 1 December 1997 concerning tax policy, available at https://op.europa.eu/en/publication-detail/-/publication/0731e175-b38d-4fea-906a-c3af5efeb89f/language-en (accessed 18 Sept. 2020).
89. *See also* Nouwen, *supra* n. 87, at sec. 3.2.1.
90. Eccleston, *supra* n. 50, at p. 89.
91. Communication from the Commission to the European Parliament and the Council, An Action Plan to strengthen the fight against tax fraud and tax evasion, COM(2012) 722 final (6 Dec. 2012), available at https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2012_722_en.pdf (accessed 7 July 2020). *See also* Nouwen, *supra* n. 87, at sec. 3.1.1.

supported by the G20, took the lead in the reform process by virtue of their joint OECD/G20 BEPS Project. The final BEPS package was presented in October 2015,[92] and its importance was described by the OECD as "the first substantial – and overdue – renovation of the international tax standards in almost a century".[93] The United Nations and the International Monetary Fund (IMF) also made substantial contributions to the BEPS reform process. The United Nations Conference on Trade and Development (UNCTAD), for instance, issued its 2015 World Investment Report: Reforming International Investment Governance, with "international tax and investment policy coherence" as the topic on which an in-depth analysis was conducted,[94] while the IMF issued its policy paper "Spillovers in International Corporate Taxation".[95]

1.2.5. Concluding remarks

To conclude, after almost a century, IGOs have finally started to work on a fundamental reform of the ITR. For this reform to succeed, a reconsideration of the way states cooperate and coordinate is required. Therefore, tax sovereignty should be reconsidered. Although states relied heavily on their de jure tax sovereignty in the pre-BEPS era, the fact that the OECD and G20 managed to reach agreement on the final BEPS package in 2015 indicates that a reconsideration of tax sovereignty – and, accordingly, the nature of international tax relations – is no longer inconceivable.[96] Since the OECD and G20 – two IGOs with limited membership – took the lead in the reform process of the ITR, however, it is questionable as to whether the standard of procedural legitimacy is being met in this process.

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92. OECD, *OECD presents outputs of OECD/G20 BEPS Project for discussion at G20 Finance Ministers meeting* (5 Oct. 2015), available at http://www.oecd.org/tax/oecd-presents-outputs-of-oecd-g20-beps-project-for-discussion-at-g20-finance-ministers-meeting.htm (accessed 5 Feb. 2019).

93. OECD, *Explanatory Statement: 2015 Final Reports* p. 5 (2015).

94. UNCTAD, *World Investment Report 2015: Reforming International Investment Governance* (United Nations 2015).

95. IMF, *Spillovers in International Corporate Taxation* (IMF 2014).

96. Political and financial crises have given rise to global policy innovations in other policy areas in the past. The fact that the recent global financial crises have resulted in political momentum for the reform process of the ITR to take place indicates that this is also true for international taxation. *See* E. Helleiner, *Special Forum: Crisis and the Future of Global Financial Governance*, 15 Global Governance 1, p. 1 (2009); and R. Eccleston, A. Kellow & P. Carroll, *G20 Endorsement in Post Crisis Global Governance: More than a Toothless Talking Shop?*, 17 The British Journal of Politics & International Relations 2, pp. 298 and 304 (2015).

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