Edited by
Reuven S. Avi-Yonah

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Edited by

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Introduction

Reuven S. Avi-Yonah

This collection of articles is intended to exemplify some of the major contributions to international tax scholarship in the last 20 years. Its length illustrates the difficulty of choosing, since this area of tax law has been characterized by a veritable explosion of scholarship, with many of the most important tax academics contributing to it. Nevertheless, it is by no means a comprehensive collection, and many important articles had to be left out.

The organizing principle of this anthology has been to focus on the most important debate, in the editor's opinion, in international tax: whether there exists a supra-national 'international tax regime' embodied in the over 3,000 bilateral tax treaties and in general principles, which meaningfully constrains the domestic tax laws of various countries as applied to cross-border transactions. The editor has argued for the existence of such a regime, which he described in 1996 as a 'flawed miracle'. But many distinguished international tax scholars have disputed this assertion, and argue that each nation's international tax laws are independent and should reflect only its own interests. An attempt has been made to fairly reflect both sides in this debate (which can also be described as multilateral vs. unilateral approaches to international tax law) and to do this in chronological fashion, so that the reader can trace the evolution of the dispute over time. In the contemporary context, this academic debate is reflected in the arguments around the OECD base erosion and profit shifting (BEPS) project, which reflects a multilateral attitude that is anathema to the opponents of the international tax regime. Fittingly, therefore, the collection ends with a recent piece about BEPS, whose author (Hugh J. Ault) was both a major scholar of international tax before the 1990s, and a major theoretician behind the BEPS project.

Chapter 1 in Volume I by the editor, Reuven S. Avi-Yonah, assumes the existence of the international tax regime in its opening sentence. The remainder, however, tries to show both that the regime exists and what its fundamental principles were. The chapter sets out the basic division that was made in 1923 between passive and active income, with passive income taxed primarily by the residence country and active income by the source country. It then shows how this principle (which was later called the benefits principle) is embodied in US tax treaties and domestic laws, and what its principal challenges were – primarily sourcing corporate income and enforcing residence-based taxation of individuals. This article is clearly written from a multilateral perspective, although it does not explicitly say so.

Michael J. Graetz and Michael M. O'Hear's chapter on the 'original intent' of US international taxation follows as an early example of a unilateral approach (Chapter 2, Volume I). It explains that the United States' regime for taxing international income took shape during the decade 1919–1928. In the Revenue Act of 1918, the US enacted, for the first time anywhere in the world, a credit against US income for taxes paid by a US citizen or resident to any foreign government on income earned outside the US. The Revenue Act of 1921, the first major tax enactment following World War I, introduced a limitation on this foreign tax credit

(FTC) to ensure that a taxpayer's total FTCs could not exceed the amount of the US tax liability on the taxpayer's foreign source income. While details of the FTC have changed and the methodology for determining the FTC limitation has varied from time to time, these two provisions still constitute the linchpin of US law taxing income earned abroad by US citizens and residents. In Graetz and O'Hear's opinion, these unilateral enactments indicate that the US tax regime stands on its own, and that it originally emphasized the primacy of source-based taxation.

The editor's chapter on international taxation of electronic commerce (Chapter 3, Volume I) first sets out the two basic principles that, in his view, form the basis of the international tax regime: the benefits principle and the much more disputed single tax principle, which states that income should not be subject to tax more or less than once, at the rate set by the benefits principle (that is, the source rate for active income and the residence rate for passive income). The editor then applies these principles to the new area of electronic commerce and shows how it threatens to especially undermine source-based taxation of corporate income.

Nancy H. Kaufman's article (Chapter 4, Volume I) was a ground-breaking effort to introduce principles of fairness into the international tax regime. This chapter explains the theoretical foundations of the benefits principle and in particular argues for a better way of sourcing corporate income. In light of the limits of economic analysis of international tax, it injects an important concern for equity into the debate, while taking a clear pro-international tax regime perspective.

In 2000, the debate on whether an international tax regime exists was joined explicitly in the interaction between H. David Rosenbloom of NYU, who devoted his Tillinghast lecture to denying the existence of the regime and the editor who commented on it. According to Rosenbloom (Chapter 5, Volume I), the differences among national tax systems are both inevitable and prove that no supra-national tax regime can or should exist, and therefore attempts to enact national rules that embody supra-national principles, like the single tax principle, are bound to fail.

The editor follows with a major article on tax competition and its implications for the international tax regime (Chapter 6, Volume I). The chapter argues that the current age of globalization can be distinguished from the previous one (from 1870 to 1914) by the much higher mobility of capital than labor (in the previous age, before immigration restrictions, labor was at least as mobile as capital). This increased mobility is the result of technological changes (the ability to move funds electronically) and the relaxation of exchange controls. The mobility of capital is linked to tax competition, in which sovereign countries lower their tax rates on income earned by foreigners within their borders in order to attract both portfolio and direct investment. Tax competition, in turn, threatens to undermine the individual and corporate income taxes, which traditionally have been the main source of revenue (in terms of percentage of total revenue collected) for modern welfare states. The response of developed countries has been first to shift the tax burden from (mobile) capital to (less mobile) labor, and second when further increased taxation of labor becomes politically and economically difficult, to cut the social safety net. Thus, globalization and tax competition lead to a fiscal crisis for countries that wish to continue to provide social insurance to their citizens at the same time that demographic factors and the increased income inequality, job insecurity and income volatility that result from globalization render such social insurance more necessary. The result is increasing pressure to limit globalization (for example, by re-introducing exchange controls) which risks reducing world welfare. This chapter concludes that if both globalization and social insurance are to be maintained, it is necessary to cut the intermediate link by limiting tax competition in a way that is congruent with maintaining the ability of democratic states to determine the desirable size of their government.

Victor Thuronyi (Chapter 7, Volume I) joined the debate from a multilateral perspective. His chapter argues that, given the similarities in country tax regimes, it is now possible to reach a multilateral tax treaty, and that such a treaty is necessary because tax competition makes the bilateral tax treaty regime fail in its major goals.

A major boost for the unilateral side of the debate came with Michael J. Graetz's Tillinghast lecture of 2001 (Chapter 8, Volume I). Graetz argues that the taxation of international income is based on outdated concepts, and that US international taxation needs to be reconfigured with US interests in mind. Specifically, the US should abandon worldwide residence-based taxation of corporate income and return to source-based taxation.

Yariv Brauner joined the debate on the multilateral side, but with significant caveats. He argues (Chapter 9, Volume I) that the grand illusion of a single, worldwide tax system that will eliminate all international inefficiencies and assist all the nations of the world to maximize their relative advantages, is, as commonly accepted, utopian. The academic and professional writing in the field of international taxation, and cross-border interaction between tax systems and jurisdictions has grown exponentially in the last decade, but no significant work has been done to prove, or disprove, the naivety of this hypothesis. Some scholars and tax executives in certain international organizations have discussed ideas along this line, but no single organization has, seriously, attempted to promote global tax harmonization. Additionally, no national government has provided support to enable research of this idea. In this chapter Brauner advocates the benefits of a true global approach. He examines the possibility of worldwide adoption of a single set of international tax rules. Unlike prior literature he seeks to avoid an 'all-or-nothing' perspective for the analysis of a possible World Tax Regime and prefers to explore each component of it as it is at present in light of a unification proposal. Eventually, he advocates a gradual and partial rule-harmonization effort led, preferably, by the OECD. His intention is not to present a specific proposal, but present a framework for thinking about it and, possibly, negotiating it. The basic theme is that any one (or more) of the sets of rules of international taxation could be adjusted at any given practical time and then, gradually, as possible, the rest of the rules may be brought into harmony. The structure of the international tax rules allows for such flexibility and gradualness without adverse implications.

The next contribution includes a new emphasis on developing countries and their interests, and casts doubt on the convergence hypothesis that underlies the argument for an international tax regime. Miranda Stewart (Chapter 10, Volume I) argues that tax reform has been a significant part of economic development and structural adjustment projects for developing and transition countries since World War II. While much work has been done critiquing these programs and, in particular, the work of institutions such as the International Monetary Fund and the World Bank, there has not been a detailed examination of the content and role of tax reform projects. Her chapter begins to fill that gap. It examines tax reform projects in developing and transition countries in the context of the history of economic development and the contemporary context of economic globalization. The first goal of the article is descriptive: to map the processes and agencies engaged in tax reform since World War II. The second goal is analytical: to begin a critical examination of the discourse of tax reform. The chapter examines the changing way in which tax reform discourse has viewed the role of the state in economic development of its people. It also examines the changing way in which tax reform discourse has addressed issues of poverty, inequality and redistribution. It concludes with some suggestions for a new direction for tax reform in developing and transition countries.

Mitchell A. Kane (Chapter 11, Volume I) attacks the international tax regime hypothesis directly by focusing on international tax arbitrage, which involves the deliberate exploitation of differences among country tax rules to achieve double non-taxation. He argues that international tax arbitrage may be loosely defined as a phenomenon in which an inconsistency in the substantive law of two or more jurisdictions yields a tax benefit that would not be available if the laws of the relevant jurisdictions were completely harmonized. Taxpayers engaging in international tax arbitrage may, for example, be able to duplicate valuable tax attributes, such as deductions or losses. Unlike instances of aggressive tax planning in which taxpayers push statutory tax provisions or judicial anti-abuse doctrines to their limits, international tax arbitrage typically involves cases in which the taxpayer is indisputably compliant with domestic law. Although the US government has sought to eliminate such arbitrage opportunities in a number of instances, either through legislation or regulation, its policy reasons for attacking transactions in which taxpayers are fully compliant with the law have remained opaque. The literature on the subject has explored a number of possible justifications, ranging from the existence of implicit, though initially obscured, assumptions in domestic law to considerations of worldwide efficiency. A common strand running through this literature is the attempt to determine the problem that arbitrage transactions present. Once one has identified the problem, if any, the appropriateness of the governmental response can then be assessed. This chapter argues that rather than presenting a potential problem, international tax arbitrage may present governments with strategic opportunities to further their interests in the location and control of international investment. Understanding governmental interests in this context depends crucially on distinguishing between cases of direct versus portfolio investment and cases of inbound versus outbound capital flows. Kane concludes that, from a unilateral perspective, depending on the circumstances, a government's strategic interests may be best served by curtailing, ignoring or possibly even creating arbitrage opportunities.

Chang Hee Lee (Chapter 12, Volume I) adds a voice from a developing country to the discussion. He argues from a multilateral perspective that, as a result of electronic commerce, advanced countries have suggested an increase of their share in inter-jurisdictional allocation of revenue, justifying their position with the rhetoric tax neutrality and residence jurisdiction. But, he argues, these suggestions can be hardly justified in that the economic and legal assumptions underpinning the existing norm of inter-jurisdictional revenue allocation are not valid in a digital era. Tax neutrality will rather justify a new order that would assign more revenue to the developing countries. Maintaining the existing international tax order and fixing it in a makeshift way will not lead to this new order of international taxation, however, because digital technology enables a taxpayer to circumvent attempts. Lee further argues that creating an entirely new norm and imposing it on developed countries appears to be beyond the reach of developing countries, judging from the past experience of bargaining between developed and developing countries, which may have no other choice but to acquiesce to these changes. Despite this pessimism, the UN may consider revising the UN Model to the interest of developing countries, because the very role of the UN Model is to provide bargaining leverage for a developing country in negotiating a real world treaty.

A final chapter by the editor (Chapter 1, Volume II) attempts to situate a multilateral view of international tax within international law. The chapter aims to introduce to the international lawyer the somewhat different set of categories (for example, residence and source rather than nationality and territoriality) employed by international tax lawyers, and explain the reasons for some of the differences. At the same time, it attempts to persuade practicing international tax lawyers and international tax academics that their field is indeed part of international law, and that it would help them to think of it this way. For example, knowledge of the Vienna Convention on the Law of Treaties would help international tax lawyers in interpreting tax treaties, and avoid some common mistakes.

Allison Christians' chapter on sovereignty, taxation and the social contract (Chapter 2, Volume II) adds a Lockean perspective on the debate. It argues that while national tax policy is one product of the classic Lockean social contract between individuals and government, countries are now so economically interdependent that one nation's tax policies can profoundly undermine another's attempts to implement the bargain. This chapter argues that tax experts from the US and its peer countries are implicitly drafting a transnational social contract that potentially constrains national tax policy bargaining. Christians identifies the existence and terms of this implied contract, analyzes it from a political philosophy perspective, and argues that meaningful debate about tax policy must address how principles arise and are implemented as well as whether the chosen principles are appropriate. She concludes that if an international social contract exists, its terms should be explicitly articulated so that national responsibilities to the international community can be acknowledged and confronted in domestic tax policy deliberations.

Steven A. Dean (Chapter 3, Volume II) criticizes the multilateral perspective by arguing that efforts to foster improved international tax cooperation have become preoccupied with tax harmonization. He argues that deharmonization offers the possibility of harmony without uniformity. By exploring two examples of tax deharmonization in practice and considering the origins and limitations of tax harmonization, his chapter brings the traditional emphasis on harmonization into question. It then makes the case that deharmonization – cooperation without uniformity – could provide a viable alternative. Dean concludes that achieving tax deharmonization's potential would require revisiting some of the most basic elements of our current international tax regime, particularly the benefits principle.

Ruth Mason (Chapter 4, Volume II) brings a new perspective to the debate by focusing on labor rather than capital mobility. She argues that governments often deliver social welfare benefits through 'tax expenditures'; provisions of the tax code (such as home mortgage deductions) designed to serve social policy objectives. Her chapter considers the criteria for granting tax expenditures to individuals who work abroad. International tax norms currently assign the primary entitlement to tax labor income to the state where the taxpayer works, but they assign the obligation to confer personal tax expenditures exclusively to the state where the taxpayer resides. At a time when leading tax treaty policymakers have begun to question this allocation rule, the article examines its normative underpinnings, and concludes the current practice is efficient, fair and simple. In constructing the efficiency arguments, this chapter introduces the conceps of 'labor export neutrality' and 'labor residence neutrality' as tools for analyzing government policies that affect global labor mobility. A policy is labor export neutral if it does not distort taxpayers' decisions about where to work. A policy is labor residence neutral if it does not distort taxpayers' decisions about where to reside.

J. Clifton Fleming, Jr., Robert J. Peroni and Stephen E. Shay (Chapter 5, Volume II) are leading advocates of residence-based taxation from a unilateral US perspective. In the selected article, they discuss how various defects in the current US international tax system – deferral, defective income-sourcing and cost allocation rules, lenient transfer-pricing rules, generous cross-crediting, the export sales source rule, the effectively tax-exempt treatment of many types of foreign-source royalties and the deduction of foreign losses against US-source income – can be combined to make the present US system as generous as, and in some important respects more generous than, a properly designed exemption or territorial system for taxing foreign-source income of US resident corporations. In other words, when judged from a public policy standpoint, the current US system can produce worse-than-exemption results. Because of this, the US multinational corporate community largely has shifted its lobbying efforts away from support for an exemption or territorial system and toward support for changes in the current incoherent international tax system that would further reduce the effective US income tax rate on US corporations' foreign-source income by magnifying the worse-than-exemption results. In their view, reform efforts in the international tax area should be directed toward comparing the strengths and weaknesses of a properly designed worldwide system with the strengths and weaknesses of a properly designed exemption system, and then proceeding to enact one of those two coherent systems for taxing the international income of US persons. Based on their prior work in the international tax area they believe that such an analysis will lead to a conclusion that a strengthened and properly designed worldwide system is superior to a properly designed territorial system and is definitely superior to our defective and incoherent current US international tax system.

Wolfgang Schön is a leading critic of multilateralism from a European perspective. He argues (Chapter 6, Volume II) that international business taxation has become the object of debate in recent years. The allocation of taxing rights between residence and source countries is challenged. Time-honored rules that address different types of business profits – like sales and services, royalties and interest – in different ways are put to the test. Profit attribution under the arm's length principle faces the alternative of formulary apportionment. Moreover, international tax competition takes its toll: while some countries exert their tax jurisdiction as far as possible, other countries are no longer willing to tax capital income at all cost and prefer an attractive tax environment for investors. This chapter analyzes the value of legal and economic principles for international tax coordination and proposes a 'second-best approach', which leaves domestic tax systems as they are and tries to do away with discontinuities under international taxation, thus avoiding arbitrary results which lead to inequity, inefficiency and tax arbitrage.

Allison Christians' second contribution to this collection (Chapter 7, Volume II) is the first in a series of articles addressing the debate from a post-financial crisis perspective. She argues that, after decades of directing global economic policy standards alone, the US and Europe publicly extended leadership power to some developing countries in response to the economic crisis of 2008–2009. But an entrenched international architecture of tax policy expertise ensures that a small group of established players continue to shape tax norms and practices throughout the world. This architecture is based on historical international power relationships and institutional history. For diplomatic restructuring on the world stage to usher in a new age of inclusion for previously marginalized states and peoples, systemic changes must also take place in these entrenched institutions and processes.

Neil Brooks and Thaddeus Hwong (Chapter 8, Volume II) offer a response to critics of convergence. They argue that one of the central issues in comparative law and political economy is whether the forces of globalization will result in the convergence of public policies across countries. Noting in particular that taxes collected still cover a considerable range across industrialized countries – from a low of 20 percent of GDP to a high of 50 percent – some have argued that globalization has not resulted in a loss of tax sovereignty. However, following a review of the evidence, in this chapter they conclude that globalization has had significant but subtle effects on tax levels and structures. Moreover, these pressures will make it increasingly difficult for countries to raise revenue to finance new public needs and to structure their tax systems in order to achieve a more socially acceptable distribution of income than what market forces dictate. Tax levels in most countries have remained essentially flat over the past 20 years, but there is a host of reasons for thinking they would have continued to rise were it not for the pressures of globalization. Statutory corporate tax rates have declined dramatically and, although corporate tax revenues have remained robust, this has been due to factors unrelated to deliberate tax policy choices. Personal marginal tax rates have also declined sharply and tax revenues have been increasingly raised by regressive consumption taxes. These trends stem from tax competition brought on by the forces of globalization, not from changing ideas or other political variables. In this article, Brooks and Hwong conclude that in order to prevent tax competition from completely eroding the ability of countries to fashion their own tax systems, there will have to be considerable cooperation among the major countries and some harmonization of aspects of their tax systems, particularly as they apply to footloose factors of production.

Daniel Shaviro (Chapter 9, Volume II) has emerged as a major critic of the current US tax system from a unilateral perspective. In this chapter he states that in international tax policy debate, it is usually assumed that, if one chooses not to exempt residents' foreign source income, the preferred system would offer FTCs. He then argues that this assumption is mistaken, given the bad incentives created by the credits' marginal reimbursement rate (MRR) of 100 percent and the unpersuasiveness of common rationales for granting them, such as those based on aversion to 'double taxation' or support for capital export neutrality. While taxing foreign source income at the full domestic rate with only deductions for foreign taxes would over-tax outbound investment, at least in principle creditability is dominated by a burden-neutral shift to deductions plus a reduced tax rate for such income. And even if such a shift is unfeasible or unwise, the incentive problems resulting from a 100 percent MRR for foreign taxes paid may illuminate various more practical tax issues, such as (1) the merits of shifting to an exemption system, which features implicit deductibility and (2) the merits of various proposed reforms, such as removing disincentives in subpart F for foreign tax planning by US multinationals.

Edward D. Kleinbard (Chapter 10, Volume II) has recently become a major advocate for multilateralism. In his chapter he analyzes the tax consequences and policy implications of the phenomenon of 'stateless income'. Stateless income comprises income derived for tax purposes by a multinational group from business activities in a country other than the domicile of the group's ultimate parent company, but which is subject to tax only in a jurisdiction that is neither the source of the factors of production through which the income was derived, nor the domicile of the group's parent company. Google Inc.'s 'Double Irish Dutch Sandwich' structure is one example of stateless income tax planning in operation. This chapter focuses on the consequences to current tax policies of stateless income tax planning.

Daniel Shaviro's second contribution (Chapter 11, Volume II) focuses on corporate residence-based taxation. He argues that in an increasingly integrated global economy, with rising cross-border stock listings and share ownership, US corporate residence for income tax purposes, which relies on one's place of incorporation, may become increasingly elective for new equity. Existing equity in US companies, however, is effectively trapped here, given the difficulty of expatriating for tax purposes absent a bona fide acquisition by new owners. Both the prospect of rising tax electivity for new equity and the very different situation facing old US equity have important implications for US international tax policy. This chapter therefore explores three main questions: (1) the extent to which US corporate residence actually is becoming elective for new equity, (2) the implications of rising electivity for the age-old (though often mutually misguided) debate between proponents of residence-based worldwide corporate taxation on the one hand and a territorial or exemption system for foreign source income on the other and (3) the transition issues for old equity if a territorial system is adopted.

David Hasen (Chapter 12, Volume II) offers a new perspective on tax neutrality. He argues that efforts to identify and implement an appropriate tax neutrality benchmark have been persistent themes in scholarly and policy debates on international taxation for 50 years. This chapter questions whether the concept of tax neutrality has been adequately specified for analyzing the efficiency properties of international tax systems. As distinct from the closed-economy setting, in the open-economy setting, neither tax revenues received nor the burdens that tax revenues pay for may be taken as fixed. Because tax revenues finance infrastructure and other productivity-enhancing goods – so-called 'tax amenities' – and because capital burdens infrastructure, the reallocation of tax revenues among jurisdictions and the movement of assets and productive capacities across borders cause the amount of tax revenue collected in each jurisdiction to diverge from the revenue target. A consequence is that what are viewed as tax-incentive effects, or distortions, improve productivity in some cases. Neutrality as a value, however, rests on the idea that tax incentive effects reduce efficiency by causing resources to be allocated away from some optimum non-tax-affected baseline; this idea is what justifies referring to tax-influenced allocations as distortions. An implication is that the baseline is not well specified in the open-economy setting. Hasen's chapter suggests that, in light of these considerations and of the difficulty in implementing a theoretically satisfactory specification of neutrality, an analysis focusing on the allocative, distributive and competitive properties of international tax rules would be more helpful than one focused on their neutrality properties. A simple model relating tax revenue and population to productivity is offered.

Eduardo A. Baistrocchi (Chapter 13, Volume II) offers a multilateral perspective on the emergence of the BRICs and how they relate to traditional international tax analysis. He argues that the global economy's center of gravity is shifting. Emerging and developing countries have been contributing over 50 percent of the global GDP since the onset of the twenty-first century, which is unprecedented since the Industrial Revolution. This chapter offers the first analysis of the creeping convergence of the BRIC world (that is, Brazil, Russia, India and China) with global legal standards in a key area of International Law: the International Tax Regime (ITR). The ITR is a legal technology fundamentally designed by the League of Nations in the 1920s, when the BRICs played no relevant role. This chapter proposes a theory that aims to illuminate the core driving forces of the ongoing trend towards global convergence in this area of international law from both the static and dynamic dimensions. It is grounded on the logic of two-sided platforms.

Arthur J. Cockfield (Chapter 14, Volume II) offers a contemporary critique of multilateralism. He argues that, as explained by Ronald Coase, transaction costs are the costs associated with discerning a price on a given exchange. This chapter conceptualizes the international tax regime as a political and legal system striving to address transaction cost challenges, and claims it has an uneven record. On the one hand, the international tax regime lowers transaction costs and hence promotes global economic growth. It does this by facilitating credible government commitments to ensure that the same cross-border profits are not taxed twice by two countries. Multinational firms are thus protected against the risk that their cross-border activities will be unduly deterred by taxation, which encourages more global economic activities. On the other hand, governments are unable to offer credible commitments that they can effectively address other important international tax policy concerns. First, despite ongoing reform efforts governments are not able to offer reasonably reliable promises that they will inhibit aggressive international tax planning that dilutes revenues in countries like the US. Second, the international tax regime affords governments opportunities to develop their own policy solutions (such as the 2010 US anti-tax evasion initiative to create a global tax information reporting system through the Foreign Account Tax Compliance Act) and thus governments can renege on earlier promises to abide by traditional international tax norms.

Finally, Hugh J. Ault, who is a major force behind the current BEPS efforts at OECD, offers his views on the process and its relationship to historical international tax principles (Chapter 15, Volume II). His chapter focuses on the OECD's work on the definition of 'permanent establishment', the transfer pricing treatment of Intangibles and the recently announced project on BEPS. After describing these positive law developments, Ault relates to more basic questions of how principles of international tax law, and particular the normative claims to taxing rights, are established.

This debate will no doubt continue. In the editor's opinion, recent developments such as BEPS and the Multilateral Agreement on Administrative Assistance in Tax Matters (MAATM) indicate that there is growing consensus that an international tax regime exists and that its two basic principles need to be bolstered on a multilateral basis, but the precise shape of such a multilateral future remains very much in flux. It is hoped that this collection of articles will help the reader understand what is at stake.

Contents