A multilateral tax treaty: designing an instrument to modernise international tax law

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1 Introduction

Globalisation has changed the way businesses do business. The importance of electronic commerce and intangibles has risen, and NGOs are underscoring that the current international tax regime works to the detriment of developing countries. Low effective tax burdens on multinationals' (MNE) profits make for newspaper headlines.

Generally, the globalisation hypothesis runs thus. Capital is global, but governments are local and divided. Absent a level playing field or further integrative cooperation, governments have no other choice but to compete to attract investors, e.g., by lowering corporate tax burdens or by relaxing regulation. The globalising nature of the economy constrains the ability of governments to pursue preferred social policies. So,

> 'while cooperative action is collectively rational, in the absence of a coordinating coercive authority, and in the absence of trust between jurisdictional units (which would enable them to coordinate their actions), there is a temptation to engage in individually rational competition, to protect one's national producers. But the end result of that 'game' is a collectively irrational, non-optimal state of affairs where people in society experience fewer (labour, safety, and environmental) protections and lower wages; and the state as a whole finds its capacity to raise revenue, through taxing multinational corporations, much reduced'.[1]

Where circumstances have indeed been changing, the norms of the international tax system itself have not. The network of bilateral tax treaties is extensive and hard to adjust to changing circumstances. Under the influence of globalisation, international tax law has become a series of unrelieved collective action problems related to the issues of tax competition and tax arbitrage, particular in respect of the taxation of multinational enterprises.[2] It has, in simple terms, become outdated.[3]

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1 M. Moore, *Globalization and Democratization: Institutional Design for Global Institutions*, 37 Journal of Social Philosophy 21 (2006).

2 See for this term: A. Christians, et al., *Taxation as a Global Socio-Legal Phenomenon*, 14 ILSA Journal of International and Comparative Law 304 (2007), available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1088455, p. 304.

3 OECD, *Action Plan on Base Erosion and Profit Shifting* (2013) OECD Publishing, http://www.oecd.org/ctp/BEPSActionPlan.pdf, p. 73; C. Peters, *On the Legitimacy of International Tax Law* (IBFD 2014).

For this reason, many states have set out to develop a multilateral instrument with the purpose of amending bilateral treaties in a quicker and more comprehensive fashion. Indeed, as much as 100 jurisdictions have participated in the ad-hoc group on the implementation of the Base Erosion and Profit Shifting (BEPS) Project,[4] leading to the recent adoption of the text of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (hereinafter: '*BEPS Convention*').[5]

First and foremost, the main purpose of this instrument is the coordinated and consistent implementation of the output of the BEPS Project. Indeed, the BEPS Project requires a number of changes to the bilateral tax treaty network. Amendments are needed on points such as hybrid mismatch arrangements (Action 2), treaty shopping (Action 6), the permanent establishment threshold (Action 7) and dispute resolution (Action 14). As renegotiating each and every bilateral tax treaty would take decades, this could jeopardise the Project: political momentum might be lost. The multilateral agreement could provide a solution: it would 'modify a limited number of provisions common to most existing bilateral treaties, and would, for those treaties that do not already have such provisions, add new provisions specifically designed to counter BEPS'.[6]

Secondly, under the current loose-type of coordination by means of the OECD Model Tax Convention (hereinafter: OECD MTC) and its Commentaries, states are free to modify, to postpone, etc. in their bilateral treaty relations. By agreeing with new guidelines, states show a basic willingness to move in the same direction. But many, if not all, of the current solutions needed to tackle BEPS require coordinated responses. A country will only move if the others do too. Again, the multilateral agreement is key: a level playing field established by a multilateral agreement enables parties to coordinate on their policy directions.

That the text of the multilateral convention to implement the BEPS outcomes has been agreed upon, can be called an impressive achievement. But zooming out from the efforts of the BEPS Project, reactions to collective action problems are also likely to be necessary in the future, stressing the need for a structural, rather than an ad-hoc, multilateral solution for international tax. The BEPS Project has, so to speak, merely unveiled the problems related to amending and coordinating on bilateral tax relationships. A more fundamental reconsideration is, in the words of the OECD, 'necessary not only to tackle BEPS, but

4 http://www.oecd.org/tax/treaties/work-underway-for-the-development-of-the-beps-multilateral-instrument.htm.

5 *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, OECD, available at http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.

6 OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties* (2014) OECD/G20 Base Erosion and Profit Shifting Project, http://dx.doi.org/10.1787/9789264219250-en p. 17-18.

also to ensure the sustainability of the consensual framework to eliminate double taxation'.[7] The benefits of a structural multilateral solution would allow policy makers to continuously adapt and respond to the 'rapidly evolving nature of the global economy'.[8]

Yet, the outlook for full-fledged universal multilateralism is bleak: international law is often no panacea, as it is, at the end of the day, characterised by anarchy and without higher authority. Ultimately, the enactment of international rules depends on the joint consent of sovereign states, which are materially different from one another. In fact, there are only a few multilateral treaties that enjoy widespread (if not universal) ratification; most multilateral treaties fail to attract universal support,[9] and big contemporary problems of international cooperation, like global warming, prove very hard to solve.[10] In addition, states almost never agree to centralised international enforcement mechanisms, and rely on self-enforcement instead.[11] What actually can be achieved in international cooperation is, in other words, limited.

Hence, the question arises: *how to design a multilateral agreement for international taxation that fundamentally transforms the way states cooperate in the field of international tax* (hereinafter: 'the multilateral agreement for international taxation' or 'the multilateral agreement')? The answer to this question is relevant: it helps us understand what international policy makers need to work towards. What may be expected of a multilateral agreement? In this regard, the purpose of this research transcends the matter of implementing the outcomes of the BEPS Project. Implementing the BEPS Project is important, but unlikely the last international tax policy project for which changes to bilateral tax treaties will be required. Nevertheless, the BEPS Convention does provide a great acid test for the research's outcomes.

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7 Id. at p. 9; OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15: 2015 Final Report* (2015) OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264241688-en, p. 9 (emphasis added).

8 OECD, *BEPS Action Plan (2013)* (2013) p. 24.

9 See: G. Blum, *Bilateralism, Multilateralism, and the Architecture of International Law*, 49 Harvard International Law Journal 323 (2008) p. 335.

10 See for such scepticism: J.L. Goldsmith and E.A. Posner, *The Limits of International Law* (OUP 2005).

11 From a political perspective: R.O. Keohane and J.S.J. Nye, *Power and Interdependence* (Longman 3d ed. 1989) p. 295: 'Centralized enforcement of rules in international regimes through hierarchical arrangement is normally out of the question: There is no police force and only a tiny international bureaucracy. If states are to comply with regime rules, they must do so on the basis of long-term self-interest'. And a lawyers' perspective: F. Mégret, *International Law as Law*, in: The Cambridge Companion to International Law (J. Crawford and M. Koskenniemi eds., Cambridge University Press 2012) at p. 71: 'The international legal system has traditionally had little enforcement capability in the form, for example, of an international executive. This fundamental weakness of international law is all too well known'.

So, the research questions addressed in this book are:

1 *What are the problems related to the non-binding and loose form of multilateral tax cooperation practiced by the OECD (Chapter 3)?*
2 *What should multilateral tax cooperation ideally look like (Chapter 4)?*
3 *What can realistically be achieved in multilateral tax cooperation (Chapter 5)?*
4 *What strategy should be employed to design a multilateral agreement for international taxation that fundamentally and structurally transforms the way states coordinate their international tax relations (Chapter 6)?*
5 *How should a multilateral agreement for international taxation be designed (Chapter 7)?*
6 *How should, in the light of the answers to questions IV and V, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting be evaluated (Chapter 8)?*

Chapters 2 and 3 introduce the thinking about the type of multilateral agreement discussed in this book. First, Chapter 2 analyses earlier efforts for multilateral international tax rules in the period of about 1920 until 1992. Chapter 3 assesses current multilateral coordination in international tax law, which takes place in the form of the OECD MTC and its Commentaries. What follows from the analysis in both chapters, is that a multilateral agreement for international taxation should not completely replace the bilateral tax treaty network currently in force. Rather, the potential of a multilateral agreement is to solve the issues related to the implementation of new norms in the network of bilateral tax treaties, and to create a level playing field, so that cooperation between states can converge on solutions for collective action problems.

But this understanding provides little insight in what a multilateral agreement *can and should look like*. For this reason, Chapters 4 and 5 build two views on multilateral cooperation in international taxation, providing the footing for a design strategy for a multilateral agreement set forth in Chapter 6. The first view, set forth in Chapter 4, uses political philosophy to construct a normative view on how states can ensure that international tax law is 'fair' and sustainable in the future. Chapter 5, on the other hand, explores the limits of multilateral cooperation in the area of international taxation from a 'realistic' perspective. A multilateral agreement is not easily agreed upon. Indeed, what a multilateral agreement would do, is shift the balance between multilateral agreement and national autonomy, and upset the equilibria struck in tax treaties. To get some grip on this matter, Chapter 5 explains international cooperation in international tax matters through the lens of liberal thought, regarding states as self-interested, rational and calculating actors, that enter into either multilateral or bilateral structures depending on expected gains. From this point of view, cooperation is seen as 'instrumental', in that international rules perform valuable functions for states that are looking to maximise (or protect) their interests. States accept rules that they favour, and

free-ride or renege when rules diverge from their needs. Chapter 6 then combines the normative and instrumental optics of Chapters 4 and 5 into a design strategy for a multilateral agreement for international taxation by means of which states can structurally address collective action problems of international taxation and swiftly implement cooperation outcomes in their bilateral relations.

Chapter 7 then offers a number of international public law mechanisms by means of which the multilateral agreement for international taxation should be designed, illustrating the book's core arguments.

Chapters 1-7 were – ostensibly – finished on the 24th of November 2016, three hours before the text of the BEPS Convention was released by the OECD. I nevertheless decided to add an extra chapter, evaluating the BEPS Convention against the findings presented in the book. This evaluation, set forth in Chapter 8, does however not engage in any 'new' research on the topic nor deals with questions not previously covered by Chapters 1-7. In adding Chapter 8 to the book, Chapters 1-7 were largely left unaltered.

As follows from this short overview, the book's core arguments are indebted to viewpoints from the fields of international relations and political science. As an international tax lawyer, I have drawn inspiration from these fields in drafting the two main criteria – principled and pragmatic – of the framework set forth in Chapters 4-6. In this regard, my approach is fundamentally different from that of the 'traditional' legal scholar, whose research activities relate to positive (international tax) law and its sources. To him or her, international tax law's legal sources are a given.[12] When I started off with this work in 2011, however, the OECD BEPS Project had not yet started. I therefore had to come up with an external perspective to explain and envisage the problem structure and possible objectives of a multilateral agreement for international taxation.

The book's normative framework therefore reflects a central concern: it seeks to confront multilateral cooperation in international taxation without losing touch with reality. For this reason, the normative framework includes a normative or 'idealist' (Chapter 4) as well as a pragmatic or 'realist' (Chapter 5) view on multilateral cooperation in international taxation, ultimately resulting in the position taken in Chapter 6.[13] Perhaps as a result of this cen-

12 S.C.W. Douma, *Legal Research in International and EU Tax Law* (Kluwer 2014), p. 18.

13 For the different optics of Ch. 4 and 5, I was inspired by the distinction between international law and international relations set out by R.O. Keohane, *International Relations and International Law: Two Optics*, in: Power and Governance in a Partially Globalized World (R.O. Keohane ed., Routledge 2002). Keohane argues that international law provides a 'normative' optic, which is about the legitimacy and fairness of the way international law is created, whereas international relations perspective provides an 'instrumentalist' optic, which explains state cooperation on the basis of self-interests.

tral concern, I have continuously had the feeling of moving in parallel with the cooperative outcomes of the BEPS Project (see further Chapter 8).

Chapter 4's normative view is important: it should not be forgotten that international law, created for and *by* states, can allow and legitimise *any* type of state behaviour – i.e., of any state (or group of states) that finds itself in a position of power. Consequently, Chapter 4's analytical starting point is a cosmopolitan take on procedural fairness, permitting a normative consideration of multilateralism in an anarchical world. But a normative view on cooperation in international taxation *alone* would potentially overestimate what multilateral agreements can realistically do, making it vulnerable to the critique that it fails to reflect actual cooperative outcomes. Hence Chapter 5's focus on states' self-interests, which attempts to explain – and predict – 'realistic' outcomes of multilateral cooperation in the field of international taxation.[14]

The decision to use an external perspective helped shape other methodological choices as well. First of all, to achieve a higher degree of abstraction, it has sometimes been necessary to depart from existing paradigms, such as the idea that bilateral tax treaties only *allocate* taxing rights between jurisdictions. Moreover, I have not been able to fully escape from considerations about amendments to (domestic) tax systems. The OECD in the BEPS Project clearly distinguishes between multilateral measures that will require tax treaty amendments and multilateral measures that require amendments to domestic law.[15] The same distinction is not meticulously observed in this book. Chapter 5's view on multilateral cooperation, for instance, which explains as much as possible with as little as possible, may also be applied to policy considerations concerning domestic law.[16] Furthermore, I have not considered the

14 Presenting the 'idealist' and 'realist' perspectives of Chapters 4 and 5 as direct opposites is, strictly speaking, not accurate. The 'idealist' view presented in Chapter 4 relies on some 'realism' to show it is not too far removed from what actually exists in the real world (for instance, reference is made to states' intentions underlying the BEPS Project). Vice-versa, the 'realist' view of Chapter 5 is rooted in 'idealist' conceptions of social reality (it for instance builds on assumptions related to contracting under uncertainty). Nevertheless, Chapter 4 and 5 have different analytical points of departure ('fairness' versus 'state interests') and even though more fluid than presented, both positions serve to end up in Chapter 6's intermediate position, anyway. In any case, the inevitable reliance of 'idealist' views on 'realist' arguments, and vice-versa, is structural to international legal scholarship, as M. Koskenniemi, *From Apology to Utopia: the Structure of International Legal Argument* (Cambridge University Press Reissued ed. 2005) has argued.

15 Domestic law changes are e.g. needed in relation to BEPS Actions 2-5. The OECD aims to proceed on the basis of an 'implementation framework' to implement the Project's outcomes.

16 I do recognize that explaining necessary amendments to domestic law might require a more complex political view on state cooperation than the one build up in Ch. 5. In Ch. 5, I conceive states to interact as unitary actors, i.e., as 'black boxes'. A more complex, two-level model would have the benefit to 'open up the black box', i.e., to take into account domestic politics too. See e.g. R.D. Putnam, *Diplomacy and Domestic Politics: The Logic of Two-Level Games*, 42 International Organization 427 (1988). See further for a discussion: D. Beach,

relationship between a worldwide multilateral agreement and the efforts of harmonizing corporate income taxation within the EU.[17] Finally, I have been inspired by the BEPS Project in providing examples and points for discussion; hence the emphasis on collective action problems of corporate income tax. The book's conclusions, however, also hold for collective action problems of international tax law, unrelated to the BEPS Project.

Analyzing Foreign Policy (Palgrave Macmillan 2012) p. 47-57.

17 The competence on direct taxation is with the EU Member States: the EU Treaties hence do not prevent Member States to conclude an external multilateral tax treaty (see art. 216 of the Treaty on the Functioning of the EU), as long as norms concluded are consistent with EU law.
Nevertheless, the implementation of an anti-avoidance directive (which concerns amendments to domestic law) might have legal consequences as regards the possibility of Member States to enter into a worldwide agreement on the same issues individually. Article 216 TFEU holds that 'the Union may conclude an agreement with one or more third countries where (…) the conclusion of an agreement (…) is likely to affect common rules or alter their scope'. This rule codifies the ERTA-doctrine (as in ECJ, *Commission v. Council,* 31 March 1971, C 33/70 (ERTA)), in which the ECJ held in paras. 17 and 18: 'each time the Community, with a view to implementing a common policy envisaged by the Treaty, adopts provisions laying down common rules, whatever form these may take, the Member States no longer have the right, acting individually or even collectively, to undertake obligations with third countries which affect those rules (…). As and when such common rules come into being, the Community alone is in a position to assume and carry out contractual obligations towards third countries affecting the whole sphere of application of the Community legal system'. As the worldwide multilateral implementation of the BEPS Project could undermine the collective efforts within the EU, the ERTA doctrine may be applicable in relation to the issues that the anti-abuse directive covers.