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

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Answering the research questions related to the multilateral agreement for international taxation has proven a continuous balancing test between bilateralism and multilateralism. And indeed, if full-fledged multilateralism would be perceived as white, and bilateralism as black, then certainly, a multilateral agreement for international taxation is painted in shades of grey. Ideas on a multilateral agreement should, by implication, be modest.

From their start, the rules for the avoidance of double taxation have never been purely bi- or multilateral. Although the rules to avoid double taxation have always been based on bilateral treaties, the OECD MTC and its Commentaries provided for a multilateral template around which bilateral tax treaty negotiations could be coordinated. In fact, the current system is the second-best result of a failed effort for a comprehensive multilateral tax treaty. Where states could not agree on the distribution of taxing rights over mobile capital, a bilateral tax treaty system slowly evolved. And in the light of this expanding network of bilateral tax treaties, a comprehensive multilateral tax treaty proved less and less practicable. Yet, a 'weak' form of multilateralism could be introduced in the form of the flexible OECD MTC and its Commentaries. And the system has been particularly resilient in relation to its core concepts: 'permanent establishment'; 'arm's length', and also 'residence' and 'dividends': these are concepts that practitioners all over the world recognise, perhaps even making these terms 'multilateral' in the strong sense. The OECD MTC and Commentaries, although a second-best outcome, have hence provided the international tax system with a great deal of uniformity and solidity.

Yet, the use of this loose-type form of regulatory influence on bilateral tax treaties is not without limits. Despite its immense influence on tax treaties, OECD soft tax law falls short on dynamic grounds. Indeed, the loose type of tax coordination by means of soft law norms has not been able to prevent the international tax system to become outdated and unresponsive. As has been shown in Chapter 2, states rarely amend their bilateral tax treaties. Of the 397 tax treaties in force before 1977, 41% were not amended between 1977 (the year of the first update to the OECD MTC) and 2013. And the figures related to later OECD MTC updates provide an even bleaker view on reality. Would the results of Chapter 2 be applied to the BEPS outcomes for which the OECD proposes OECD MTC amendments, these would be not be fully implemented in bilateral tax treaties before the year 2035 (in approximately 18 years from the time of writing). But that is not all: amendments to the OECD Commentary,

introduced by the OECD so as to influence the contents of tax treaties, are regularly ignored by courts of OECD Member countries, who have, after all, 'the last word' on tax treaty interpretation, and hence on the contents of tax treaties.

Moreover, as states are free to modify on and postpone the implementation of soft OECD standards in their bilateral tax treaty relationships, the current system is characterised by the absence of a level playing field, necessary to arrive at common solutions for current and future collective action problems of international taxation, such as tax arbitrage and tax competition. What is at stake? Establishing a level playing field is essential because inaction may lead, at least in the long term, to either the redundancy of corporate income taxation due to increased tax competition, or to an incoherent chaos of unilateral anti-abuse rules, caused by public outrage. An indication of the relevance of this observation is that tax avoidance is estimated to lead to a reduction of global corporate income tax revenues of about 4-10%. A level playing field, established for multilateral agreement, provides a more suitable and appealing alternative.

So, a fundamental reconsideration of the way tax treaties are amended is necessary. What can and should the multilateral agreement then look like? Re-enter the balancing test between bilateralism and multilateralism, first identified in Chapter 2. In between the normative, comprehensive model on multilateral tax cooperation, aimed at restoring the 'fairness' of international taxation by means of 'correct' procedure (Chapter 4), and a model on cooperation that reflects the political realities of collaboration in the field of international tax (Chapter 5), lies the concept of the multilateral agreement for international taxation (Chapter 6). This multilateral agreement is of a procedural rather than regulatory character. It provides a level playing field in the form of a forum for discussions (section 6.2). Where agreement on true multilateral norms ('substantive multilateralism') proves slow or unfeasible, a multilateral agreement may at least reduce the transaction costs traditionally associated with bilateral tax treaty negotiations by bringing states together at one central place and time, and by providing for an institutional structure ('formal multilateralism'), see section 6.2.2.

Ideally, what a multilateral agreement should do (see Chapter 4) is create a level playing field that includes in its deliberations all states that are interested in participating, in a transparent manner. This would enable states to, over time, reach 'fair' multilateral solutions to collective action problems such as tax competition and tax arbitrage, as the law thus created would come to include all relevant social, moral and political perspectives.

Achieving 'procedural fairness' seems politically feasible in the long run: transparent and inclusive deliberations may be gradually achieved and further institutionalisation seems not so far off. In fact, the OECD recognises the importance of equal and inclusive negotiations, hence the 'ad hoc group' and the 'inclusive framework' that have recently been formed. But political realities

restrict the type of substantive rules that states can agree on, as is argued in Chapter 5. In the considerations to enter into a multilateral or bilateral agreement on international tax rules, countries are likely to be led by the motive of maximising or protecting their national interests. Multilateral agreement is unlikely when the distributive consequences of cooperation are relatively certain, but likely when the distributional aspect is uncertain or absent. Indeed, states that are faced with uncertainty as regards their own positions in the future will tend to agree on 'centralised' or 'fair' multilateral arrangements, i.e., arrangements that may be expected to generate acceptable outcomes for all. Vice versa, Chapter 5's perspective suggests that multilateral agreement on rules that generate *certain* distributive outcomes, such as those necessary to fundamentally counter BEPS (e.g., replacing the arm's length standard with formulary apportionment to tackle certain difficult issues such as 'hard to measure intangibles'), will prove politically unfeasible, or at least highly unlikely. The selection of and ratio between any of the baselines of a formula or CCCTB ('sales', 'assets' or 'labour') create obvious winners and losers. A state that foresees losing gains under a new baseline to divide the 'tax pie' (which includes states' source as well as residence interests, see sections 5.3.2 and 5.3.3) will only accept such a baseline when placed under high internal or external political pressure. Likewise, proposals for a switch to a destination-based corporate income tax, which embody the economist's solution to most current issues of tax competition and tax arbitrage, are pie in the sky, as they emphasise conflict between consumption and producing states. But this does not necessarily mean that multilateral agreement will be impossible in international taxation. Diverging state interests may be accommodated in a multilateral deal by 'rules of the road' (i.e., rules that operate 'fairly' for all participants) and distributional conflict may be relaxed by reservations or inter se bilateral negotiations. Nevertheless, this does compel tax policy makers to take on a modest view on what is possible in a multilateral agreement.

A level playing field in which collective action problems are 'managed' over time seems the only fruitful step forward (see Chapter 6). But does this also imply that the implementation of new norms in bilateral tax treaties will take place in a quicker and 'more streamlined' fashion? This is hard to predict. A complex multilateral negotiation may take just as long as many bilateral ones. But provided that the negotiation on a 'substantive' multilateral norm (i.e., a 'rule of the road') does not exceed the 18 years identified in Chapter 2, multilateral agreement may indeed be the quicker option, as it amends the network of bilateral tax treaties *in one fell swoop*. And for those issues for which 'substantive multilateralism' proves unnegotiable, the two-step logic of multilateral negotiations suggests that a mere 'formal' multilateral arrangement may also be able to do the trick. The mundane reduction of transaction costs of the 'first step' of a multilateral negotiation, i.e., agreeing on where and when states will meet and identifying the objectives of the negotiations (termed 'speed dating' by the OECD), may prove sufficient to quicken the bilateral

negotiations that take place in 'step two'. An institutional arrangement may further reduce transaction costs by facilitating the exchange and generation of information. 'Formal multilateralism' hence provides states with economies of scale that the current 'system' by means of which bilateral tax treaties are (re)negotiated lacks.

A central theme in the discussions of Chapter 6 is the coordinative role of legal rules. In providing the infrastructure to reach tax policy goals over time, legal rules form the multilateral agreement's pivotal element: by agreeing on 'rules of the road' and some guiding principles, states do not need to re-enter into discussions already entered into before. Agreement on a 'rule of the road' prevents states from engaging in bilateral discussions each time they run into each other at the figurative intersection. But 'rules of the road' will also function as shared background assumptions in ongoing, evolving discussions on norms. Similarly, as there are several solutions to each issue, procedure and guiding principles can be used to inform and guide the selection and identification of feasible solution. Indeed, as argued in Chapter 6.3, provided that states repeatedly interact, and provided that legal rules are used to pin down the understandings that have become common, international norms may be changed modestly when states come to share new understandings about issues and possible solutions. This means that requirements of 'fair' procedure, as discussed in Chapter 4, are indispensable: 'learning' cannot be fully realised when deliberations within the regime are non-transparent and under-inclusive. Hence, the coordinative function of legal rules propels states into deeper commitments, provided that the other conditions for 'managing' the international tax regime (building on shared understandings, repetition of interaction) are present. This means that, even if understandings about optimal solutions for collective action problems may be heavily debated or unclear in practice, 'fair procedure' is, in any case, a prerequisite for driving states into substantive multilateral solutions over time.

So, binding multilateralism in the area of international tax law has to be seen as a system to 'manage' the evolution and modernisation of international tax law by influencing bilateral tax treaties from 'the top down' rather than marginally from 'the bottom up'. This is illustrated using some legal tools of international public law in Chapter 7 and Annex A and B. The bottom line is that the multilateral agreement for international taxation should, at the least, constitute a quasi-formal international organisation (a 'Conference of the Parties') that organises recurring meetings, and under which common value-maximising terms are established towards which the regime can build. The regime hence created should facilitate 'learning' by providing or working towards transparent and inclusive deliberations and by facilitating the exchange of relevant information. Connections with other international organisations, such as the OECD, can be used to generate knowledge and inform the discussions (e.g., by means of model conventions, reports, commentaries, etc.). But the point of establishing a treaty body is its independence: states

participating in the forum, OECD-member and non-member alike, should get a real influence on the vital phase of discussions and norm generation.

On top of this 'constitutional' basis, states can then mix-and-match some relevant tools of international public law. Where *substantive* multilateralism, such as 'rules of the road', proves feasible, it makes sense to use elements of the framework convention-protocol design, so that the regime may be developed towards common ideals. Where, on the other hand, substantive multilateralism proves unfeasible, *formal* multilateralism may be employed, in which states merely agree on the procedure in 'step one' to flesh out the common value-maximising terms in their bilateral tax treaties in 'step two'. It is important to note that the distinction between both design types should not be perceived as strict. Formal multilateralism may have substantive characteristics when groups of states further agree to common terms; substantive multilateralism may have formal characteristics when states use reservations and 'menu options' to further tailor a multilateral norm to their needs. And indeed, as shown in Chapter 8, the BEPS Convention contains a mix of both institutional forms.

The overall picture is that, regrettably, a multilateral agreement for international tax law will not provide a quick fix for most modern collective action problems of international tax law. Multilateral agreement on the 'big' solutions to tax arbitrage and tax competition may never be possible. The BEPS Convention, in this respect, does not 'solve' the issues of international tax competition and tax arbitrage. But the prospect of a multilateral agreement is indeed a quicker tax treaty amendment process. Moreover, it may provide the prelude towards more integrative and 'fair' cooperation in the international tax field in the future. This however requires a shift in thinking on the part of policy makers. Discussions on international tax law have mostly resulted in texts and proposals of a dominantly technical and 'ad hoc' nature. The BEPS Project and its Convention, for instance, are presented as the final stop on the line against tax avoidance. But they must rather be perceived as the beginning of a longer process of integrative cooperation in the international tax field. Without the facilitation of 'correct' procedure, endurance, the generation and exchange of ideas, 'learning', vision and innovation, the international tax regime may remain stuck in its adolescence of the 1960s. The multilateral agreement for international taxation may provide the breakthrough for the international tax regime to come of age.

