Limitations to the rule of law argument in international tax law

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PART III

The Rule of Law in EU and International Context

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Limitations to the Rule of Law Argument in International Tax Law

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Abstract

Several concerns that have been raised about new international tax initiatives such as Pillar 2 explicitly or implicitly invoke values related to the rule of law. For instance, it has been argued that the international law-making process is undemocratic; that the new rules create too much legal uncertainty; or that they conflict with customary international law or human rights. We argue that in those arguments, rule-of-law values such as prospectivity, clarity, stability, democracy and human rights should not be invoked as strict and supreme criteria. Instead, they are based on complex concepts that are open to divergent interpretations, and always require trade-offs with other values and goals. This applies particularly in the international realm that lacks one overarching definition of the rule of law. Both 'thick' versions of the rule of law based on democracy and human rights and 'thin' versions based on the legality principle are interpreted differently across countries. Therefore, their international application is hard to separate from power, persuasion and politics.

Introduction

The landscape of international tax law has been changing considerably over the last decade and will likely continue to do so over the next, driven by a commitment among states to reduce MNE tax planning. The scope of the measures implemented or under consideration is broader than just anti-avoidance rules; it includes, for instance, new allocation rules (Pillar 1) and a minimum effective tax rate (Pillar 2). Those new rules have raised several concerns, many of which relate to some conception of the rule of law.

Pillars 1 and 2 and likely more initiatives to come depart from the ideas that underly current international tax law. They create interactions and potential conflicts with existing domestic laws, EU law and bilateral tax treaties. This increases complexity and contributes to a rapidly changing, uncertain legal environment for internationally mobile taxpayers.[1] A specific example is that according to some authors, the Under Taxed Payments Rule (UTPR) of Pillar 2 is contrary to principles of customary international law, in particular against 'well established principles' of 'nexus' that underpin residence and source taxation.[2] A concrete rule-of-law concern with respect to that particular conflict is that taxing someone without a factual link with the state imposing the tax would be 'unreasonable, excessive or arbitrary'.[3] And as the concrete legal repercussions of this conflict are unclear, legal uncertainty increases.

Another concern is that the source of legal changes is shifting from the domestic legislative process to international agreements and pressure. Indeed, it can be argued that Pillars 1 and 2 and future initiatives represent multinational[4] tax legislation, only formally endorsed in national legislative procedures. This raises 'taxation without representation'-style questions that are relevant in a more substantive version of the rule of law going beyond mere legality. Finally, even more substantive rule-of-law values are invoked in arguments that Pillar 2 may infringe the right to property when it leads to disproportionate tax burdens on an entity level,[5] or, though unconvincingly substantiated, that it may conflict with 'rights to health, social security, and food … if it results in reducing … tax revenues for developing countries'.[6]

The concept of the rule of law limits the political discretion of lawmakers by legal means.[7] Whether the values invoked in the arguments above are indeed rule-of-law values depends on the particular definition of the rule of law one adheres to – and many alternative definitions exist.[8] But regardless of the width of one's definition, the meanings of its values are usually established within legal communities that take the shape of a national state.[9] That is only natural, as laws (including implementation of

[1] See P Hongler, IJ Mosquera Valderrama, F Debelva, V Chand and J Chaisse, 'UTPR: Potential Conflicts with International Law' (2023) 111 *Tax Notes International* 141; F Debelva and L De Broe, 'Pillar 2: An Analysis of the IIR and UTPR from an International Customary Law, Tax Treaty Law and European Union Law Perspective' (2022) 50 *Intertax* 898.

[2] See, for an overview, G Kofler, SCW Douma, A Kardachaki, P Bräumann and M Tumpel, 'The UTPR and International Law: Analysis from Three Angles' (2023) 110 *Tax Notes International* 857 and RS Avi-Yonah, 'UTPR's Dynamic Connection to Customary International Tax Law' (2022) 108 *Tax Notes International* 951; J VanderWolk, 'The UTPR: Taxing Rights Gone Wild' (2022) 108 *Tax Notes International* 1369.

[3] Debelva and De Broe, 'Pillar 2', above n 1, 899.

[4] The emerging body of international tax law and legal norms that is substantively formed in a multi-jurisdictional setting of design, pressure and compromise (such as the BEPS minimum standards and the Pillar 2 rules) is still lacking a good descriptive label. 'Tax coordination' usually refers to legal instruments like EU Directives. Multinational tax legislation produces results that are neither legally binding nor enforceable; yet those results are perceived as politically binding or as inevitable restraints on national policy choices. 'Transnational legal ordering' seems to cover all forms of legal regulation of transnational issues, and hence does not particularly focus on multinational decision-making versus national legislation: G Shaffer, 'Theorizing Transnational Legal Ordering' (2016) 12 *Annual Review of Law and Social Science* 231.

[5] Hongler, above n 1.

[6] Letter from four experts appointed by the United Nations Human Rights Council to the Director of the Centre for Tax Policy and Administration at the OECD, AL OTH 21/2022. Available at: https://spcommreports.ohchr.org/TMResultsBase/DownLoadPublicCommunicationFile?gId=27165&idp=https%3A%2F%2Fengine.surfconext.nl%2Fauthentication%2Fidp%2Fmetadata (accessed 16 May 2024); but see P Baker, 'Human Rights and the Two-Pillar Solution' (2022) 50 *Intertax* 574.

[7] J Waldron, 'The Rule of Law', *Stanford Encyclopedia of Philosophy* (Summer edn, 2020) [2].

[8] BZ Tamanaha, *On the Rule of Law: History, Politics, Theory* (Cambridge: Cambridge University Press, 2004).

[9] 'The rule of law, then, is an ideal that strives to achieve an effective legal ordering within a community': BZ Tamanaha, 'Why Sovereigns Are Entitled to the (Horizontal) Benefits of the International Rule of Law' (2023) 8 *UC Irvine Journal of International, Transnational, and Comparative Law* 5, 15.

international agreements) are enacted by national states and adjudicated by national courts.[10] Hence, a practicable view is that any rule of law argument concerning taxation of cross-border income can only be raised in the national setting of legislation and legal procedure. This is, however, an uneasy conclusion. It provides no ready answer to the abovementioned rule-of-law concerns related to multinational tax law. The question is, therefore, whether the limits put by the rule of law to national lawmaking also apply to the project of multinational lawmaking.

Indeed, there is a tendency to widen the application of rule-of-law values to rules, norms and procedures at the international level. For instance, the UN General Assembly decided in 2012 that the rule of law applies to all states equally, and to international organisations. Such a statement may have a variety of meanings. One is that the relations among states are or should be governed by the rule of law.[11] A more controversial one is that every state is governed by the rule of law, or even more controversially, by the same rule of law. The pluralistic nature of the international arena – many domestic legal orders mean many rule-of-law conceptions – may be problematic in this respect. To illustrate, several countries would probably object to a world-wide, substantive rule of law that includes democracy as a core value.[12]

The issue that specifically concerns us here is the impact of multinational tax agreements on taxpayers – should they enjoy the protection of the rule of law? Prima facie, it is not quite clear what the rule of law can mean for taxpayers in the absence of world-wide legislation, administration and legal protection. Is this only due to implementation difficulties; or are those values indeed less relevant to multinational tax law? If so, is this the case only with substantive rule-of-law versions or also with formal versions?

We will first set out the different conceptions of the rule of law that will be referred to in this chapter. We will do this briefly because we believe that the distinction between those conceptions is semantical in the context of our argument: even under a 'thin' and uncontroversial rule-of-law definition based on the legality principle, conformity to the rule of law is a matter of degree and entails a trade-off with other values; and this trade-off is determined politically. More substantive values such as democracy and human rights logically require trade-offs that are at least as complex and political. As these trade-offs are normally made domestically, the application of rule-of-law values in the international sphere can only be more political.

We will present the latter argument in a subsequent section that first underscores the political nature of all international law in general and then zooms in on the supposed conflict between Pillar 2 and international customary law. We argue that this conflict

[10] 'National' may be replaced by 'EU' – but that only underscores the point, as the EU is an important source of legislation and adjudication for its Member States.

[11] Tamanaha, above n 9.

[12] In fact, the UN Secretary General in 2004 described the rule of law as: 'a principle of governance in which all persons, institutions and entities, (…) including the State itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards. It requires, as well, measures to ensure adherence to the principles of supremacy of law, equality before the law, accountability to the law, fairness in the application of the law, separation of powers, participation in decision-making, legal certainty, avoidance of arbitrariness and procedural and legal transparency': Secretary-General of the United Nations, *The rule of law and transitional justice in conflict and post-conflict societies*, S/2004/616. When this definition would have had significance for legal and political practice, quite a number of UN Member States would have found reason to object to it.

has an inevitable political dimension and that, as a result, its legal analysis can never be watertight. This weakens the claims that this conflict increases complexity and legal uncertainty, and that taxation based on the UTPR is excessive or arbitrary. We argue that a similar conclusion can be drawn with respect to the application of any other rule-of-law value at the international level.

We give two illustrations of this core argument. First, we examine the supposed democratic deficit in multinational tax law making. Insofar as the rule of law should incorporate substantive values, democratic decision making is particularly relevant, especially in the field of multinational tax law. In this field, there is a trade-off between the amount of democratic deliberation and the substantive tax policy outcome. In line with the preceding section, we will argue that taking a position in that trade-off is a political decision rather than a supreme Rule-of-Law value. Second, we examine one 'thin' or formal rule-of-Law value, namely the predictability of legal change. We will argue in the context of Pillar 2 that conformity to this value, again, is a matter of degree.

The Rule of Law

Waldron's discussion of the rule-of-Law concept shows that its content is not fixed.[13] Some authors use it to underscore the value of traditional customary law against legislative activism, while others connect it to human rights and social justice; yet others stick to formal requirements to laws and law making. Many of those elements map onto the distinction between 'thin' and 'thick' versions of the rule of law.[14]

The thinnest version is defined by Bingham as the notion 'that all persons and authorities within the state, whether public or private, should be bound by and entitled to the benefit of laws publicly and prospectively promulgated and publicly administered in the courts',[15] and by Tamanaha simply as '[t]he rule of law exists in a society when government officials and the populace are generally bound by and abide law'.[16] Others, especially Fuller and Raz, add formal requirements that the law should be able to meet, such as being general and stable, prospective, clear and practicable.[17]

What Fuller and Raz also did was to underscore the normative underpinning for a 'thin' concept of the rule of law in terms of personal freedom. The idea is that a free society does not require the rule of man, but generally applicable rules that are suited

[13] Waldron, above n 7.

[14] See, for an overview of the demands of 'thin' versions, S Daly, Chapter 2 in this volume. A different distinction is made by Lindsay, Chapter 3 in this volume, between a narrow scope rule of law (requiring legal norms to be general, prospective and impartial) and a wide scope rule of law (which 'concerns whether the government rules through law or through some extra-legal method').

[15] T Bingham, 'The Rule of Law' (2007) 66 *Cambridge Law Journal* 67, 69. Bingham himself went beyond pure formalism. He added sub-principles aimed at the functioning of the state, eg that the state should ensure the adequate protection of human rights.

[16] BZ Tamanaha, 'Functions of the Rule of Law' in J Meierhenrich and M Loughlin (eds) *The Cambridge Companion to the Rule of Law* (Cambridge: Cambridge University Press, 2021).

[17] Drawn from L Fuller, *The Morality of Law* (revised edn, New Haven CT: Yale University Press, 1969) 39, Raz has partially overlapping criteria that focus more strongly on legal protection by courts: J Raz, *The Authority of Law: Essays on Law and Morality* (Oxford: Oxford University Press, 1979) 214–18.

to guide people's choices as to their legal consequences. That is, a free society cannot exist without the rule of law in a formal sense: 'the law must be capable of guiding the behavior of its subjects.'[18] 'Law as guidance' entails that laws should be accessible to all, prospective, and reasonably stable. Predictability is key.[19]

Raz argued that this basic requirement has nothing to do with democracy or human rights.[20] But of those thicker values, democracy lies relatively close to the core concept of 'law as guidance'. Tamanaha's two-dimensional classification of rule-of-law values distinguishes between formal and substantive definitions, and identifies 'thin' versus 'thick' definitions in both categories.[21] In this scheme, democracy is not a substantive rule-of-law value but a formal one, insofar it is merely a political procedure and is not judged on the basis of its substantive outcomes.[22] A rule of law that includes democracy is the thickest of three formal definitions, the thinnest being 'rule by law' (that is, the mere exercise of control through positive law) and the middle one being legality (which includes the values stipulated by Raz and Fuller). When not prescribing any substantive outcomes such as negative and positive rights and social welfare, democracy is merely a formal criterion to be met by the legislative process, one step away from the commonly accepted legality requirement.[23]

That step can be defended on multiple grounds. For instance, whereas legality boils down to 'law as guidance', actual law-making is not necessarily aimed at or concerned with guidance – a government might want to signal some goal or concern without actually being prepared to commit to a clear norm.[24] A 'thin' concept of rule of law may offer some protection against such poor legislation by underscoring the value of the predictability of law. However, an inclusive law-making process would offer more protection because it better captures the intentions of the community – a point that is not usually reflected in legal analysis (which tends to construe monolithic legislative 'intent').[25]

[18] Raz, above n 17, 214.

[19] When we believe the rule of law to require that laws offer guidance, the implication could be that legal rules which do not meet that requirement cannot be law. Indeed, Fuller comes close to the normative statement that law should be predictable to constitute valid law. Fuller, above n 17, 39.

[20] Raz, above n 17, 211: 'A non-democratic legal system, based on the denial of human rights, on extensive poverty, on racial segregation, sexual inequalities, and religious persecution may, in principle, conform to the requirements of the rule of law better than any of the legal systems of the more enlightened Western democracies.'

[21] Tamanaha, above n 8, 91.

[22] Democracy is, in fact, often judged on its outcomes. In order to be called democratic, tax policy should arguably not only be legitimised by the democratic process but also effectuate the preferences of the demos: see J Jaakkola, 'A Democratic Dilemma of European Power to Tax: Reconstructing the Symbiosis Between Taxation and Democracy Beyond the State?' (2019) 20 *German Law Journal* 660.

[23] Tamanaha later moved democracy to the category of substantive definitions: B Tamanaha, 'A Concise Guide to the Rule of Law', St John's University School of Law Legal Studies, Research Paper Series No 07-0082, as noted in J Møller and SE Skaaning, 'Systematizing Thin and Thick Conceptions of the Rule of Law' (2012) *The Justice System Journal* 33, 136, 138.

[24] JA Grundfest and AC Pritchard, 'Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation' (2002) 54 *Stanford Law Review* 627. In legal theory, the related concept is legislative intent. Intent can be understood as the will to express a (new) rule, as the will to give a text the status of law, or as the wish to achieve some result through the instrument of legal rules. M Matczak, 'Three Kinds of Intention in Law-making' (2017) 36 *Law and Philosophy* 651.

[25] There is an extensive jurisprudential literature on the identification of the purposes of the legislator. See, eg KA Shepsle, 'Congress Is a "They", not an "It": Legislative Intent as an Oxymoron' (1992) 12 *International*

Alternatively, in a liberal tradition where freedom is the underlying goal of the rule of law, one may argue that the rule of law requires democracy because one can only be free as a co-author of the laws one is subject to.[26] Even more fundamentally, echoing Habermas, one may stress that the rule of law requires a source of authority to be universally accepted. While its authority has long been anchored in the supremacy of natural law, our modern loss of faith in natural law leaves us with only democracy as a source of legitimacy of the legal order.[27]

Regardless of whether democracy (or even human rights) should be added to the definition of the rule of law, its core meaning remains 'law as guidance' and builds on predictability. However, in practice, laws cannot always meet the test of predictability. For instance, income tax law may be too complex to offer guidance to people who lack legal training. Apparently, we are able to live with some level of technicality and opaqueness in our laws. Homo economicus is not a fully informed agent, as it is costly to acquire and digest information.[28] In dealing with our legal environment, we probably assume that laws are generally reasonable, and only start paying closer attention when we need to. Predictability of how the law regulates choices, therefore, cannot be an all-overriding concern of the legislator. This may explain why Bingham added to his definition as quoted previously: 'I doubt if anyone would suggest that this statement, even if accurate as one of general principle, could be applied without exception or qualification. But it seems to me that any exception calls for close consideration and clear justification.' The reason is that we always need to balance rule-of-law requirements with other demands, such as effectiveness. As Raz put it: 'Conflict between the rule of law and other values is just what is to be expected. Conformity to the rule of law is a matter of degree, and though, other things being equal, the greater the conformity the better – other things are rarely equal. A lesser degree of conformity is often to be preferred precisely because it helps realization of other goals.'[29]

'Thick' versions of the rule of law build on and hence retain the elements of 'thinner' versions. Although there is no clear hierarchy between them,[30] all 'thick' versions have the 'thin' element of 'law as guidance' at their core. Hence, Raz's observation that '[c]onformity to the rule of law is a matter of degree'[31] logically applies to both 'thick' and 'thin' versions. Furthermore, the requirements added by 'thicker' versions, such as democracy or human rights, can only increase the complexity of the trade-off between the rule of law and other values.

Review of Law and Economics 239; JF Manning, 'Textualism as a Nondelegation Doctrine' (1997) 97 *Columbia Law Review* 673.

[26] See I Kant, *Political Writings* (Cambridge: Cambridge University Press, 1991) 78–80; J Habermas, *Between Facts and Norms: Contributions to a Discourse Theory of Law and Democracy* (William Rehg tr, Cambridge MA: MIT Press, 1996) 408.

[27] Habermas, above n 26.

[28] 'Rational choice' implies decision-making on the basis of limited information (up to the point that the marginal benefit of evaluating more information is exceeded by the marginal cost of acquiring it).

[29] Raz, above n 17, 228.

[30] Møller and Skaaning, above n 23.

[31] See text to n 29.

International Law as a Political Project

This trade-off also becomes no less complex on the international level. In fact, as we will argue in this section, the rule of law on the international level is hard to separate from politics. Koskenniemi,[32] well-known to international law scholars,[33] shows that international legal argument moves between two poles: between 'concrete' or 'apologetic' arguments on the one hand, and 'normative' or 'utopian' arguments on the other. Normative arguments represent the aspiration for a more just (cosmopolitan?) world order. The more normative an argument, the more political it is because the weaker is its reference to the real-world social context.[34] Concrete arguments, on the other hand, refer to actual state practice, meaning that a particular rule can be defended by pointing at actual (and perhaps contingent) state behaviour. But this then equates the law with the will of a state, making the law infinitely flexible. International law is then used as an apology for state power.[35] These normative and concrete arguments exclude each other.

Many international tax arguments, like arguments generally in international law, as Koskenniemi shows,[36] work this way.[37] We apply his insights to core issues of international tax. We first examine two issues related to fiscal sovereignty: unilateral tax competition and the division of taxing rights between countries. These issues do not directly relate to the rule of law but are intended as general examples that illustrate Koskenniemi's reasoning and at the same time highlight the normative tension that is present within all multinational tax initiatives. We then focus on the potential conflict between Pillar 2's UTPR and customary international law that may lead to rule-of-law concerns. Our analysis of those rule-of-law concerns is illustrative of our broader argument, namely that any international application of the rule of law is inseparable from political values.

Fiscal Sovereignty

Fiscal sovereignty is understood as the power to tax those with a 'nexus' or 'genuine link' to a territory; and to be able to design tax policy according to national preferences.[38] Under increasing externalities, it suffers from the 'sovereignty paradox': in order to be able to exercise their fiscal sovereignty, states have no choice but to cooperate – that

[32] M Koskenniemi, *From Apology to Utopia: The Structure of International Legal Argument* (Cambridge: Cambridge University Press, 2009).

[33] See, eg E Jouannet, 'Koskenniemi: A Critical Introduction' in M Koskenniemi (ed) *The Politics of International Law* (Oxford: Hart Publishing, 2011).

[34] ibid, 8.

[35] ibid, 7–9.

[36] Koskenniemi, above n 32.

[37] Koskenniemi's more general point with respect to international law is that it is impossible 'to make substantive decisions within the law which would imply no political choice': M Koskenniemi, 'The Politics of International Law' (1990) 1 *European Journal of International Law* 4, 31.

[38] D Ring, 'Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation' (2009) 9 *Florida Tax Review* 555; P Dietsch and T Rixen, 'Tax Competition and Global Background Justice' (2014) 22 *Journal of Political Philosophy* 150.

is, to limit their freedom in setting competitive tax rates so as to protect the freedom of all states in designing tax policies according to national preferences.[39] In the frame of Koskenniemi's dichotomy, the fiscal sovereignty argument is either normative or concrete.

On the one hand, we cannot define a state's fiscal sovereignty without a notion of the fiscal spheres of other states; it requires delimitation. Unilateral tax policy autonomy thus requires an external theory that attaches normative weight to the interests of other jurisdictions.[40] For instance, Risse and Meyer argue that '[a]ny state should design its fiscal policy to advance justice, both domestic and global'.[41] But such theories can be criticised for being detached from reality, for being utopian or infeasible, closer to natural law than to social facts, and hence political. On the other hand, we cannot speak of fiscal sovereignty with reference to an external theory, without losing what 'makes up the fiscal state'. Fiscal sovereignty protects important notions such as self-determination, consent and equality. It requires respecting individual states' (democratic) justification for certain tax policy choices and hence refers to the concrete status quo. But abandoning the normative, utopian, external theory and relying on the status quo instead is a political decision as well: one would then opt for a world in which states are sellers of investment and residence opportunities, where their competitiveness is determined by pre-established divisions in state power, resources and wealth, and where inequality between taxpayers is affected by their ability to enjoy the fruits of global mobility.[42] That choice is vulnerable to the critique that 'the law' is not driven by principle, but forms an apology for a structural bias of power and interests.

The discussion concerning fair international distribution of taxing rights works in a similar way. States' fiscal sovereignty currently allows them to conclude bilateral tax treaties as they see fit – somewhat analogously to freedom of contract between individuals. The result, a territorially based international tax system that favours taxation by the residence state, is mainly shaped by the parties with the most bargaining power: capital exporting (OECD) nations who prefer limitations on source-country withholding taxation. This fundamentally restricts the rights of source (capital importing) countries.[43] A change to a more equal division of the international tax base cannot be construed on the intellectual basis of fiscal sovereignty and contract freedom alone. Freedom of contract itself provides no normative guidelines on how to deal with structural differences in negotiating power between treaty partners, or with the effects of tax treaties on third parties.[44] Fiscal sovereignty in this sense becomes vulnerable to

[39] Dietsch draws an analogy with individual liberty: that 'has to be limited in order maximise the analogous liberty of everyone else': P Dietsch, 'Rethinking Sovereignty in International Fiscal Policy' (2011) 37 *Review of International Studies* 2107, 2117; P Hongler, *Justice in International Tax Law* (Amsterdam: IBFD, 2019) 277–78.

[40] Dietsch, ibid, 2115.

[41] M Risse and M Meyer, 'Tax Competition and Global Interdependence' (2019) 27 *The Journal of Political Philosophy* 480, 492.

[42] T Dagan, 'Klaus Vogel Lecture 2021: Unbundled Tax Sovereignty – Refining the Challenges' (2022) 76 *Bulletin for International Taxation* 318.

[43] See A Christians and L van Apeldoorn, *Tax Cooperation in an Unjust World* (Oxford: Oxford University Press, 2022) ch 2.

[44] BN van Ganzen, DM Broekhuijsen and H Vording, 'Contract Theory as a Guide to Fairness in Tax Treaties' in I Lindsay (ed) *Fairness in International Taxation* (Oxford: Hart Publishing, forthcoming).

the critical theory that the current international tax system is hegemonic and distributionally biased towards existing structures of power and expertise (that is, favouring residence taxation claims).[45] Instead, any theory of tax base distribution that departs from fiscal sovereignty and contract freedom in bilateral tax treaties in order to reduce these persistent injustices (for instance, entitlement based on location of economic activities; 'inter-nation equity';[46] or the 'equal benefit principle'[47]) requires a cosmopolitan 'world tax regime' and negates a nation's right to liberty and self-determination. Most comprehensive 'tax cooperation' theories are hence open to the critique of being too far from social context, infeasible, utopian and political.[48]

Validity of the UTPR under International Custom

The same argumentative structure exists in discussions of a more concrete legal nature, as illustrated by the recent argument on the validity of the OECD's (and the EU's) work on Pillar 2 as regards the UTPR under international custom. Some authors hold that the UTPR is contrary to principles of customary international law, in particular against 'well established principles' of 'nexus' that underpin residence and source taxation.[49]

Customary international law is based on the presumption that there is a material practice of states (the objective element), grounded on those states' belief that this practice is obligatory (*opinio juris*, the subjective element).[50] As there are no independently applicable criteria for ascertaining international customary law, it is based on the intensity of evidence in favour of state practice and *opinio juris*.[51] Finding a customary law argument is at the same time a normative affair and an infinitely flexible affair, because the subjective element is analogous to what Koskenniemi calls the 'normative' argument, whereas the objective element is 'concrete' or 'apologetic'. The problem is that those arguments are incommensurable: on the one hand, international customary law is based on the practices of states, but on the other hand serves to regulate those very practices.

[45] TD Magalhães, 'What Is Really Wrong with Global Tax Governance and How to Properly Fix It' (2018) 10 *World Tax Journal* 499; and his PhD Thesis: *Critical Theory of International Tax Law, Teoria Crítica Do Direito Tributário Internacional* (Belo Horizonte: Letramento, 2020).

[46] RA Musgrave and PB Musgrave, 'Inter-nation Equity' in RM Bird and JG Head (eds) *Modern Fiscal Issues: Essays in Honor of Carl S. Shoup* (Toronto: University of Toronto Press, 1972) 63.

[47] Christians and van Apeldoorn, above n 43.

[48] Exemplary in this regard is T Dagan, *International Tax Policy: Between Competition and Cooperation* (Cambridge: Cambridge University Press, 2017): Dagan oscillates between the two poles and aims to find a compromise.

[49] See n 2.

[50] The argument is drawn from Koskenniemi, above n 32, ch 6.

[51] Koskenniemi, above n 37, 26. According to the International Law Commission, this 'involves a careful examination of available evidence …. To establish that a claim concerning the existence or the extent of a rule of customary international law is well-founded thus entails a search for a practice that has gained such acceptance among States that it may be considered to be the expression of a legal right or obligation': International Law Commission, *Draft conclusions on identification of customary international law, with commentaries* (A/73/10; GE.18-13644) 125.

Evidence of a practice as regards 'nexus' – for instance, residence and source state taxation as evidenced by almost all tax treaties – is used by scholars to criticise the legal validity of the UTPR under the 'common approach'.[52] The goals of this 'newer' Pillar 2 consensus as regard taxing nexus, are, however, put forth by the same states, as they want the Pillar 2 rules to work and be widely implemented. Evidence of the widely shared *belief* of states that the 'old' nexus principles are legally binding, must somehow be harmonised with a statement of states contrary to that belief. The argument that the new consensus on UTPR runs against existing nexus principles of customary international law, is, in other words, an 'I-know-you-better-than-you'-argument.

The opposite statement, namely that the UTRP does not run against customary international law, can be similarly deconstructed. To argue that Pillar 2's UTPR is valid, a new nexus link is introduced, which is said to form customary law. Under this new customary nexus link, any jurisdiction hosting a constituent entity that is part of the MNE group is said to have a customary connection with the MNE group's income.[53] But this argument conflates the (informal and even partial) consensus under Pillar 2's 'common approach' with the first requirement of international customary law: state practice. If states consider the 'new' nexus rule binding, why do they not explicitly say so? It raises the question why we would need treaties, and state consent to treaties, if we could do with any form of state consensus to establish binding international (tax) law. It makes the argument defensible only on the basis of the political importance of the subject matter.

Thus, the political consensus regarding Pillar 2 and its UTPR is at the same time the object that is precluded or limited by customary international law; and the very criterion to test whether customary international law should preclude it. As a result of this paradox, neither of the two positions above can be based on watertight reasoning. This weakens any claims that taxation based on the UTPR is excessive or arbitrary.

While the supposed conflict of the UTPR and customary international law is a very specific example of how multinational tax rules may lead to rule-of-law concerns, we think that the paradox of customary international law as described above is analogously present in the rule of law in general. The rule of law on the one hand serves to limit political choices by legal means in order to protect individuals from arbitrary decisions by lawmakers, but on the other hand, its definition is a political choice itself – absent a belief in natural law. The intensity of this problem increases with the substantivity or thickness of its definition. For instance, the questions whether Pillar 2's tax burdens on individual entities violate the right to property[54] and whether its minimum rate violates the right to social security[55] are essentially political: what is an excessive tax burden; what is the appropriate minimum rate? Defining a substantive rule of law is a challenge

[52] The 'common approach' stands for informal international consensus on Pillar 2 and is used by the OECD to envisage implementation of Pillar 2 rules in domestic law systems. It is hence not a treaty and is perhaps unlikely to turn into one. See, for this argument, J VanderWolk, 'The UTPR is Inconsistent with the Nexus Requirement of Tax Treaties' Kluwer International Tax Blog, 26 October 2022. On the implementation of Pillar 2: OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules* (2021).

[53] Avi-Yonah, above n 2.

[54] See text to n 5.

[55] See text to n 6.

already on the national level, but an additional problem with its application on an international level is that we would require one overarching, global definition. Echoing Koskenniemi, that scenario is utopian. Alternatively, the rule of law may be domestically defined. But then, we run into the problems of legal pluralism, making it hard to separate the rule of law from power, persuasion and politics at the international level.

Hence, there is a case for more formal rule-of-law definitions on which countries can more easily agree. However, we aim to show in the next two sections that the international application of formal versions may similarly depend on political considerations. We first focus on the value of democracy, which, we have argued, can be seen as a 'thick' but formal rule-of-law value that lies relatively close to the legality principle. We then examine the value of predictability, which is an unequivocally 'thin' value.

Democracy as an International Rule-of-Law Value

An analysis of democracy as an international rule-of-law value begins with the question whether democracy is indeed a rule-of-law value. This chapter has listed several arguments in favour of that position, and indeed, the incorporation of democracy into the Rule-of-Law concept has been gaining some momentum recently, as evidenced, for instance, by a communication of the European Commission and by a 'rule of law checklist' of the Venice Commission of the Council of Europe.[56] Still, a quick look at the definitions by Fuller, Raz and Bingham shows that the inclusion of democracy is not uncontroversial; and there are good reasons to limit oneself to a purely formal definition based on the legality principle.[57] However important, democracy may well be a separate value instead of being part of 'the' rule of law. But that discussion is semantical here. In many concerns expressed recently about democratic deficits in multinational tax law making, democracy in fact functions in a similar way as 'the' rule of law: it is invoked as a criterion to test whether a certain tax policy, or the governance process behind it, is acceptable. Formulated differently, it serves as a supreme value that limits certain political outcomes.

The starting point of most worries about the democratic nature of multinational tax legislation is that parliaments are less involved in its drafting process than they are in drafting domestic laws. For instance, Lind expects that global tax cooperation 'will require tax administrations to be more active in the law-making process as the implementation of the toolboxes provided by the OECD and EU becomes more of

[56] European Commission, *Further strengthening the Rule of Law within the Union. State of play and possible next steps* (COM/2019/163), underscoring that 'all public powers always act … in accordance with the values of democracy and fundamental rights …' and that '[t]he rule of law includes … principles such as legality, implying a transparent, accountable, democratic and pluralistic process for enacting laws'. Relatedly, the Venice Commission of the Council of Europe spells out various criteria for a 'transparent, accountable, inclusive and democratic' process for enacting law, including the supremacy of Parliament and a meaningful opportunity for the public to provide input to draft legislation: European Commission for Democracy Through Law (Venice Commission), *Rule of Law Checklist* (711/2013) 13.

[57] As argued by Lindsay, Chapter 3 in this volume, incorporating 'thick' values into the rule of law blurs the meaning of the concept and reduces consensus about its normative significance. Furthermore, it encourages debates over which values to include, and those debates distract from direct analyses of the values as such.

a tax technical implementation unlike past practices where the domestic legislatures have taken their own initiatives based on the needs and traditions of respective individual nations'.[58] Similarly, Wiman observes that international tax law is increasingly made not by states but by groups of experts: civil servants working at domestic and international (tax) administrations who seem to rely on the public input of (mostly commercial and non-governmental) stakeholders.[59] Relatedly, Essers argues that 'the present debate on international tax justice is polluted by power play and deception.'[60] The OECD and G20, and their output such as the BEPS Action Plan, suffer from democracy deficits. What is required, says Essers, is more 'Habermas', that is, 'deliberative democracy' between peoples, in which 'a true dialogue with national parliaments and citizens will be necessary'.[61] The point of all three authors is not that democratically elected parliaments should be able to formally endorse multinational tax rules, which they are, but that elected representatives of the people should be actively engaged with the legislation that implements multinational tax rules.[62] As Peters argues, that engagement diminishes once governments delegate the matter to the OECD.[63]

Peters refers to Scharpf's distinction between input legitimacy (the government system itself, which should be 'by the people') and output legitimacy (the actual policy output, 'for the people').[64] Scharpf himself underlines the trade-off between these concepts in the EU: the unanimity required for many decisions on an EU level (the input side) results in an extensive bargaining process that stands in the way of an effective resolution of problems caused by European integration, such as tax competition (the output side).[65] A similar trade-off is mentioned by de la Feria.[66] Peters notes that Pillar 2 is rooted in the same thinking because the OECD apparently accepts a defective democratic input – relying solely on expert knowledge – in order to effectively resolve the collective action problem of tax competition.

Echoing Scharpf, Peters suggests that sole reliance on output legitimacy requires a form of normative consensus about the policy output in question, which, he argues, does not exist with respect to the global minimum tax.[67] This argument seems to suffer from Koskenniemi's paradox explained in the previous section. The trade-off between input legitimacy and output legitimacy implies that we can legitimise a policy based on its effective solution to a collective action problem, while reducing the standards

[58] Y Lind, 'Blurring the Separation of Powers. A Legal and Political Study of the Phenomenon of Tax Administrations Moving from the Executive Branch towards the Legislative Branch' (2023) 21 *eJournal of Tax Research* 383, 405.

[59] B Wiman, 'Klaus Vogel Lecture 2022: Who Should Be in the Driver's Seat in Developing International Tax Norms – Civil Servants or National Parliaments?' (2023) 77 *Bulletin for International Taxation* 157.

[60] P Essers, Klaus Vogel Lecture 2013, 'International Tax Justice between Machiavelli and Habermas' (2014) 68 *Bulletin for International Taxation* 54, 55.

[61] Essers, ibid, 65. See also C Peters, *On the Legitimacy of International Tax Law* (Amsterdam: IBFD, 2014).

[62] See also S Hemels, 'Tax Autonomy from a Member State Perspective: Are We Faced with a Democratic Deficit?' Erasmus University Rotterdam, 29.

[63] C Peters, 'The Legitimacy of the OECD's Work on Pillar Two: An Analysis of the Overconfidence in a 'Devilish Logic'' (2023) 51 *Intertax* 554, 561.

[64] F Scharpf, *Governing in Europe: Effective and Democratic?* (Oxford: Oxford University Press, 1999), as cited in Peters, above n 63, 559.

[65] ibid.

[66] R de la Feria, 'Pillar 2, Fiat, and the EU Unanimity Rule on Tax Matters' (2023) 32 *EC Tax Review* 2.

[67] Peters, above n 63, 566.

of democratic consensus-building (for the reason that tax competition is a multilateral Prisoners' Dilemma where it takes only a few defectors to render the outcome greatly sub-optimal). Here, formulated in terms of Koskenniemi's dichotomy, democratic consensus is limited by a 'normative' argument. At the same time, it is part of a 'concrete' argument: following Scharpf and Peters, the existing amount of consensus would be the very criterion on the basis of which we are allowed to make this trade-off. The consequence of this dual role of democratic consensus is that we cannot invoke it as a supreme value to judge the normative right of the OECD to implement Pillar 2; this judgement is instead political.

Peters also argues that insofar we do make a trade-off between input legitimacy and output legitimacy, a precondition is that 'the governance process of the OECD should meet burdensome standards of 'good' governance including accountability', which he and Schmidt call 'throughput legitimacy'.[68] Throughput legitimacy requires, for instance, that stakeholders can evaluate the work of technical experts and that national parliaments are more involved in the process than merely rubber-stamping the outcome. Although we are very sympathetic to these goals, we again find it hard to view them as absolute and independent touchstones of the acceptability of the policy, and of the authority of the policymaker, as several authors seem to do.

Hemels, for instance, argues that we need 'fully democratically legitimized legislation' (with which she would mean input and/or throughput legitimacy) 'that has been discussed openly, and not just on a technical level behind closed doors, by national parliaments in the presence of journalists and the broader public',[69] even if this reduces the quality of the policy outcome; otherwise 'we might end up in a technocratic dictature'.[70] Instead, we would argue that democratic deliberation, like conformity to other rule-of-law values, is a matter of degree, and that the amount of input and throughput legitimacy required in multinational policy making is a political choice. We would also argue that throughput legitimacy is part of the political trade-off between input and output legitimacy, rather than an independent criterion outside this trade-off. For one thing, if all national parliaments had the right to evaluate and amend the Pillar 2 proposal at every stage of the process, there probably would have been no output at all.

The argument above applies to a greater extent on the international level than on the national level, where the requirements for the democratic process might be stricter. The underlying reason is legal pluralism regarding the definition of democracy as a rule-of-law value. Barring the fact that countries take divergent stances towards democracy as such, the point is that different countries have different preferences for policy output, such that their input/output/throughput trade-offs will also be different and not necessarily commensurable. Thus, while technical accountability and involvement of national parliaments in Pillar 2 certainly are desirable goals, it is infeasible to use a particular minimum level of accountability and involvement as an independent touchstone of the legitimacy of the OECD's Pillar 2 project.

[68] ibid, 554; V Schmidt, *Europe's Crisis of Legitimacy. Governing by Rules and Ruling by Numbers in the Eurozone* (Oxford: Oxford University Press, 2020) 31.
[69] Hemels, above n 62, 28.
[70] ibid, 30.

Whatever trade-off between input, output and throughput legitimacy is made, the formal democratic requirement remains intact: national parliaments must approve the new legislation. Therefore, the trade-off should not be put on a slippery slope towards a 'technocratic dictature' insofar the outcome does not maximise the levels of input and/or throughput legitimacy.[71] To most rule-of-law theorists it is obvious that none of its values are absolute, internationally as well as nationally. To repeat Raz, 'other things being equal, the greater the conformity the better', but 'other things are rarely equal'.[72] In the words of Bingham, any deviation still 'calls for close consideration and clear justification'. Closely considering and justifying the governance process behind Pillar 2, we should take as a benchmark the democratic nature of national tax law making and, in particular, the situation before the Pillar 2 project was launched.

Although direct parliamentary involvement in tax law making is greater on the national level than on the international level, it does not seem fair to lament the technocratic nature of multinational tax law without any reference to how national tax law is often made: we may safely assume that it is also largely written by unelected civil servants. Perhaps, this process behind closed doors even may have the incidental advantage that it reduces the influence of lobby groups, such that the outcome is based on a fairer weighing of everyone's interests. Another point is that in a world with unrestricted tax competition, countries have no option but to act as competitive sellers of investment and residence opportunities, such that their national processes of law-making are distorted by non-domestic interests and concerns. The resulting unequal concern for mobile and immobile constituents is arguably a grave violation of input legitimacy.[73] One could even argue that the categorisation of legitimacy into input, throughput and output becomes semantical in the first place, because regardless of the democratic control exercised by national parliaments, a wide range of policy options are out of the question because capital mobility renders them unaffordable – namely those policies that significantly raise the effective unilateral tax rate on corporate income. Again, we acknowledge that parliaments have more direct influence on the drafting of national tax laws than on the new multinational rules aimed at curbing tax competition. However, given the above problems of democratic legitimacy that exist without those new rules, we would be hesitant to say that Pillar 2 significantly worsens the democratic legitimacy of tax policy compared to the situation ex ante.

As in the previous section, this particular policy issue can also be seen as an illustration of a broader point. We have argued that democracy is often invoked as a Rule-of-Law value, because it serves as a touchstone for the acceptability of a policy and of the legitimacy of policy making. As with any other Rule-of-Law value, conformity to it is already a matter of degree on the national level. But its international application adds another dimension: countries define the value nationally, and their different conceptions of what the value entails might not be commensurable on the international level. This makes it difficult to appeal to Rule-of-Law values internationally, however important these values are.

[71] See text to n 70.
[72] See text to n 29.
[73] See generally T Dagan, 'The Tragic Choices of Tax Policy in a Globalized Economy' in Y Brauner and M Stewart (eds) *Tax, Law and Development* (Cheltenham: Edward Elgar Publishing, 2013).

Predictability as an International Rule-of-Law Value

Finally, to show that even 'thin' Rule-of-Law values may run into the problem of being political, we briefly highlight a debate on the value of predictability. This debate hinges upon 'legitimate expectations'.

Ignoring definitional issues, the core question is: when tax law changes, should losers be compensated?[74] The notion that legal subjects should not suffer retroactive effect is old. As Thomas Hobbes put it: 'No Law, made after a fact done, can make it a Crime: because … a Positive Law cannot be taken notice of, before it be made; and therefore cannot be obligatory'.[75] And indeed, '(t)he principle that the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place has timeless and universal human appeal'.[76] The underlying argument is that legal subjects should be able to rely on the law, or the law loses its capacity to offer guidance. Therefore, the issue of predictability does not merely involve laws that inherently have retroactive effects, but also overlaps with the issues of complexity and legal uncertainty: when rules are very complex or when conflicts between new rules and existing laws and treaties are still unresolved, subjects will find it difficult to understand the legal consequences of their actions ex ante. Exactly these concerns have been raised with respect to current initiatives in international tax law.[77]

In opposition to the traditions that the ex-post legal consequences of one's actions should always be predictable, a New View on retroactivity has developed, starting with Graetz and Kaplow.[78] The New View is clearly rooted in the law-and-economics tradition with economic efficiency of legal rules as the key concept, and free market transactions as the benchmark.[79] The core of the New View is the idea that the risks of legal transitions are best borne by market parties rather than by the government (that is, the community of taxpayers at large). People make their best decisions when they take into account all relevant information; this includes information about all types of risks that they may face. And changes in the law are risks – from the taxpayer's perspective comparable to business cycles or natural disasters. In principle, there should be no relief for losses caused by changing law because it would discourage taxpayers to anticipate socially desirable changes in the law. The New View rejects the 'reliance' argument for being circular – people's reliance on old rules should be protected because they rely on those old rules. This circularity of the reliance argument is reminiscent of Koskenniemi's paradox applied in the previous sections, which we will not repeat here. Instead, the New View replaces reliance by expectations.

[74] For an analysis of the prospectivity requirement, see generally Gillis, Chapter 4 in this this volume.

[75] T Hobbes, *Leviathan* (first published 1651, R Tuck ed, Cambridge: Cambridge University Press, 1992) XXVII, 203. Note that Hobbes only refers to ex-post changing the law.

[76] *Kaiser Aluminium Chemical Corporation v. Bonjorno* [1990] 494 US 827, Scalia, concurring, para 67.

[77] See text to n 1.

[78] MJ Graetz, 'Legal Transitions: The Case of Retroactivity in Income Tax Revision' (1977) 126 *University of Pennsylvania Law Review* 47; L Kaplow, 'An Economic Analysis of Legal Transitions' (1986) 99 *Harvard Law Review* 509.

[79] Some recent overviews of the discussion: M Doran, 'Legislative Compromise and Tax Transition Policy' (2007) 74 *University of Chicago Law Review* 545; RL Revesz and AL Westfahl Kong, 'Regulatory Change and Optimal Transition Relief' (2010) 105 *Northwestern University Law Review* 1581.

Taxpayers should be taught not to rely on the improbable (that is, unalterable law) but to expect the reasonable (that is, adaptation of law to changing preferences and circumstances). In that way, the transaction costs of legal change are reduced to a minimum.

The ensuing debate has generated some conclusions that seem to express a certain level of consensus. One is that the level of legal certainty to be provided always requires trade-offs, especially against any need to adapt laws to changing priorities, preferences and circumstances.[80] And the second is that an evaluation of the legitimacy of taxpayers' expectations may be required to decide whether they should receive protection from retroactivity. Could they believe bona fide that the tax law would not change – or should they have picked up signs that legal norms would be adapted to changing social perceptions?[81]

Applying these considerations to the uncertainty created by multinational tax law-making, the core issue is what MNE taxpayers may legitimately expect as the architecture of cross-border tax law is being adapted. If changing circumstances require new rules, if complexity is required for these rules to function properly, and if conflict with existing laws and treaties is unavoidable, can the rule of law be invoked in arguments against these new rules? We doubt it. While the above considerations do not negate that 'thin' rule-of-law values such as predictability, prospectivity, clarity and stability are very much desirable, it again becomes clear that conformity to these values is a matter of degree and involves political choices. As a result, the extra dimension of complexity added on the international level also applies in the case of 'thin' values: as the rule of law is politically defined, we either need one overarching theory or must rely on the problematic reality of legal pluralism. As there is no international theory on what taxpayers may legitimately expect from new initiatives in tax law, it is hard to invoke 'law as guidance' as an argument against these new rules.

Conclusion

The concept of the rule of law limits the political discretion of lawmakers by legal means. Conformity to the rule of law is a matter of degree and entails trade-offs with other values, such that, paradoxically, the concept itself is to some extent political. This observation primarily applies to 'thick' or substantive rule-of-law definitions; but even the interpretation of 'thin' versions based on legality and predictability may require political choices. As countries have different value systems and no single international conception of the rule of law exists, the use of rule-of-law values in the international realm, like all other international law, is often hard to separate from power, persuasion and politics.

[80] D Shaviro, *When Rules Change: An Economic and Political Analysis of Transition Relief and Retroactivity* (Chicago: Chicago University Press, 2000).

[81] JE Fisch, 'Retroactivity and Legal Change: An Equilibrium Approach' (1997) 110 *Harvard Law Review* 1055, 1119; J Prebble, R Prebble and C Vidler Smith, 'Legislation with Retrospective Effect, with Particular Reference to Tax Loopholes and Avoidance' (2006) 22 *New Zealand Universities Law Review* 17.

In analyses of multinational tax initiatives, authors should therefore be cautious in asserting that the law-making process is 'undemocratic'; that the new rules create too much legal uncertainty; or that they conflict with customary international law or human rights. Instead of functioning as strict and supreme criteria, these concepts are multifaceted and open to divergent interpretations. Although multinational tax law should be as prospective, clear, stable and democratic as possible, deviations from these criteria should be possible, provided that they are closely considered and clearly justified.