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## Breaking BEPS: The New International Tax Diplomacy

Itai Grinberg

*Georgetown University Law Center*, [itai.grinberg@law.georgetown.edu](mailto:itai.grinberg@law.georgetown.edu)

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## Breaking BEPS: The New International Tax Diplomacy

Itai Grinberg

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### Abstract

*International tax avoidance by multinational corporations is now front-page news. In a time of public austerity, citizens and legislators around the world have focused on the erosion of the corporate income tax base. In response, in 2012 the G-20—the gathering of the leaders of the world’s twenty largest economies—launched the “Base Erosion and Profit Shifting” (BEPS) project, the most extensive attempt to change international tax norms since the 1920s.*

*This article is the first to explain that in the course of the BEPS project, the field of international tax has adopted the institutional and procedural architecture for multilateral action used in international financial law. But will that architecture work in the international tax context? To answer that question, the article applies lessons from the international financial law literature to assess international tax agreements that are now being reached through soft law instruments and procedures comparable to those that characterize international financial law. This initial analysis is largely pessimistic. However, the article then describes how model tax treaty law—although also a form of soft law—is highly effective, and differentiates the political economy of international tax law from that of international financial law. As a result, a key theoretical point emerges: bifurcating analysis of multilateral efforts to change international tax norms into their Model Treaty-based and non-Model Treaty-based components is necessary in order to understand the new regime for international tax governance. At a more practical level, bifurcating the analysis highlights that observers should expect the Model Treaty-based parts of the BEPS project to be implemented, as well as most parts of the project focused on tax transparency. By contrast, sustained international coordination in implementing other dimensions of the project is doubtful. In reaching these conclusions, the Article contributes to the broader international economic governance literature by using a high-profile example from international tax diplomacy to show how underlying legal institutions affect the prospects for implementation of international regulatory agreements.*

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# Breaking BEPS: The New International Tax Diplomacy

Itai Grinberg<sup>1</sup>

## Introduction

In recent years, international tax avoidance by multinational corporations has been front-page news. Senior executives from companies like Amazon, Apple, Google, and Microsoft were hauled before parliamentary committees around the world to face heated inquiries into their international tax strategies.<sup>2</sup> Demonstrators picketed Starbucks to protest aggressive international tax planning.<sup>3</sup> Australian diplomats started calling international tax a “barbeque stopper,” meaning that Australians stop eating their beloved barbeque to discuss international tax avoidance.<sup>4</sup> Across Europe, Asia, and the United States, press exposés and high-profile legislative hearings concentrated public attention on aggressive international tax planning. In a time of public austerity—a result of the greatest financial crisis in a generation—citizens around the world have been more focused on the erosion of the corporate income tax base than ever before. In response to that concern, Presidents and Prime Ministers are now insisting on change in the international tax regime.

With all the pressure for change, the thorny question is: will meaningful coordination to address international tax avoidance by multinational corporations be agreed to and implemented by tax authorities, and why or why not? A moment’s reflection suggests that the challenges of transnational economic regulation are not unique to international taxation. This Article argues that we can draw lessons from international finance, because the field of international tax is currently moving in the direction of an institutional and procedural architecture for multilateral action that resembles international financial law.

The growing institutional and procedural similarity between international tax and international financial law is a key consequence of the “Base Erosion and Profit Shifting”

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<sup>2</sup> See e.g., *Offshore Profit Shifting and the U.S. Tax Code, Part II (Apple, Inc.): Hearing before the Permanent Subcomm. on Investigations*, 113th Cong. 35-53 (2013) (testimony of Timothy D. Cook, Apple, Inc., and Peter Oppenheimer, Apple, Inc.); *Public Accounts Committee, United Kingdom, Minutes of Oral Evidence, HC 716* (2012) (examination of Troy Alstead, Starbucks; Andrew Cecil, Amazon; Matt Brittin, Google); *Economic References Committee, Official Committee Hansard, Australian Senate: Hearing on Corporate Tax Avoidance* 42-60 (2015) (testimony of Maile Carnegie, Google Australia; Tony King, Apply Pty Ltd; & Bill Sample, Microsoft).

<sup>3</sup> *UK Uncut Protests over Starbucks ‘tax avoidance,’* BBC (Dec. 8, 2012), <http://www.bbc.com/news/uk-20650945>.

<sup>4</sup> Lee A. Sheppard, *Barbecue Stoppers and Permanent Establishment*, 2015 WORLDWIDE TAX DAILY 113-4 (June 12, 2015).

(BEPS) project—a global effort to address international tax avoidance launched by the G-20, the annual gathering of the leaders of the world’s twenty largest economies. The BEPS project is the most extensive attempt to change international tax norms since the 1920s.<sup>5</sup> At its core, the focus of the project is simple: it is meant to address features of the tax regimes of different countries that allow multinational corporations (MNCs) to shift income to low-tax or no-tax jurisdictions and expenses to high-tax jurisdictions, thereby eroding the corporate income tax base of higher-tax, often larger-market economies.<sup>6</sup> The Organisation for Economic Cooperation and Development (OECD), which the G-20 has tasked to undertake the BEPS project, is widely recognized to be “moving full-speed ahead with an initiative that will drastically change the international tax landscape.”<sup>7</sup>

The institutional and procedural similarities that are developing between international tax law and international financial law as a result of the BEPS project reflect the heightened public salience of international tax matters, as well as the fact that international tax law, like international financial law—and unlike international trade law—lacks an international organization with substantial autonomy and authority. A rich academic literature recounts when international financial regulatory diplomacy undertaken at the G-20’s direction has been effective, and when it has not. The bulk of that scholarly literature is broadly pessimistic about the range of issues that can be successfully addressed utilizing the soft law forums and procedures that characterize international financial law.<sup>8</sup>

However, unlike most areas of international financial law, the international tax regime includes a substantial treaty-based component in the form of a network of more than 3,800 bilateral tax treaties.<sup>9</sup> The OECD Model Tax Convention on Income and Capital (the “OECD Model Treaty”), although technically soft law, informs the content of this tax-treaty network in a way that is surprisingly self-enforcing. Importantly, in practice, when changes are made to the OECD Model Treaty, to some degree those changes are incorporated into domestic law and given direct effect by tax administrators and courts, even if the relevant bilateral tax treaties are not renegotiated.

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<sup>5</sup> The BEPS project was launched when the G-20 asked the OECD to create the BEPS Action Plan. See Communiqué, G-20, Los Cabos Summit Leaders’ Declaration, at 7 (June 19, 2012), [hereinafter *Los Cabos Communiqué*], available at, <http://www.g20.utoronto.ca/2012/2012-0619-loscabos.html>, <http://perma.cc/J963-ZZ3D>; OECD, *Action Plan on Base Erosion and Profit Shifting*, OECD PUBLISHING 22 (2013), available at <http://dx.doi.org/10.1787/9789264202719-en> [hereinafter *BEPS Action Plan*].

<sup>6</sup> Pascal Saint-Amans & Raffaele Russo, *OECD: What the BEPS are We Talking About?*, 70 TAX NOTES INT’L 339 (Apr. 22, 2013).

<sup>7</sup> *KPMG Survey: Corporate Tax Leaders Skeptical That OECD Will Meet Goals of “BEPS” Action Plan by Deadline*, KPMG, <http://www.kpmg.com/us/en/issuesandinsights/articlespublications/press-releases/pages/kpmg-survey-corporate-tax-leaders-skeptical-that-oecd-will-meet-goals-of-beps-action-plan-by-deadline.aspx> (last visited Oct. 29, 2014).

<sup>8</sup> For a more detailed discussion, see sources cited *infra*, notes 17-19, 28, and accompanying text.

<sup>9</sup> OECD/G-20 Base Erosion and Profit Shifting Project, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties*, OECD PUBLISHING 11 (2014) [hereinafter *Multilateral Instrument*], available at <http://dx.doi.org/10.1787/9789264219250-en>. For a description of the purpose of bilateral tax treaties, please see *infra*, notes 173-174 and accompanying text.

This Article thus argues that in assessing the BEPS project and other future multilateral efforts to change the international tax regime, we must bifurcate our analysis of efforts to change the international tax regime into their Model Treaty–based and non-Model Treaty–based components. Doing so allows us to understand the new regime for international tax governance at the multilateral level. At a practical level, this understanding should lead observers to expect the Model Treaty–based parts of the BEPS project to be implemented, as well as many parts of the project focused on tax transparency. Everything else is subject to substantial doubt.

In arriving at these conclusions, the Article makes four contributions that link the international tax and international political economy literatures. First, the article shows how high-salience crises can destabilize even long-established systems of international governance, substantially changing what can and cannot be achieved multilaterally. In international tax, the political pressures brought to bear by the financial crisis swept aside a well-established and highly technocratic system of governance. The substantial changes wrought to that system are not well appreciated, but are fundamental. Second, the Article illustrates that international tax has now adopted the procedural soft-law forms of international financial law, including G-20 convocation, standard-setting, and monitoring. This descriptive claim is new to the literature, and is essential to understanding the new regime for international tax governance at the multilateral level. Third, the Article draws lessons from the rich academic literature analyzing the evolution of international financial law and applies them to the enforceability of international tax agreements reached through international financial law-style forums and procedures. This critical perspective highlights some challenges the new regime for international tax governance faces. Fourth, the Article illustrates that tax treaty law differentiates the political economy of international tax law from that of international financial law in certain respects, because the OECD’s Model Treaty acts as an independent variable that affects the political economy of international tax affairs.

The picture that emerges is of a new, bifurcated regime for international tax governance, one that involves two quite different and inconsistently effective mechanisms for coordinating international tax affairs. In demonstrating how the new international tax governance regime works, the Article contributes to the broader literature on international economic law by providing a high-profile example from international taxation of how underlying legal institutions can affect the prospect for international regulatory agreements to be implemented.

Part I introduces the BEPS project, describes its components, and explains why the outcomes of the BEPS project should be important to a U.S. audience. It then introduces international financial law and highlights the similarities between G-20 interventions in international financial law and G-20 interventions in international taxation since 2008. Part II gleans lessons from the international financial law literature regarding the potential efficacy of international economic governance projects and applies them to parts of the BEPS project that are not based on the OECD Model Treaty. Part III describes why changes to the OECD Model Treaty are unusually self-enforcing for soft

law, such that the lessons of international financial law are not applicable to the Model Treaty-based portions of the international tax regime.

## I. International Tax and International Financial Law

### A. What Is the BEPS Project, and Why Should We Care About It?

The G-20's endorsement of the BEPS project inaugurated a unique era in international tax diplomacy. International tax officials from across the OECD and G-20 member countries endeavored to set new standards in a wide range of technical areas of international tax, including in areas that had never been explored before multilaterally, in just two short years.<sup>10</sup> The OECD claims that the outputs of their "BEPS Action Plan" will reinforce the coherence of the corporate income tax laws at the international level, primarily by combatting "double non-taxation," insisting that a deduction on one side of a cross-border, intra-company transaction should match up with a taxable inclusion on the other side, realigning taxation and "substance" by requiring that MNCs recognize income in the jurisdictions where "value is created," and providing improved transparency and a more stable compliance environment for all stakeholders.<sup>11</sup> In contrast, some academic commentators characterize the fifteen items in the BEPS Action Plan as a laundry list of

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<sup>10</sup> In short, the fifteen items in the BEPS Action Plan attempt to achieve the following: 1) establish new principles to eliminate certain mismatches between income in one jurisdiction and deduction in another in transactions between related parties, which result in deductions in one country without corresponding taxation in another, as well as the generation of multiple deductions or multiple foreign tax credits through a single expense (Action 2); 2) articulate best practices for anti-deferral rules that prevent the accrual of income in intermediary jurisdictions that are neither the country of source of a payment nor the country of residence of the parent of the entity receiving the payment (Action 3); 3) limit the use of debt to obtain excess interest deductions in high-tax jurisdictions (Action 4); 4) address "harmful tax practices" by defining when a tax regime that provides a reduced rate for income generated from intellectual property is not "harmful," because it includes sufficient protections to ensure that the tax benefit is provided in the context of substantial activity, rather than mere income-shifting (Action 5); 5) limit tax treaty abuse and redefine tax nexus requirements (so-called permanent establishment rules) for the twenty-first century, and negotiate a multilateral instrument to implement these and other "treaty-based" measures (Actions 6, 7, and 15); 6) change the transfer pricing guidelines to shift understandings of "arm's length" pricing within multinational groups away from a respect for intragroup contracts and intragroup capital allocation and toward a "people functions" theory of value creation (Actions 8-10); 7) gather data on profit-shifting by multinationals in order to quantify the magnitude of base erosion and profit shifting problems and highlight improvements in a post-BEPS era (Action 11); 8) establish mandatory disclosure regimes and substantially expanded transfer pricing reporting requirements to cabin tax planning by MNCs and special tax deals made between an MNC and a sovereign, by relying on the chilling effect of transparency (Actions 5, 12, and 13); and 9) improve dispute resolution mechanisms for double taxation disputes (Action 14). OECD, *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing (2013), available at <http://dx.doi.org/10.1787/9789264202719-en> [hereinafter *BEPS Action Plan*]. A report entitled *Addressing the Tax Challenges of the Digital Economy* effectively concluded that the "digital economy" is increasingly the entire global economy, and that therefore online activity could not be "ringfenced." As a result, concerns raised under "Action 1" of the BEPS Action Plan were folded into other parts of the BEPS project. OECD/G20 Base Erosion and Profit Shifting Project, *Addressing the Tax Challenges of the Digital Economy*, OECD PUBLISHING (2014), available at <http://dx.doi.org/10.1787/9789264218789-en>.

<sup>11</sup> *BEPS Action Plan*, *supra* note 10.

issues that were raised by various sovereigns but left unaddressed by the OECD over the last twenty years.<sup>12</sup>

Regardless of whether one believes there is a coherent intellectual framework for the BEPS project, most agree that it is the most extensive effort to set multilateral international tax norms since work was undertaken to create such norms under the auspices of the League of Nations beginning in the 1920s. Historically, however, U.S. tax lawyers and academics tended to dismiss multilateral discussion of international tax rules as a second-order matter. The conventional wisdom was that the United States would ultimately have a veto over any outcome at the OECD, and would not agree to anything unfavorable to the United States. Furthermore, the U.S. Congress would not pass laws to implement any multilateral agreement that was not consistent with U.S. policy interests, and until such laws were passed, the content of any multilateral agreement was irrelevant.

Given this backdrop, one initial question is why academics and practitioners in the United States should care about the BEPS project or G-20 discussions about international tax issues in general. An answer is that the United States' highly atypical system for taxing the earnings of foreign subsidiaries of U.S.-resident multinational corporations (U.S. MNCs)<sup>13</sup> has undermined the validity of the historic presumption that multilateral discussions would not constrain U.S. national interests. The planning structures U.S. MNCs must implement to reduce their effective tax rates to levels similar to those faced by their foreign competitors are highly reliant on the tax treatment of "foreign-to-foreign" cross-border transactions between related controlled foreign corporations within U.S. MNCs.<sup>14</sup> As a result, from a U.S. MNC tax-planning perspective, foreign parliaments adopting new rules regarding the taxation of cross-border income can matter as much as or more than developments in the U.S. Congress.<sup>15</sup>

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<sup>12</sup> For a summary of the items in the BEPS Action Plan, *see* note 10, *supra*. *See e.g.*, Graeme Cooper, *Coordinating Inconsistent Choices – The Problem of Hybrids*, Legal Studies Research Paper No. 14/108, SYDNEY LAW SCHOOL (Dec. 2014) (arguing that the BEPS action items lack conceptual coherence).

<sup>13</sup> *See, e.g.*, *Evolution of Territorial Tax Systems in the OECD*, Report Prepared for Technology CEO Council, PWC 3 (Apr. 2, 2013), *available at* [www.techceocouncil.org/clientuploads/reports/Report%20on%20Territorial%20Tax%20Systems\\_20130402b.pdf](http://www.techceocouncil.org/clientuploads/reports/Report%20on%20Territorial%20Tax%20Systems_20130402b.pdf).

<sup>14</sup> Careful planning to take advantage of the deferral benefit allowed by the United States' international tax rules allows U.S. MNCs to achieve tax burdens on their foreign-source income that are often similar to those faced by their foreign competitors, despite the fact that foreign statutory corporate tax rates are well below U.S. statutory corporate tax rates. However, doing so requires substantial foreign-to-foreign tax planning. *See, e.g.*, Edward Kleinbard, *Stateless Income*, 11 FLA. TAX REV. 699 (2011). A very different way to make this point is to observe that because the U.S. has the highest statutory corporate tax rate in the world, it generally does not make sense for a U.S.-based multinational to react to changes in foreign law by having a U.S. entity earn foreign-source income in place of a foreign affiliate. *See* Letter from Jeffrey Bergmann and Barry Slivinsky, Co-Chairs, Silicon Valley Tax Dir. Grp., to Sen. Ron Wyden, (then) Chairman, Senate Fin. Comm., and Sen. Orrin Hatch, (then) Ranking Member, Senate Fin. Comm. (Aug. 1, 2014), *available at* [http://svtdg.org/docs/svtdg\\_letter\\_to\\_wyden-hatch\\_on\\_tax\\_reform.pdf](http://svtdg.org/docs/svtdg_letter_to_wyden-hatch_on_tax_reform.pdf).

<sup>15</sup> The International Tax Bipartisan Tax Working Group of the U.S. Senate Finance Committee observed in June 2015 that "[a]lmost every U.S. multinational company and trade group that met with the working



One consequence of the tax-planning environment created by current U.S. law is that the United States has participated in negotiations in the BEPS project without its usual bargaining strength. Despite being the world's largest economy, in this context its negotiating power has been significantly eroded. Most countries understand that U.S. MNCs are reliant on "foreign-to-foreign" tax planning involving transactions between two or more of their foreign subsidiaries. Thus, foreign sovereigns have more flexibility to change the rules of the game for U.S.-parented multinationals, without having to deal directly with U.S. authorities or address their bilateral treaty arrangements with the United States.<sup>16</sup> Furthermore, other sovereigns may believe that the United States' weakened bargaining position is likely to persist over the near to medium term, given gridlock on tax reform in Washington. That perception further erodes the United States' leverage in international negotiations. At the same time, the history of G-7 and G-20 initiatives in international economic affairs suggests that once those bodies engage an issue area within economic law, they tend not to disengage.<sup>17</sup> As a result, diplomatic processes akin to the BEPS process are likely to be an ongoing feature of international tax affairs going forward.

In this environment, in which U.S. influence over international tax norms has been reduced relative to historic norms (at least for the time being), and G-20 involvement in international tax affairs is likely to continue, it is important for U.S. practitioners, policymakers, and academics to develop a better understanding of how multilateral projects like the BEPS initiative work, and whether they can or will be effective. As section I.B. below suggests, understanding the growing procedural and institutional similarities between international tax and international financial regulatory coordination provides a helpful starting point for that analysis.

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group expressed serious concerns about the impact the BEPS project will have . . . and, in fact, [they] are the intended targets of many of the new rules going into effect." UNITED STATES S. COMM. ON FINANCE, THE INTERNATIONAL TAX BIPARTISAN TAX WORKING GROUP REPORT 9-10 (2015).

<sup>16</sup> For instance, all U.S. tax treaties include a "mutual agreement procedure" that provides recourse to U.S. taxpayers to ask for assistance from the Internal Revenue Service when they believe that the actions of a treaty country result in or will lead to taxation not intended by the treaty between the two countries. See *Competent Authority Assistance*, IRS, <http://www.irs.gov/Individuals/International-Taxpayers/Competent-Authority-Assistance> (last visited June 21, 2015). However, in the case of transfer pricing adjustments imposed by a foreign sovereign, it is difficult for U.S. MNCs to invoke so-called "competent authority assistance" from the Internal Revenue Service when the transaction at issue does not involve a U.S. entity. Moreover, finance ministries abroad are aware that U.S. MNCs generally will not change their tax planning structures to take advantage of the protections provided by U.S. bilateral tax treaties as a means of defending against increased tax burdens imposed by source states. The reason is that relying on a U.S. treaty would require subjecting the income in question to U.S. tax—that is to say, to the highest corporate tax rate in the developed world.

<sup>17</sup> The G-7 and G-20 have made and sustained open-ended commitments to involvement in at least a dozen areas of international economic law over the last two decades. In contrast, the author's investigations suggest only two areas where the G-7/G-20 committed to a subject and subsequently fully disengaged with the issue: these are the Doha trade round, which the Leaders emphasized from 2008-2012, but set aside in 2013 as Doha appeared to collapse; and IOSCO reporting on the functioning of credit default swap markets. See *Goodbye Doha, Hello Bali*, THE ECONOMIST (Sept. 8, 2012), available at <http://www.economist.com/node/21562196>; OICV-IOSCO, THE CREDIT DEFAULT SWAP MARKET (2012) (concluding IOSCO's research).

## B. The International Financial Law Lens and the Growing Influence of the G-20

For a quarter century, scholars have worked to explain the political economy and institutional architecture surrounding the creation and strengthening of international financial regulatory standards.<sup>18</sup> Most international financial law is established through regulatory agreements that are not usually ratified by legislators, and are not legally binding on signatories in the traditional sense of international law.<sup>19</sup> Instead, across a wide array of subfields of international financial regulation, one sees informal intergovernmental organizations that are not constituted by treaty and are not granted agency—legal or otherwise—to act in international affairs, but that nevertheless drive standard-setting agendas at the international level.<sup>20</sup>

Although these organizations are constituted by, and issue, agreements and declarations with no formal sense of international obligation, they sometimes successfully function to coordinate regulation of complex cross-border financial matters internationally.<sup>21</sup> The Basel Committee, the International Organization of Securities Commissions (IOSCO), the Financial Action Task Force, and the Financial Standards Board are representative examples.<sup>22</sup> For instance, under the G-20's influence, the Basel Committee on Banking Supervision has imposed and refined standards of capital adequacy for internationally active financial institutions; IOSCO has set global standards and best practices for international securities regulation; and the Financial Action Task Force is known for its 40+9 guidelines to ensure that financial institutions do not facilitate money laundering or terrorist financing.<sup>23</sup> Each of these bodies devises standards for subsequent adoption or

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<sup>18</sup> Most of these scholars come from international relations or political economy backgrounds. *See, e.g.*, Ethan B. Kapstein, *Resolving the Regulator's Dilemma: International Coordination of Banking Regulations*, 2 INT'L ORG. 43 (1989); DANIEL DREZNER, *ALL POLITICS IS GLOBAL: EXPLAINING INTERNATIONAL REGULATORY REGIMES* (Princeton Univ. Press, 2007); TONY PORTER, *GLOBALIZATION AND FINANCE* (Wiley, 2005); DAVID SINGER, *REGULATING CAPITAL: SETTING STANDARDS FOR THE INTERNATIONAL FINANCIAL SYSTEM* (Cornell Univ. Press, 2007); ANDREW WALTER, *GOVERNING FINANCE: EAST ASIA'S ADOPTION OF INTERNATIONAL STANDARDS* (Cornell Univ. Press, 2008); Thomas Oatley & Robert Nabors, *Redistributive Cooperation, Market Failure, Wealth Failures and the Basel Accord*, 52 INT'L ORG. 35 (1998). However, key contributions by legal scholars have shown the way in which law acts as an independent variable in shaping outcomes in financial regulation. *See e.g.*, CHRIS BRUMMER, *SOFT LAW AND THE GLOBAL FINANCIAL SYSTEM: RULE MAKING IN THE 21<sup>ST</sup> CENTURY* (2012); Pierre-Hugues Verdier, *The Political Economy of International Financial Regulation*, 88 IND. L. REV. 1405 (2013).

<sup>19</sup> BRUMMER, *supra* note 17; David Andrew Singer, *Capital Rules: The Domestic Politics of International Regulatory Harmonization*, 58 INT'L ORG. 531, 535 (2004).

<sup>20</sup> Note that while the OECD is a formal organization with legal standing under international law, the "OECD plus G-20"—the body that is implementing the BEPS project—has no such status.

<sup>21</sup> ANNE-MARIE SLAUGHTER, *A NEW WORLD ORDER* 38 (2004).

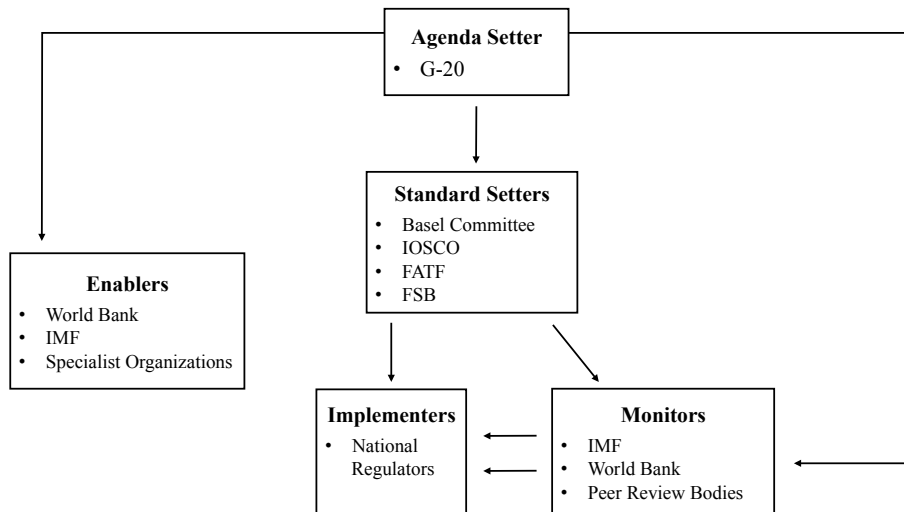
<sup>22</sup> Other "soft law" financial standard-setters include the International Accounting Standards Board, and the Committee on Payments and Settlement Systems (known for its Recommendations for Central Counterparties and Core Principles for Systematically Important Payments Systems). These have narrower mandates than IOSCO or the BCBS. The Financial Action Task Force (FATF) also has a narrow mandate, but is notable because of the efficacy of its peer review mechanism and the enforcement pressures associated with those peer reviews.

<sup>23</sup> BRUMMER, *supra* note 17, at 63–69.

implementation by national regulators. The Financial Standards Board has developed standards for macro-prudential regulation while also coordinating the activities of other international financial regulatory bodies. None of these organizations have any formal legal basis in the sense of traditional international law, but each has influence on international regulatory coordination in their issue area in member and non-member states alike.<sup>24</sup>

Each of the various standard-setters in specific sub-areas of international financial law depends on the G-20. At least since the financial crisis, the G-20 has acted as the primary agenda-setter for their work, defining broad strategic objectives for international financial regulation. The G-20 not only requests international coordination around the standards created by the standard-setters it convenes, but frequently establishes monitoring bodies, enforcement vehicles, and technical assistance providers (“enablers”) to support compliance with the new international standard. Thus, a monitoring body may determine whether national regulators are complying with a standard, potentially imposing discipline. Enforcement mechanisms are often established or threatened by the G-20 and tied to the monitoring bodies’ judgments. Finally, jurisdictions that lack the human capital needed to meet the standards may be offered technical assistance.<sup>25</sup> Taken together, the G-20 and its associated standard-setters, monitoring bodies, enforcement mechanisms, and enablers create a soft-law meta-framework for international financial law.<sup>26</sup> A key feature of this framework is a “top-down” architecture, in which G-20 convocation and agenda setting provides the impetus for law- and regulation-making.

### Simplified Architecture of International Financial Law



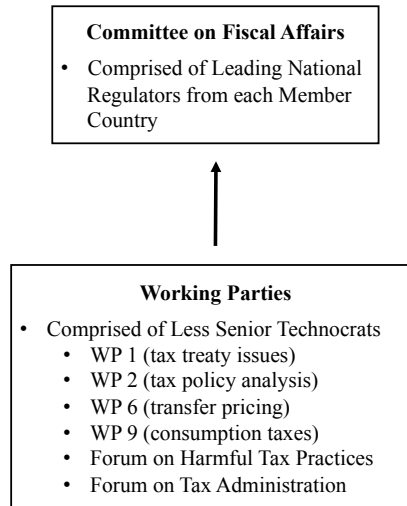
<sup>24</sup> *Id.* at 63-69, 76.

<sup>25</sup> *Id.* at 61–114. Before the G-20’s emergence as a major player in 2008, the G-7 had played a similar role.

<sup>26</sup> See Chris Brummer, *How International Financial Law Works (And How It Doesn’t)*, 99 GEO. L.J. 257 (2011). The diagram below borrows from Brummer, *supra* note 17, at 68.

In contrast to the G-20–centric process for addressing international coordination in international finance, multilateral dialogue about international tax matters was historically centered on the Committee on Fiscal Affairs at the OECD, a body whose membership consisted of leading technocrats with authority over international tax affairs in their respective countries.<sup>27</sup> Topics for consideration by the Committee on Fiscal Affairs were most often generated by means of prior, often multiyear discussions in the Committee on Fiscal Affairs’ subsidiary bodies, staffed by lower-level technocrats.<sup>28</sup> Given this “bottom-up” process, multilateral agreement on changes to international tax norms happened slowly and deliberately, with significant OECD projects involving even moderate changes to agreed-upon principles often taking as much as a decade from onset to completion.<sup>29</sup>

### Simplified (Historic) Architecture of International Tax Multilateralism



All that began to change in 2009. At their London meeting that year, the leaders of the G-20<sup>30</sup> endorsed a “more cooperative” international tax environment.<sup>31</sup> For two years,

<sup>27</sup> Hugh Ault, *Reflections on the Role of the OECD in Developing International Tax Norms*, 34 BROOK. J. INT’L L. 757, 760 (2009). For instance, the representative of the United States at the CFA has usually been the International Tax Counsel of the United States or the Deputy Assistant Secretary of the Treasury (International Tax). *Id.*

<sup>28</sup> Ault, *supra* note 30, at 761.

<sup>29</sup> *Id.* at 762-63. For example, the OECD’s Report on Attribution of Profits to Permanent Establishments was over a decade in the making. *Id.*

<sup>30</sup> The G-20 describes itself as “the premier forum for its members’ international economic cooperation and decision-making.”

<sup>31</sup> The G-20’s London Declaration explicitly committed to a “new cooperative tax environment,” and that commitment has been reiterated at each subsequent G-20 meeting. Communiqué, G-20, Declaration on Strengthening the Financial System—London, at 5 (Apr. 2, 2009), [hereinafter *London Communiqué*], available at [http://www.treasury.gov/resource-center/international/g7-g20/Documents/London%20April%202009%20Fin\\_Deps\\_Fin\\_Reg\\_Annex\\_020409\\_-\\_1615\\_final.pdf](http://www.treasury.gov/resource-center/international/g7-g20/Documents/London%20April%202009%20Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf), <http://perma.cc/4NG7-M657>.

the G-20 limited its efforts to the area of tax administrative cooperation.<sup>32</sup> Then, in 2011, the G-20 added a tax “pillar” to its economic development agenda.<sup>33</sup> Finally, in 2012, the G-20 expressed an interest in substantive international tax rules governing the taxation of the cross-border activities of multinational corporations. As its engagement with international tax grew, G-20 statements about international tax matters both paralleled the structure and borrowed from the architecture and tools used in G-20 efforts to shape international financial law.<sup>34</sup>

Consider the G-20 Leaders’ *Declaration on Strengthening the Financial System* in 2009.<sup>35</sup> In that document, the G-20 included a section on “Tax Havens” in which they emphasized that they had agreed on a toolbox of counter-measures for jurisdictions that did not meet international standards for tax transparency, much as they had done in earlier years when addressing money laundering and terrorist financing through the financial system.<sup>36</sup> Simultaneously, the G-20 requested that an existing OECD-affiliated body known as the Global Forum on Transparency and Administrative Cooperation in Tax Matters (“Global Forum”) be transformed into a peer-review organization of the type commonly seen in international financial law.<sup>37</sup> The reformed Global Forum was incorporated into a “peer review trifecta” based on the Financial Action Task Force (FATF) model, which also strengthened the peer review mechanisms used by the Financial Standards Forum (now the Financial Standards Board).

Thereafter, the G-20 brought the area of administrative cooperation in international tax law fully within the rubric of international financial law, addressing it as part of the international financial law portion of its communiqués and overseeing the peer-review mechanisms therein as one piece of a broader financial law peer-review package.<sup>38</sup>

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<sup>32</sup> Cross-border administrative cooperation in tax matters was the one area of international tax matters in which the G-20—and previously the G-7—had maintained some level of continuing involvement since 1997. See Communiqué, G-8, Confronting Global Economic and Financial Challenges—Denver, at para. 33 (1997), available at [http://www.g8.fr/evian/english/navigation/g8\\_documents/archives\\_from\\_previous\\_summits/denver\\_summit\\_-\\_1997/confronting\\_global\\_economic\\_and\\_financial\\_challenges.html](http://www.g8.fr/evian/english/navigation/g8_documents/archives_from_previous_summits/denver_summit_-_1997/confronting_global_economic_and_financial_challenges.html),

<http://perma.cc/JV7Q-F723>; *London Communiqué*, *supra* note 34, at 4–5. See also Itai Grinberg, *The Battle Over Taxing Offshore Accounts*, 60 UCLA L. REV. 313–317 (2012). Eventually the G-20 Finance Ministers’ interest in transparency and information exchange expanded into a commitment to developing a global standard on automatic information exchange that would make information on offshore accounts broadly available to tax administrations around the world. Communiqué, G-20, Meeting of Finance Ministers and Central Bank Governors (Apr. 19, 2013), available at <http://www.g20.utoronto.ca/2013/2013-0419-finance.html>.

<sup>33</sup> See Communiqué, G-20, Seoul Summit Leaders’ Declaration (Nov. 11–12, 2010), [hereinafter *Seoul Communiqué*], available at <http://www.treasury.gov/resource-center/international/Documents/1%20%20FINAL%20SEOUL%20COMMUNIQUE.pdf>.

<sup>34</sup> *C.f.* Eccleston, *infra* note 41, at 49 (discussing how the most significant consequence of the financial crisis was the transformation of the G-20 into a body that took on new agendas and functions).

<sup>35</sup> *London Communiqué*, *supra* note 34, at 4.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> For extended discussions of these developments see Grinberg, *supra* note 35 as well as RICHARD ECCLESTON, *THE DYNAMICS OF GLOBAL ECONOMIC GOVERNANCE: THE FINANCIAL CRISIS, THE OECD, AND THE POLITICS OF INTERNATIONAL TAX COOPERATION* 86-99 (2012).

Thus, at the G-20's direction, the Global Forum developed a "terms of reference" and created a "methodology" for conducting peer reviews to determine whether countries were meeting global standards for tax information exchange upon request.<sup>39</sup> In order to successfully promulgate the new standards for information exchange upon request worldwide, the Global Forum searched for enablers that would help implement the standard.<sup>40</sup> These tools were all imported from international financial law, and over four years an international financial law–style meta-architecture, involving a standard-setter, a monitoring mechanism, enablers, and enforcement threats, was established for information exchange in cross-border tax administrative cooperation.<sup>41</sup>

In 2012, the G-20 broadened its interest in international tax affairs to encompass the taxation of MNCs when it identified base erosion and profit shifting by multinational enterprises as a threat to the G-20's own public fiscs in the midst of politically unpopular austerity.<sup>42</sup> It requested that the OECD develop a plan to address the newly labeled BEPS phenomenon, and the OECD subsequently produced its BEPS Action Plan in a specially created working group incorporating officials from all non-OECD G-20 countries. The G-20 then endorsed that action plan, simultaneously mandating that the OECD provide "regular reporting on the development of proposals and recommendations to tackle the 15 issues identified in the action plan."<sup>43</sup>

Again, the rhetoric and form of the G-20's efforts to expand its involvement in international tax matters to encompass substantive rules for taxing the cross-border activities of multinational enterprises shared the trappings of international financial law.<sup>44</sup>

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<sup>39</sup> *Id.* See OECD, Terms of Reference: To Monitor and Review Progress towards Transparency and Exchange of Information for Tax Purposes (2010), available at <http://www.oecd.org/dataoecd/37/42/44824681.pdf> (describing in detail international standards for information exchange upon request in tax matters); Global Forum on Transparency & Exch. Of Info. For Tax Purposes, OECD, Revised Methodology for Peer Reviews and Non-Members Reviews (2011), available at <http://www.oecd.org/ctp/44824721.pdf> (detailing how to conduct reviews).

<sup>40</sup> The OECD lacked sufficient capacity or experience engaging in technical assistance to less developed countries, so the Global Forum leadership sought additional assistance from multilateral organizations focused on development, and in particular focused on the tax team at the World Bank. They did so to fulfill another G-20 mandate: to treat tax information exchange as a mechanism by which to help build sustainable revenue bases for inclusive growth and social equity by improving developing country tax administration systems. *Seoul Communiqué*, *supra* note 36, at para. 51(h).

<sup>41</sup> See generally Itai Grinberg, *Taxing Capital Income in Emerging Countries: Will FATCA Open the Door?*, 5 *World Tax J.* 325-367 (2013). Shortly thereafter the Global Forum began to import the peer review architecture into the area of automatic information exchange, as opposed to information exchange upon request, as part of a broader effort to enforce the OECD's Common Reporting Standard. The Common Reporting System builds on U.S. automatic information exchange efforts developed under the auspices of legislation known as FATCA (Foreign Account Tax Compliance Act).

<sup>42</sup> The G-20 addressed the BEPS issue as part of its declaration about "reforming the financial sector and fostering financial inclusion." *Los Cabos Communiqué*, *supra* note 5, at 7.

<sup>43</sup> Communiqué, G-20, Meeting of Finance Ministers and Central Bank Governors—Moscow (Jul. 19–20, 2013), available at <http://www.g20.utoronto.ca/2013/2013-0720-finance.html>.

<sup>44</sup> Indeed, the 2012 communiqué that launched the BEPS project described it as part of the G-20's efforts in "reforming the financial sector and fostering financial inclusion." *Los Cabos Communiqué*, *supra* note 5, at 7. Separately, it is worth noting that at about the time the BEPS project was launched, Pascal St. Amans, the leading official of the Global Forum, became the leader of the OECD's Centre for Tax Policy and

Rhetorically, the G-20 justified its expanded interest in substantive international tax rules as necessary to ensure the perception of fairness vis-à-vis the fiscal burden borne by citizens in an era of public austerity. Meanwhile, in form, the “action items” endorsed by the G-20 consisted almost exclusively of soft-law measures.<sup>45</sup> In other words, as is the case in the G-20’s international financial law agenda, the BEPS Action Plan anticipated countries agreeing on recommendations and instruments that lack formal legal obligation. Moreover, the G-20 regularly addressed the BEPS issue in the part of its communiqué devoted to international finance (even though the focus of the BEPS project is not primarily on the financial sector). Taken together, these features suggest that at the G-20 deputies’ level, international tax may have come to be thought of—procedurally—as analogous to “international financial law.”<sup>46</sup> Now, in 2015, as the BEPS project is scheduled to conclude, OECD and government speakers talk of building systems to monitor compliance with best practices and incorporate peer reviews of whether minimum BEPS standards are being met.<sup>47</sup> These are the mechanisms that characterize international financial law. They were not often used in international tax in the past, but now detailed discussions about establishing institutional mechanisms akin to those found in international financial law are beginning.<sup>48</sup>

One lesson of potentially general application that emerges from this story of regime change in international tax is that high-salience crises can change even long-established processes of multilateral decision-making in technocratic areas of international economic law. Appreciating those changes can help analysts focus on the right actors and decision-making levers when evaluating international developments in a given area of international economic governance.

## II. Outside the OECD Model Treaty: Lessons from International Financial Law

Scholars have worked for many years to explain the political economy and institutional architecture surrounding the creation and strengthening of international financial standards and regulation in the absence of a formal international law forum for multi-jurisdictional coordination. Their analysis focuses largely on the interests and exercise of power by leading states, the interplay between regulators, industry groups, and elected

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Administration, where he brought the experience and some of the international financial law-style practices that were utilized at the Global Forum into his new role.

<sup>45</sup> Indeed, only the proposal for a multilateral instrument for tax matters crosses the threshold into a binding formal commitment made by sovereigns, and unlike any other part of the BEPS Action Plan, this measure is expressly reserved for “interested parties”: in other words, it is limited to a coalition of the willing.

<sup>46</sup> At the same time, G-20 communiqués have begun to recognize the distinctions between international taxation writ large and financial sector regulation. Notably, when refining the charter for the FSB, which acts as an overarching coordinator for G-20 efforts in international financial regulation, the G-20 did not include the OECD’s CFA as one of the standard-setting bodies that engages with the FSB.

<sup>47</sup> See, e.g., Post-2015, OECD International Tax Conference (June 2015) (slides on file with author); See also Stephanie Soong Johnston, *Differing Approaches Pose a Key Post-BEPS Challenge, Panelists Say*, TAX NOTES TODAY (June 12, 2015) (quoting comments of Brian Ernewein, general director of tax policy for the Canadian Department of Finance).

<sup>48</sup> See, e.g., Post-BEPS Environment, OECD International Tax Conference (June 2015) (slides on file with author).

policymakers at the domestic level, and the impact of trans-governmental networks of regulators as well as non-state actors.<sup>49</sup> Within that context, legal scholars describe the ways that soft international financial law informs the behavior of a host of regulatory and financial actors.<sup>50</sup>

In this Part, I argue that five broad lessons from the international financial regulatory literature may be applicable to analysis of the BEPS project and future multilateral efforts in international tax law. First, as the political salience of an issue increases,<sup>51</sup> the importance of traditional understandings among transnational regulatory communities declines. Rational calculations about domestically determined national interests (logics of consequences) increasingly trump technocratically constructed understandings of global policy coherence (logics of appropriateness) as decision-making moves from a technocratic to a political level.<sup>52</sup> Second, in this environment, soft international economic law is much more likely to be effective when preferences are aligned and distributive problems are largely absent among the major economies.<sup>53</sup> Third, even when incentives are not aligned between major state actors, “agreements” can occur when political pressures demand it. However, for those agreements to be implemented, there must be either the exercise of coercion by a sufficiently powerful subset of leading economies or market dynamics that allow a subset of states to impose a standard without affirmatively coercing other states. In this context, when nation-states do not identify distributive problems at the outset, path dependence may also be important. Finally, the ultimate efficacy of agreements often depends on the ease of evaluating compliance and the extent to which enforcement mechanisms work. Mock compliance is an option, including for smaller economies, in various circumstances. As explained in Part III, these lessons are most applicable to multilateral efforts outside the scope of the OECD Model Treaty.

Of course, there are limits to analogies between international financial law and international tax law. For example, the balance of power among stakeholders and the perceived sources of influence are not identical.<sup>54</sup> Moreover, analysis by analogy to past events in other policy areas cannot account for the particular predispositions of individual decision makers, whose choices are often a key variable in international diplomatic

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<sup>49</sup> Eric Helleiner & Stefano Pagliari, *The End of an Era in International Financial Regulation*, 65 INT’L ORG. 169, 169–200 (2011).

<sup>50</sup> BRUMMER, *supra* note 17.

<sup>51</sup> See note 64, *infra*, for a definition of political salience as used herein.

<sup>52</sup> See STEPHEN D. KRASNER, SOVEREIGNTY: ORGANIZED HYPOCRISY 51 (1999) (arguing that in the international system, when decisions are made by actors subject to or cognizant of domestic political pressures, logics of consequences, meaning rational calculation designed to maximize a given set of unexplained national preferences, tend to trump logics of appropriateness, meaning, for example, regulator community understandings about policy coherence and consequent “appropriate” courses of action for sovereigns).

<sup>53</sup> For example, regulatory agreements intended to force public disclosure of information can create non-excludable benefits that are also largely non-rival among G-20 countries, thereby approaching a global public good, which facilitates agreement.

<sup>54</sup> As described in Part I, U.S. influence in international tax affairs is, at least at present, weaker than it is in international financial law.



processes.<sup>55</sup> Finally, taxation is more explicitly distributional than is financial regulation; tax revenue represents the “lifeblood of the state.”<sup>56</sup> Thus, countries tend to view autonomy in tax policy as a core attribute of their authority and may protect “tax sovereignty” more forcefully than sovereignty in international financial regulatory matters. Nevertheless, when a G-20–convened economic diplomacy effort (like the BEPS project) encourages domestic adoption of international tax law by way of soft-law recommendations backed by the meta-architecture of international financial law, reflecting on the lessons of international financial governance may provide a useful perspective.<sup>57</sup>

#### A. Political Salience Can Simultaneously Broaden the Agenda and Lower the Efficacy of Transnational Regulatory Networks

Before the financial crisis, there was relatively little public awareness of both international financial law and international tax law.<sup>58</sup> Indeed, until recently, most literature on international financial law assumed that the complexity of these matters would ensure that politicians remained largely uninvolved. The idea that leading politicians would attempt to comprehensively address the multilateral dimension of international tax affairs in response to public pressure was so remote that the literature never seriously considered the question.<sup>59</sup> As a result, subject-matter specialists in government and industry were thought to address issues in a relative vacuum.<sup>60</sup> In this

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<sup>55</sup> C.f. RICHARD N. HAASS, HONEY AND VINEGAR: INCENTIVES, SANCTIONS, AND FOREIGN POLICY (2000).

<sup>56</sup> Grinberg, *supra* note 35, at 354.

<sup>57</sup> The lessons garnered from international financial law are particularly helpful in part because the way international tax diplomacy works is so deeply understudied. Philipp Genschel & Thomas Rixen, *Settling and Unsettling the Transnational Legal Order of International Taxation*, in TRANSNATIONAL LEGAL ORDERS 154 (Gregory Shaffer & Terrance Halliday, eds., 2015); Diane Ring, *International Tax Relations: Theory and Implications*, 60 TAX L. REV. 83 (2007). One noteworthy exception to that general point comes from the literature on the OECD’s (largely unsuccessful) Harmful Tax Competition project from the late 1990s. That project is distinguishable from BEPS for three important reasons. First, the BEPS project does not seek to develop different standards for OECD and non-OECD countries and therefore does not explicitly create a group of insiders and outsiders. Second, BEPS focuses primarily on constraining private sector rather than government behavior. Third, BEPS is much more politically salient than was the HTCP, and therefore much more heavily driven by G-20 processes, rather than OECD processes. In each of these respects BEPS is more like international financial law than HTCP, and therefore I do not focus on the literature regarding the HTCP in this paper.

<sup>58</sup> *Id.* at 98. See also Stefano Pagliari, *Public Salience and International Financial Regulation, Explaining the International Regulation of OTC Derivatives, Rating Agencies, and Hedge Funds* 8-9 (2013). Similarly, the claim by the OECD that international tax issues are at a high point of political prominence is in part an acknowledgement that they had no political prominence before 2008. See Angel Gurria, OECD Secretary-General, Remarks delivered at Joint Press Conference on the G-20 Tax Agenda (Sept. 20, 2014), <http://www.oecd.org/g20/topics/taxation/g20-tax-agenda-press-conference.htm> (stating that “International tax evasion and avoidance has been a headline issue for more than 5 years”).

<sup>59</sup> See Hugh J. Ault, Wolfgang Schon, & Stephen E. Shay, *Base Erosion and Profit Shifting: A Roadmap for Reform*, 68 BULLETIN FOR INTERNATIONAL TAXATION 275, 276 (2014).

<sup>60</sup> Pagliari, *supra* note 60, at 8-9. This assumption of constructivist analysis echoes Anne-Marie Slaughter’s broader argument that transgovernmental regulatory networks foster more extensive and more effective international cooperation by “disaggregating states.” SLAUGHTER, *supra* note 19. For another celebratory account of transnational regulatory networks, see work by Kal Raustiala, who argues that the

context, the practices and expectations of the community of regulators from other nation-states, as well as private-sector advisors, could be powerful motivators in reaching agreement among the relevant technocrats.<sup>61</sup>

Recent analysis suggests that this constructivist approach to understanding cross-border regulatory cooperation—which focuses on notions of policy coherence and fairness developed among national regulators participating together in a transnational regulatory community (logics of appropriateness)—is less helpful in understanding international economic regulatory developments as the salience of an issue increases.<sup>62</sup> For instance, since the financial crisis, most observers agree that domestic political pressures have been instrumental in shaping international financial law.<sup>63</sup>

Indeed, numerous scholars cite politicization and domestic pressures as an important reason that the regulatory agenda of international financial law has broadened in the last five years.<sup>64</sup> Thus, when international financial law became more politicized after the financial crisis, the G-20 pushed regulators to revisit global capital standards (Basel III), identify and heighten prudential standards for global systemically important banks and insurers, develop cross-border resolution mechanisms to attempt to limit taxpayer losses, and expand international regulatory discussions of risks emanating from hedge funds, OTC derivatives, and other features of the shadow-banking system. Technical specialists had identified all of these issues before the financial crisis, but political will was required for them to become part of regular discussions among cross-border regulators.

Similarly, the OECD's BEPS project has substantially broadened the international tax agenda. Agreed-upon principles on addressing hybrid instruments,<sup>65</sup> best practices for

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disaggregation of the state through direct international cooperation among national regulatory agencies was a logical response to changes in the regulatory environment brought about by technological innovation, the expansion of domestic regulation, and economic globalization. Kal Raustiala, *The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law*, 43 VA. J. INT'L L. 1 (2002). See also, Helleiner & Pagliari, *supra* note 52, at 174.

<sup>61</sup> See PORTER, *supra* note 17. See, e.g., Marc Quintyn & Michael William Taylor, *Should Financial Sector Regulators Be Independent?*, 32 IMF ECON. ISSUES (2004), WALTER, *supra* note 17. See also Culpepper 2001 p. 145; BRUMMER, *supra* note 17; HELLEINER, *infra* note 72, at 84.

<sup>62</sup> Helleiner & Pagliari, *supra* note 52. Saliency in the sense I intend to use the word depends on the extent to which an event raises public awareness of a given regulatory domain in the countries that dominate the international regulatory policymaking in the relevant area. Note that saliency is not directly related to the severity of the crisis, the role that the specific sector has in originating that crisis, or the likelihood that a given regulatory framework will address the issues over which there is heightened public awareness. In other words, perception and reality may diverge.

<sup>63</sup> See, e.g., Eric Helleiner & Stefano Pagliari, *Between the Storms: Patterns in Global Financial Governance, 2001–2007*, in GLOBAL FINANCIAL INTEGRATION THIRTY YEARS ON: FROM REFORM TO CRISIS (Geoffrey Underhill, Jasper Blom, & Daniel Mügge, eds., 2010).

<sup>64</sup> See *id.*

<sup>65</sup> OECD (2014) *Public Discussion Draft BEPS Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements*, available at <http://www.oecd.org/ctp/treaties/hybrid-mismatch-arrangements-discussion-draft-treaty-issues-march-2014.pdf> (“BEPS Action 2”).

controlled foreign corporation rules,<sup>66</sup> recommendations for limitations on interest expense deductibility,<sup>67</sup> and mandatory disclosure regimes intended to cabin both MNC tax planning and special tax deals made between an MNC and a sovereign<sup>68</sup> are among the items that the G-20 put on the multilateral tax agenda. Again, specialists had identified most of these items before the G-20 entered the fray, but they required political backing to be elevated to a level where serious dialogue would take place among international tax technocrats.

However, even as high public interest has broadened the international regulatory agenda in both international finance and international tax law, it has also driven more political responses to perceived problems. Public attention pressured technocrats to adopt policies their respective publics were believed to favor, in part because heightened political salience substantially increased the likelihood that elected officials (and high-level political appointees) would become directly involved in negotiations, rather than delegating most or all authority to technocrats.<sup>69</sup>

In international financial law, higher public salience increased the propensity for broad agreements of principle among the strongest states. However, those agreements around high principles often left key issues unresolved.<sup>70</sup> Then, as the distributive consequences associated with addressing these issues became clear, the G-20 process and related

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<sup>66</sup> OECD (2015) *Public Discussion Draft BEPS Action 3: Strengthening CFC Rules*, available at <http://www.oecd.org/ctp/aggressive/discussion-draft-beps-action-3-strengthening-CFC-rules.pdf> (“BEPS Action 3”).

<sup>67</sup> OECD (2015) *Public Discussion Draft BEPS Action 4: Interest Deductions and Other Financial Payments*, available at <http://www.oecd.org/ctp/aggressive/discussion-draft-action-4-interest-deductions.pdf> (“BEPS Action 4”).

<sup>68</sup> OECD (2015) *Public Discussion Draft BEPS Action 12: Mandatory Disclosure Rules*, available at <http://www.oecd.org/ctp/aggressive/discussion-draft-action-12-mandatory-disclosure-rules.pdf> (“BEPS Action 12”); OECD (2014) *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substances*, available at <http://www.oecd-ilibrary.org/docserver/download/2314271e.pdf?expires=1438480449&id=id&acname=guest&checksum=5E5B98E80AD81B6261DB433202859CF> (“BEPS Action 5”). Chapter 4(B) of Action 5 discusses mandatory disclosure of private rulings.

<sup>69</sup> *Id.* at 94. The leading international tax officials from countries like Australia, China, and the United Kingdom now routinely comment at public conferences about the importance of public sentiment in shaping their policy positions. Academics have differed on the mechanism of action by which high public salience may affect policymaking in the international financial regulatory space. In David Singer’s telling, crises may create bureaucratic incentives for regulators to take action in order to appease their political masters. DAVID SINGER, *REGULATING CAPITAL: SETTING STANDARDS FOR THE INTERNATIONAL FINANCIAL SYSTEM* 30 (Cornell Univ. Press, 2007). Oatley and Nabors argue that elected politicians rather than regulators are more likely to play a direct role in shaping the content of national and international regulatory policies after crises. Thomas Oatley & Robert Nabors, *Redistributive Cooperation, Market Failure, Wealth Failures and the Basel Accord*, 52 INT’L ORG. 35 (1998). See also Pierre-Hugues Verdier, *Transnational Regulatory Networks and their Limits*, 34 YALE J. INT’L L. 113, 127 (2009) (contending that when an issue is salient, politicians may intervene to reshape what would otherwise be the activities of a transnational regulatory network); *Pagliari, supra* note 60, at 9 (similar).

<sup>70</sup> ERIC HELLEINER, *THE STATUS QUO CRISIS* 5, 17 (Oxford Univ. Press, 2014) (discussing how despite bold initiatives posited by the G-20 in the immediate wake of the crisis, transformative change failed to occur).

technocratic work revealed a substantial propensity to elide key issues. To provide just one example, the IMF has observed that “consensus has been reached on a framework” for addressing cross-border bank resolution, but “important details still need to be worked out. As yet, orderly resolution of systemically important cross-border banks is not a feasible option.”<sup>71</sup>

In international tax, as the salience of the issues increased, preexisting norms of discourse developed by the community of international tax regulators were often wiped out.<sup>72</sup> Logics of appropriateness developed among regulators over time gave way to political and economic pressures internal to states in determining most regulators’ behavior, both on the international diplomatic stage and in connection with unilateral regulatory decisions made without regard to any international consensus.<sup>73</sup> To date the consequences are perhaps seen most clearly in the area of substantive transfer-pricing guidance.

Transfer-pricing regimes provide the conceptual framework for pricing intercompany transactions, which function to allocate income between the various tax jurisdictions in which an MNC operates. The “arm’s length” principle of international tax enforcement is designed to prevent MNCs from using transfer pricing to create tax advantages for themselves because they operate in group form rather than conducting business as independent enterprises transacting with one another across borders, and therefore can dictate the pricing of inter-firm cross-border transactions.

For more than thirty years, the arm’s length principle represented a consensual solution to the problem of allocating tax between different parts of an MNC.<sup>74</sup> Although the mantra of “arm’s length” masked real disagreement, and members of the transfer pricing practitioner community often held the view that there was substantial controversy as to the proper implementation of the arm’s length standard, the range of interpretation was, in practice, reasonably narrow. Major transfer-pricing disputes arose with regularity,<sup>75</sup>

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<sup>71</sup> IMF, Cross-Border Bank Resolution: Recent Developments (June 2, 2014).

<sup>72</sup> See, e.g., remarks of Bob Stack, June 11, 2015, at the OECD-USCIB conference in Washington DC, bemoaning that “countries are going their own way,” and emphasizing that he wanted everyone to ask the question “do we have a set of shared rules, or don’t we?”. Notes of remarks taken by author. See also Robert B. Stack, *U.S. Treasury Official Discusses the Progress and Future of the OECD BEPS Project*, 78 TAX NOTES INT’L 1193, 1196 (June 29, 2015).

<sup>73</sup> The United Kingdom’s policy positions taken in connection with the BEPS project, in terms of publicly expressed support by politicians for multilateral action in the face of domestic political pressure, and unilateral implementation of their Diverted Profits Tax despite the clear deviation from global norms, make the UK an exemplar of this model of action.

<sup>74</sup> John Neighbour, *Transfer pricing, Keeping it at arm’s length*, OECD OBSERVER (Apr. 21, 2002), [http://www.oecdobserver.org/news/archivestory.php/aid/670/Transfer\\_pricing:\\_Keeping\\_it\\_at\\_arms\\_length.html](http://www.oecdobserver.org/news/archivestory.php/aid/670/Transfer_pricing:_Keeping_it_at_arms_length.html). Of course, important academic critiques and alternative proposals existed before the onset of the BEPS project. E.g., Reuven Avi-Yonah, *Splitting the Unsplittable: Toward a Formulary Approach to Allocating Residuals Under Profit Split* (Univ. of Michigan Public Law and Legal Theory Working Paper Series, No. 378. Working Paper, 2013) (proposing that the OECD use formulary apportionment to allocate residual profit of the “profit split method”).

<sup>75</sup> The transfer pricing dispute between the United States and the United Kingdom, involving the valuation of certain marketing vs. manufacturing intangibles of Glaxo-Smith Kline provides just one particularly

but they were addressed within a framework that largely respected intercompany contracts and the concept of allocation of risk within a multinational group.<sup>76</sup> Whether one views that outcome as good policy or not, the relatively clear intellectual boundaries for these disputes were an outgrowth of the fact that discussion of transfer pricing was limited to tax administrators and other specialists.<sup>77</sup>

In the last few years, however, transfer pricing and the arm's length standard in particular have become a source of substantial conceptual controversy.<sup>78</sup> The arm's length standard drew attention from many sources outside the transfer-pricing bar, including numerous exposés in the popular press,<sup>79</sup> legislative hearings in multiple jurisdictions,<sup>80</sup> and sustained attention from advocacy groups claiming the mantle of "civil society."<sup>81</sup> As a result, transfer pricing became a subject of discussion among high-level elected officials for the first time.<sup>82</sup> In the process, preexisting norms developed by the community of transfer-pricing specialists came under heavy (perhaps deserving) scrutiny. The BEPS project then endorsed the idea that the existing transfer pricing guidelines were broken, but has heretofore failed to reach meaningful consensus on a clearly delineated alternative. Views around the level of deference to be given intergroup contractual arrangements diverged substantially, the consensus on the scope for recharacterizing intergroup transactions frayed, the consensus on respecting intergroup equity

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large dispute among an innumerable number of examples. See Audrey Nutt, *Glaxo, U.S. Settle Transfer Pricing Dispute*, 43 TAX NOTES INT'L 956 (Sept. 18, 2006).

<sup>76</sup> See Matthias Schroger, *Transfer Pricing: Next Steps in the International Debate* in TAX POLICY CHALLENGES IN THE 21<sup>ST</sup> CENTURY 310-12 (Karoline Spies & Raffaele Petrucci, eds., 2014).

<sup>77</sup> Indeed, one refrain among some tax practitioners for many years was that the arm's length standard was the worst possible answer for transfer pricing, except for all proposed alternatives.

<sup>78</sup> See, e.g., Reuven S. Avi-Yonah, *Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation*, 2 WORLD TAX J. 3, 3 (2010) (arguing that while debate quieted with regard to the arm's length standard after the adoption of the 1995 regulations and OECD guidelines, the arm's length standard is unworkable and should be replaced by formulary apportionment); *TJN Statement on Transfer Pricing*, TAX JUSTICE NETWORK (Mar. 21, 2012), <http://taxjustice.blogspot.com/2012/03/tjn-statement-on-transfer-pricing.html> (asserting that the "OECD's theory of the arm's length principle no longer applies to multinational enterprises which are highly integrated").

<sup>79</sup> E.g., *Companies Dodge \$60 Billion in Taxes Even Tea Party Condemns*, BLOOMBERG.COM, <http://www.bloomberg.com/news/articles/2010-05-13/american-companies-dodge-60-billion-in-taxes-even-tea-party-would-condemn> (last visited May 17, 2015) ("Transfer pricing lets companies such as Forest, Oracle Corp., Eli Lilly & Co. and Pfizer Inc., legally avoid some income taxes by converting sales in one country to profits in another").

<sup>80</sup> *Offshore Profit Shifting and the U.S. Tax Code: Hearing before the Permanent Subcomm. on Investigations*, 113th Cong. 2 (2013) (statement of Sen. Levin 2, Member, S. Comm. on Homeland Security and Governmental Affairs) (noting, in conjunction with Sen. McCain, how "Apple effectively shifts billions of dollars in profits offshore, profits that under one section of the Tax Code should nonetheless be subject to U.S. taxes, but through a complex process avoids those taxes").

<sup>81</sup> *Transfer Pricing*, TAXJUSTICE.NET, <http://www.taxjustice.net/topics/corporate-tax/transfer-pricing/> (last visited May 17, 2015) (deploring the arm's length standard and collecting sources that advocate for formulary apportionment).

<sup>82</sup> See Stephen Timms, Financial Secretary to Treas. UK, address at OECD Tax & Development Conference, Paris (Jan. 27, 2010); G-20, Cannes Summit Final Declaration—Building our Common Future: Renewed Collective Action for the Benefit of All, Cannes Summit (Nov. 4, 2011), available at <http://www.g20.utoronto.ca/2011/2011-cannes-declaration-111104-en.html>. See also Arun Jaitley, Hon. Fin. Minister, India, A Tax Vision for India, Peterson Institute for International Economics (Apr. 16, 2015).

contributions declined, and disputes among government officials about whether value creation in cross-border transactions undertaken by multinationals should be attributed to capital, labor, the market, or even government support are now aired routinely and publicly.<sup>83</sup> On all of these issues, it seems unlikely that new agreements that are clear enough to avoid disputes will be reached. At the same time, enormous political pressures coming from the highest levels of government and the G-20 mean that some sort of outcome in the transfer-pricing work of the BEPS project is a political necessity. The likely result is a reliance on high levels of constructive ambiguity buried in many pages of technocratic language in the transfer-pricing outputs of the BEPS project.

An important reason that transfer-pricing guidelines have become so much more heavily contested is that the circle of stakeholders opining on the guidelines has broadened dramatically relative to the recent past. As late as 2007, it would have been fair to describe transfer pricing as a kind of priesthood, where subspecialists debated arcane pricing matters using a specialized language that they found meaningful and that others left to their purview. Today, NGOs and finance ministers alike regularly opine on transfer-pricing matters. The public consultations to the BEPS project for transfer-pricing-related matters alone produced almost five thousand pages of formal comments. In this environment, the transfer-pricing technocrats that participate in the OECD's Working Party 6 are much less free to reach conclusions separate and apart from external political pressures. The result is likely to be more reliance on creative ambiguity to reach "consensus" outcomes.<sup>84</sup> Unfortunately, as Hugh Ault once wrote, "[w]hile creative ambiguity can at times be useful, masking important differences with bland platitudes is not helpful . . . if country A says the world is flat and country B says the world is round, and after a long discussion, the OECD issues a report that says the world is an attractive shape and declares a consensus has been reached, it is difficult to call that real progress in establishing international norms."<sup>85</sup>

Indeed, the lack of consensus on transfer-pricing norms, leading to agreed-upon language that provides plausible support for a wide variety of audit positions that could be taken by national tax administrations, is the primary reason that the private sector, NGOs, and the OECD itself all have expressed concern about a substantial increase in double taxation disputes.<sup>86</sup> High public salience on transfer pricing has produced broad agreement that

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<sup>83</sup> See Mindy Herzfeld, *Input Needed on Transfer Pricing Drafts*, 77 TAX NOTES INT'L 392 (Feb. 2, 2015); *Comments on Discussion Draft on the Use of Profit Splits in the Context of Global Value Chains and other Related Transfer Pricing Issues*, China International Tax Center/IFA China Branch (Feb. 6, 2015). U.S. officials, for example, have bemoaned this phenomenon in multiple public appearances.

<sup>84</sup> Mindy Herzfeld's relentless series of pointed questions posed to the leading OECD Secretariat officials in charge of the transfer-pricing workstream within the BEPS project highlighted the level of creative ambiguity required to release even some discussion drafts in this area. *Herzfeld, supra* note 85. Multiple U.S. Treasury officials, including Bob Stack, Deputy Assistant Secretary (International Tax), Michael McDonald, and Brian Jenn have similarly bemoaned the lack of clarity in the transfer pricing discussion drafts in multiple public panel appearances.

<sup>85</sup> Ault, *supra* note 30, at 763.

<sup>86</sup> See, e.g., OECD (2014) *Public Discussion Draft BEPS Action 14: Make Dispute Resolution Mechanisms More Effective* 4 (Dec. 18, 2014-Jan. 16, 2015), available at <http://www.oecd.org/ctp/dispute/discussion-draft-action-14-make-dispute-resolution-mechanisms-more-effective.pdf>; *Comments Received on Public*

the old system did not work well, while a lack of shared natural interests among the strongest states with respect to the relevant metrics for attributing value creation to a jurisdiction forces technocrats to rely on creative ambiguity to mask key tensions, thereby opening the door for substantial growth in transfer-pricing controversy. This outcome is consistent with past international financial law projects where high political salience in issue areas with distributive consequences resulted in non-resolution of key disputes.<sup>87</sup>

## **B. Where Distributive Problems Are Absent, Soft International Economic Law Is Often Effective**

When regulatory questions are politically salient, scholars of international finance emphasize that standards evolve in large part as a result of the exercise of power by dominant states.<sup>88</sup> As a result, standards may be most effective when preferences align and distributive problems are largely absent among the major economies or hidden from view.<sup>89</sup> Notably, in such areas, logics of appropriateness may continue to organize discourse among regulators. Even in these areas, a modicum of enforcement is often needed if international coordination is to succeed.

Some changes to the international tax environment recommended by the BEPS project clearly reflect parallel domestic preferences among major economies and the absence of well-recognized distributive questions among those parties. For example, the BEPS project includes work to make exchange of information between states compulsory and automatic in certain cases when a state provides a taxpayer-specific ruling related to a preferential tax regime.<sup>90</sup> Most major economies share a preference for information about private rulings issued to taxpayers by other states when that ruling has implications

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*Discussion Draft, BEPS Actions 8, 9, & 10: Revisions to Chapter I of the Transfer Pricing Guidelines (Including Risk, Recharacterization, and Special Measures)* OECD (Feb. 10, 2015) (BIAC Tax Committee, BusinessEurope, Deloitte, International Alliance for Principled Taxation, and the International Chamber of Commerce, among others, raised concern about an increase in double taxation disputes); *Key Points on Tax Issues for G20 Sherpas Meeting June 2015 G20 and OECD Must Act to Prevent Failure of the BEPS Project*, Global Alliance for Tax Justice (June 12, 2015), <https://bepsmonitoringgroup.files.wordpress.com/2015/06/key-points-on-the-tax-issues-for-g20-sherpas-meeting-june-2015.pdf>; *Comments Received on Public Discussion Draft, BEPS Action 14: Make Dispute Resolution Mechanisms More Effective*, OECD (Jan. 19, 2015) (similar concerns about increased disputes raised by EY and SAB Miller).

<sup>87</sup> See n 172, *infra*, for a discussion of the special place transfer pricing has in the Treaty-based / non-Treaty-based divide.

<sup>88</sup> See generally DREZNER, *supra* note 17; Helleiner & Pagliari, *supra* note 52; Ethan B. Kapstein, *Resolving the Regulator's Dilemma: International Coordination of Banking Regulations*, 43 INT'L ORG. 323 (1989); STEPHEN D. KRASNER, SOVEREIGNTY: ORGANIZED HYPOCRISY 127-151 (1999).

<sup>89</sup> For example, regulatory agreements intended to force public disclosure of information create non-excludable benefits that are also largely non-rival among G-20 countries, thereby approaching a global public good, which facilitates agreement.

<sup>90</sup> OECD/G-20 Base Erosion and Profit Shifting Project, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, OECD PUBLISHING 35 (2014) [hereinafter *Countering Harmful Tax*].

for the treatment of a taxpayer in their country.<sup>91</sup> Accordingly, at the OECD they have designed a framework that specifies when an obligation for informing other countries about such rulings arises.<sup>92</sup>

Similarly, the BEPS project includes disclosure rules in connection with aggressive or abusive transactions, arrangements, or structures used by MNCs.<sup>93</sup> The goal is to address asymmetry of information between taxpayers and tax administrations.<sup>94</sup> In order to achieve that goal, OECD recommendations encourage governments to put mandatory disclosure regimes in place that require taxpayers to disclose the use of certain tax planning “schemes,” as well as the promoters of those schemes. The OECD then advances specific enhanced models of information-sharing among tax administrations that delineate aggressive tax-planning arrangements, so as to encourage effective cross-border administrative assistance regarding these arrangements.<sup>95</sup>

In stark contrast to almost every other BEPS agenda item, governments, MNCs, and NGOs have objected only at the margins to compulsory spontaneous exchange of information on tax rulings related to preferential regimes and mandatory disclosure of aggressive tax-planning structures. Governments have unanimously supported such information-forcing measures. The Business and Industry Advisory Council’s statement that it “supports the development and use of well-targeted mandatory disclosure rules,” followed by suggestions for how best-practice recommendations should be structured, is representative of the private-sector stakeholder reaction.<sup>96</sup> Even the sheer volume of comments on OECD recommendations indicates that these two information-sharing items are less important to the stakeholder community relative to the remainder of the BEPS Action Plan.<sup>97</sup>

Compulsory exchange and mandatory disclosure regimes intended to cabin special tax deals made between an MNC and a sovereign and aggressive MNC tax planning fall into a broader set of initiatives that reflect an intra-governmental consensus that puts information exchange at the center of a more cooperative international tax system.<sup>98</sup> The advent of the Common Reporting Standard to address the taxation of offshore accounts of

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<sup>91</sup> *Id.* at 36.

<sup>92</sup> *Id.* at 39-41.

<sup>93</sup> OECD (2015) *Public Discussion Draft BEPS Action 12: Mandatory Disclosure Rules*, available at <http://www.oecd.org/ctp/aggressive/discussion-draft-action-12-mandatory-disclosure-rules.pdf> (“BEPS Action 12”).

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Comments Received on Public Discussion Draft BEPS Action 12: Mandatory Disclosure rules* OECD 26 (May 4, 2015), available at <http://www.oecd.org/tax/aggressive/public-comments-beps-action-12-mandatory-disclosure-rules.pdf>.

<sup>97</sup> Compare, e.g., the 873 pages of submissions on the Risk and Recharacterization Draft with 275 pages of submissions addressing aggressive tax planning disclosures.

<sup>98</sup> Here I refer to the transparency dimension of Action 5 as well as the international tax planning dimension of Action 12.



individuals both underscores and has given impetus to this trend.<sup>99</sup> Sovereigns are sharing administrative tools to enforce their tax laws, in order to reassert more de facto control over their tax policies.<sup>100</sup> Given the lack of obvious distributional consequences, as well as the optionality provided to sovereigns with respect to implementation of the mandatory disclosure rules, the logic of appropriateness associated with transparency drove agreements in principle on compulsory exchange and mandatory disclosure.

Will those agreements amount to anything in practice? The work of the International Organization of Securities Commissions (IOSCO)<sup>101</sup> in coordinating mutual assistance for securities law enforcement among regulators in developed countries provides an interesting analogy.<sup>102</sup> IOSCO has been largely successful in increasing securities enforcement cooperation among all IOSCO members. IOSCO's Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMoU) offers a common understanding of how signatories are expected to cooperate and exchange information for the purpose of regulatory enforcement regarding securities markets.<sup>103</sup> Notably, the international financial law literature accounts for IOSCO's success by pointing to the large developed economies' parallel domestic preference for effective securities fraud enforcement, and the absence of substantial distributive issues among those countries.<sup>104</sup>

Nevertheless, IOSCO eventually adopted a mild coercive sanction to ensure compliance with the standards built into the MMoU. In particular, a national securities commission is only eligible for ordinary membership in IOSCO (and the voting privileges such membership confers) if it is a signatory to the MMoU. A “monitoring group” within

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<sup>99</sup> See Itai Grinberg, *Does FATCA Teach Broader Lessons about International Tax Multilateralism?*, in GLOBAL TAX GOVERNANCE (ECPR Press) (forthcoming).

<sup>100</sup> THOMAS RIXEN, *THE POLITICAL ECONOMY OF INTERNATIONAL TAX GOVERNANCE* 5 (Palgrave Macmillan 2008).

<sup>101</sup> IOSCO is the primary institution tasked with setting international standards for securities markets. *About IOSCO*, INT'L ORG. OF SEC. COMM'N, [http://www.iosco.org/about/?subsection=about\\_iosco](http://www.iosco.org/about/?subsection=about_iosco) (last visited Feb. 2, 2015). IOSCO's members are mostly public authorities and collectively regulate more than ninety-five percent of the world's securities markets. See *IOSCO Historical Background*, OICU-IOSCO, <https://www.iosco.org/about/index.cfm?section=background> (last visited Sept. 28, 2012); *Membership Categories and Criteria*, INT'L ORG. OF SEC. COMM'N, <http://iosco.org/about/index/cfmsection=membership> (last visited Sept. 28, 2012).

<sup>102</sup> The Global Forum's work on exchange of information for tax purposes provides another important precedent for thinking through these issues. The focus of much of the Global Forum's work—the exchange of financial account information of offshore account holders between the country of residence of a financial intermediary and the country of residence of a taxpayer—represents the real substantive overlap between international tax and international financial law. See Itai Grinberg, *Does FATCA Teach Broader Lessons about International Tax Multilateralism?* in GLOBAL TAX GOVERNANCE (ECPR Press) (forthcoming).

<sup>103</sup> Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMoU), INT'L ORG. OF SEC. COMM'N, <http://www.ww.iosco.org/about/?subsection=mmou> (last visited Feb. 2, 2015) [hereinafter *MMoU*]. The MMoU includes various substantive representations regarding domestic law and regulations. For instance, countries must have rules regarding the confidentiality of information exchanged among securities regulators and ensure that no domestic banking secrecy, blocking laws or regulations will prevent securities regulators from sharing various types of information with their counterparts in other jurisdictions.

<sup>104</sup> *Verdier*, *supra* note 71, at 146.

IOSCO has discretion to consider and recommend a range of possible options to “encourage” compliance in the event that a signatory demonstrates an unwillingness to meet the MMoU provisions.<sup>105</sup>

The lesson is that even where preferences are aligned, some enforcement mechanism is often needed to implement agreements reached under the G-20’s international financial law architecture. In the context of compulsory exchange and mandatory disclosure, major economies have parallel preferences for information reporting. In the case of compulsory exchange of information on tax rulings, they have agreed to a monitoring mechanism that involves annual reviews of country practices to enforce compliance.<sup>106</sup> Given that in this area major power preferences are aligned, there is good reason to believe that compliance may occur. Would smaller jurisdictions that wish to continue offering opaque rulings be willing to ignore the rule? In the case of compulsory exchange of information to other tax administrations about a well-specified class of private rulings, reputational consequences and the implicit threat of defensive measures taken against a defecting jurisdiction may well be sufficient to ensure widespread compliance.<sup>107</sup>

In contrast, BEPS project outputs provide sovereigns with quite unfettered optionality in implementing the proposed mandatory disclosure rules vis-à-vis taxpayers. There is no clear expectation for when rules should be implemented, so even expectations of reciprocity—the least coercive form of pressure seen in international financial law-style efforts—will not play a role in national implementation decisions. In these circumstances, one would expect that countries would enact such rules only to the extent that they view it in their national interest. Coordinated implementation of any kind or substantial improvements in cross-border administrative assistance as a result of these recommendations may prove challenging.

A more difficult and instructive example regarding information exchange comes from the agreements reached in the BEPS project to increase the transparency of MNC transfer-pricing policies.<sup>108</sup> The highest-profile part of the new system endorsed by the OECD

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<sup>105</sup> In 2013, IOSCO implemented a “watch list” of countries that are non-signatories, and began the process of considering further coercive measures to affect the behavior of such countries. *MMoU*, *supra* note 105. The watch list was created to further “assist” current IOSCO members that are non-signatories “in overcoming the obstacles they often encounter in securing support from their governments or legislatures for implementing the legal and regulatory changes required for compliance with the MMoU.” *Id.*

<sup>106</sup> *Countering Harmful Tax*, *supra* note 92, at 49.

<sup>107</sup> *Cf.* Oona Hathaway & Scott Shapiro, *Outcasting: Enforcement in Domestic and International Law*, 12 *YALE L.J.* 252 (2011) (in some instances, reputational concerns and the promise of reciprocity from large states can be sufficient to engender state-level compliance; in other cases “outcasting” mechanisms and threats of sanctions are needed to enforce new international norms)

<sup>108</sup> Under the OECD’s newly agreed approach, transfer pricing documentation standards will require MNCs to produce a country-by-country report, a master file, and a local file that will be available to the tax administration of each country in which they do business. OECD/G20 Base Erosion and Profit Shifting Project, *Action 13: 2014 Deliverable Guidance on Transfer Pricing Documentation and Country-by-Country Reporting*, OECD PUBLISHING, at para. 19 (2014), available at [http:// www.oecd-](http://www.oecd-)

and the G-20 is the so-called country-by-country report (CBCR), which is intended to give tax administrations a picture of where MNC profits are reported and where real activity takes place.<sup>109</sup>

The OECD considers the country-by-country report to be part and parcel of its effort to improve transfer-pricing rules. OECD reports reason that in an environment in which transfer pricing is increasingly contentious, widely adopted documentation rules can reduce compliance costs for business while also providing tax administrations with more focused and useful information for transfer-pricing risk assessments and audits.<sup>110</sup> However, the country-by-country template takes an approach that comports more closely with so-called formulary apportionment conceptions of transfer-pricing determination than with the arm's length standard as historically understood.<sup>111</sup> The characterization of CBCR as being "just about transparency" only somewhat obscures the fact that countries could use CBCR data as an impetus to depart from the existing arm's length standard for substantive transfer-pricing enforcement.

Nevertheless, in stark contrast to other dimensions of the BEPS project associated with transfer pricing, the country-by-country reporting rules and other changes to information reporting were agreed to with relatively little controversy between governments.<sup>112</sup> Given how deeply objectionable CBCR reporting has been for the private sector, and the high levels of disagreement in revising substantive transfer pricing guidance among governments, the ease with which CBCR was agreed upon between governments is quite striking.

The key lesson, consistent with the scholarship on international financial law,<sup>113</sup> is that in G-20-convened processes transparency and information reporting will often be agreed to even when little else in an area is possible.<sup>114</sup> The simple reason is that information reporting is not facially distributional. Like other reporting regimes, revised reporting templates for transfer pricing affect tax administration, but do not, at least as a first-order

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ilibrary.org/taxation/guidance-on-transfer-pricing-documentation-and-country-by-country-reporting\_9789264219236-en\_oecd/g20 2014 deliverable action 13/2314301e.pdf.

<sup>109</sup> *Id.* at Exec. Summary.

<sup>110</sup> *Id.* at para. 4.

<sup>111</sup> See Michael Sala, *Country-by-Country Reporting: Potential Audit and Legislative Risks for MNEs*, 73 *Tax Notes Int'l* 1127, 1128-29 (Mar. 24, 2014); Ajay Gupta, *Country-by-Country Reporting Inevitable, Global Leaders Say*, 76 *Tax Notes Int'l* 866, 867 (Dec. 8, 2014); *BEPS Action Plan: Action 13—Transfer Pricing Documentation, Updates*, PWC (Sept. 24, 2014), <http://www.pwc.com/gx/en/tax/tax-policy-administration/beps/transfer-pricing-documentation.jhtml> (last accessed June 11, 2015).

<sup>112</sup> The resistance to the country-by-country reporting template that emerged in the private sector has received support from some members of the U.S. Congress. Nevertheless, for purposes of this discussion, the key point is that the U.S. administration, along with other governments, agreed to this reporting concept with relatively little resistance, and merely tried to shape the reporting template into something that companies could comply with at a reasonable cost.

<sup>113</sup> See generally Verdier, *supra* note 17.

<sup>114</sup> Cf. Kal Raustiala & Anne-Marie Slaughter, *International Law, International Relations, and Compliance*, THE HANDBOOK OF INTERNATIONAL RELATIONS (Walter Carlsnaes, Thomas Risse & Beth Simmons, eds., 2002).

matter, change substantive transfer-pricing standards or otherwise impact the international tax law of jurisdictions around the world. It can be defended as merely encouraging MNCs to avoid booking excessive income in locations that tax administrators in major economies would characterize as “tax havens.” As a result, CBCR can be plausibly characterized as merely strengthening national enforcement efforts in a non-rivalrous manner among major economies, such that the domestic preferences of tax administrations should be aligned.

CBCR, like mandatory disclosure rules under Action 12, lacks even a mild coercive measure agreed to at the international level in order to ensure compliance. Accordingly, it is possible that some countries would defect from implementation of CBCR in the post-BEPS environment.<sup>115</sup> However, the pressures that can be brought to bear by other sovereigns are important to understand, as are the reputational dynamics at play. The basic reality is that any sovereign could require the local subsidiary of an MNC to report CBCR information on the activities of an entire multinational group. Furthermore, after the BEPS project such a sovereign could point to international norms endorsing CBCR and providing a precise template for how the information should be reported both to justify its reporting requirements and to suggest that the MNC already will have developed systems to collect the relevant data, since it will need to report CBCR information to one country or another. Thus, noncompliance by any individual sovereign (even a powerful sovereign like the United States) may not be effective.<sup>116</sup>

CBCR therefore offers an example where market pressure may allow a subset of states—even a subset of states that are not usually thought of as having hegemonic power—to impose the implementation of a standard without affirmatively coercing other states. Given that fact, as in international financial law, reputational pressures associated with resisting calls for transparency are likely to push jurisdictions toward conformity with CBCR.<sup>117</sup>

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<sup>115</sup> Certain practitioners and journalists in the United States can be understood to be calling on the United States to make a decision to this effect. See e.g., Mindy Herzfeld, *Questions Remain about CbC Reporting*, 78 TAX NOTES INT’L 969 (June 15, 2015).

<sup>116</sup> Indeed, the European Commission seems to recognize this dynamic: it has been proposing that all multinationals operating in Europe be required to provide global CBCR data to European authorities regardless of where the multinational is headquartered or whether such requirements are imposed in their home jurisdiction. See *Communication from the Commission to the European Parliament and the Council on Tax Transparency to Fight Tax Evasion and Avoidance*, at 5, COM (2015) 136 (Mar. 18, 2015). Note that the European Commission proposal would go one step further than CBCR as proposed by the OECD. It would make CBCR data public, rather than treating it as confidential taxpayer information available only to tax administrations. Given how abhorrent that result would be to the United States, with its deeply entrenched commitment to taxpayer confidentiality, including corporate taxpayer confidentiality, one might interpret the European Commission proposal as a kind of veiled threat against the United States. Without making any normative judgment, the point I make here is merely that under the circumstances this is a pretty effective threat.

<sup>117</sup> See *supra* note 113; *c.f.* BRUMMER, *supra* note 17. The agreement on a modified nexus approach for IP regimes reached within the course of the BEPS project also creates pressures that may, at least in the short term, lead to convergence around a common “patent box” structure. The patent box issue is significantly more complicated than CBCR, in part because of the prospect that countries may engage in mock

In contrast, consider a substantive tax subject area like interest expense allocation.<sup>118</sup> As Michael Graetz has observed, there appear to be quite limited reasons for any country to want to provide deductions that encourage local borrowing to finance foreign investment.<sup>119</sup> The base erosion accepted by the jurisdiction providing the deduction does not come with any obvious offsetting benefits—benefits of the kind that local, direct investment or research and development spending might bring, for example.<sup>120</sup> Given the linkages between source country and residence country limitations on interest expense deductions, addressing the problem multilaterally through some allocation mechanism is also normatively attractive from the perspective of a logic of appropriateness grounded in a single tax principle.<sup>121</sup> An initial understanding that there were similar domestic preferences and limited distributional concerns among the major economies therefore drove government officials to agreement in principle on the need for action in the area of interest expense allocation at the outset of the BEPS project.<sup>122</sup>

Concrete concerns of specific jurisdictions and specific industries, however, are likely to undermine implementation. If a group of high-rate countries adopted a group-wide interest-expense allocation rule, it could incentivize multinationals to locate borrowing in other jurisdictions to a sufficient extent that those other jurisdictions might feel pressured to adopt similar limitations on interest deductibility to staunch revenue losses. However, that form of market pressure toward consistent implementation likely requires collective movement by a significant subset of jurisdictions.<sup>123</sup> Increasing limitations on interest

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compliance with the limitations on IP regimes put forward under the modified nexus agreement, and in part because contrasting patent boxes with interest expense allocation would raise questions around the issue of competitiveness. Space constraints prevent a more fulsome discussion of the issue here.

<sup>118</sup> Injecting related-party debt into a high-taxed subsidiary within a related-party structure, thereby overleveraging high-tax subsidiaries relative to low-tax subsidiaries, may be the single simplest tax planning strategy available to multinational enterprises. *C.f.* U.S. DEP'T OF TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2015 PROPOSALS 49 (Mar. 2014) [hereinafter FY 2015 GREENBOOK], available at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf>, <http://perma.cc/UW4R-AFNN>.

<sup>119</sup> Michael J. Graetz, *A Multilateral Solution for the Income Tax Treatment of Interest Expenses*, BULL. INT'L TAXATION 486, 490–91 (Nov. 2008); Reuven Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of U.S. Treaty Policy*, 59 N.Y.L. SCH. L. REV. 309 (2015).

<sup>120</sup> Moreover, when borrowing in a high-tax country and financing investments in a low-tax country, the result is after-tax returns greater than the investment's pre-tax returns—which by definition decreases worldwide economic welfare through distorted capital allocations.

<sup>121</sup> Graetz, *supra* note 121, at 490-91. The conceptual appeal of a multilateral solution is enhanced by the fact that sourcing inconsistencies or other rule asymmetries can result in disallowance of interest deductions by a residence country jurisdiction that a source country may also disallow, creating double and/or excessive taxation of a productive investment. As a result, the two issues of residence countries' limitations on interest deductions for borrowing to finance low-taxed, exempt, or deferred foreign-source income and of source countries' restrictions on interest deductions intended to limit companies' ability to strip income from a higher-tax country into a lower-tax one are linked. *Id.*

<sup>122</sup> OECD (2014) *Public Discussion Draft BEPS Action 4: Interest Deductions and Other Financial Payments*, available at <http://www.oecd.org/tax/aggressive/discussion-draft-action-4-interest-deductions.pdf>.

<sup>123</sup> *But see* Martin A. Sullivan, *A Proposal for the Tax Treatment of Interest in a Territorial System*, 40 PEPP. L. REV. 1345, 1361 (2013) (arguing that unilateral adoption by the U.S. of interest allocation rules

expense singlehandedly would likely increase the effective tax rate for affected businesses, but, in contrast to a change in the tax rate, could do so to an extent that is hard to predict ex ante and may not be consistent across industries. Meaningful unilateral action by one jurisdiction might also asymmetrically increase effective capital costs, leading to concerns regarding the competitiveness of domestic firms. As a result, pressures to renege are more likely to arise from tangible fact patterns than is the case in the information-reporting context. Without meaningful enforcement mechanisms, these distributional concerns are likely to undermine the effectiveness of any agreement as to standards, or may motivate conversion of any such agreement into a more lenient regime.<sup>124</sup>

### C. Overcoming Identified Distributive Pressures Is Challenging

Soft international economic law can be effective even when the preferences of major economies diverge. However, in these circumstances, national regulators tend to take positions that reflect the interests of domestic constituencies.<sup>125</sup> As a result, “the adoption of common standards requires solving distributive problems where the interests of these constituencies diverge.”<sup>126</sup> Significant coercion will usually be required to achieve either agreement or effective implementation.<sup>127</sup> In most cases, therefore, distributive problems are likely to remain unresolved, either at the level of principle or at the level of implementation.

The OECD’s work regarding the design of controlled foreign company (CFC) rules provides a case study for the underlying principle that soft international economic law efforts are unlikely to work when distributive problems exist among the major economies. CFC rules tax a defined subset of income of a foreign subsidiary in the country of residence of the parent. CFC rules have a close connection to the broader question of whether a jurisdiction should generally tax all foreign-source income earned by foreign subsidiaries of a corporation resident in its jurisdiction, because CFC rules impose such a regime for a defined subset of income.<sup>128</sup> U.S. CFC rules go beyond those of many other countries by reaching various categories of income deemed “highly mobile” under U.S. law.<sup>129</sup>

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would incentivize MNCs to shift borrowing outside the U.S. and that multilateral adoption would level the playing field).

<sup>124</sup> *C.f. Verdier, supra* note 71.

<sup>125</sup> *Id.* at 142; *Singer, supra* note 18, at 535.

<sup>126</sup> *Verdier, supra* note 71.

<sup>127</sup> *See, e.g., Singer, supra* note 18, at 535.

<sup>128</sup> Most large economies have CFC rules that at minimum tax unrelated party passive income earned by foreign subsidiaries currently in the country of residence of the parent corporation. From there, CFC rules vary widely. *Guide to Controlled Foreign Company Regimes*, Deloitte (Aug. 1, 2015), <http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-guide-to-cfc-regimes-210214.pdf> (comparing CFC regimes).

<sup>129</sup> Similarly, U.S. law departs from international norms by taxing U.S. multinational companies on all profits earned by their foreign subsidiaries when these profits are repatriated as dividends. Among the large developed economies, the United States is now alone in imposing this system of taxation on tax-

The United States went into the BEPS project strongly advocating the need to address BEPS multilaterally through tighter CFC rules.<sup>130</sup> If implemented broadly, such changes would move all jurisdictions closer to imposing worldwide systems for the taxation of foreign-source income earned by tax-resident multinationals. The Obama administration may have believed that it could use the BEPS project to pressure legislators at home and abroad in the direction of the administration's worldwide minimum tax CFC rule ideal. Indeed, the United States' initial rationale for supporting the BEPS project may have rested on the hope that it would create international pressure for tighter CFC rules.<sup>131</sup>

Analysis through the international financial law lens would have suggested that this gambit of the Obama administration was doomed to fail. Tighter CFC rules are viewed as undesirable by a number of G-20 governments because of their distributive consequences.<sup>132</sup> On the one hand, tighter CFC rules primarily increase tax revenues for countries that are the parent jurisdiction for substantial numbers of multinationals. On the other hand, when a country's CFC rules extend beyond the scope of those imposed by other jurisdictions, they may impact corporate residence and investment location decisions made by multinationals. Financial markets are paying increased attention to the tax consequences of corporate residence.<sup>133</sup> Moreover, corporate residence is at least partially elective, so that CFC rules adopted by any state can be circumvented over

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resident multinational corporations. The move away from so-called "worldwide" (deferral) tax systems to "dividend exemption" systems in the developed economies has been driven both by competitive dynamics and scholarship suggesting that exemption systems are economically preferable to worldwide regimes. *See, e.g.* Mihir A. Desai & James R. Hines Jr., *Evaluating International Tax Reform*, 56 NAT'L TAX J. 487, 496 (2003); Eric Drabkin, Kenneth Serwin, & Laura D'Andrea Tyson, *Implications of a Switch to a Territorial Tax System in the United States: A Critical Comparison to the Current System*, Working Paper, BERKELEY RESEARCH GROUP (2013).

<sup>130</sup> Moreover, both immediately prior to the launch of the BEPS project and shortly thereafter, the Obama administration made proposals domestically to substantially tighten the CFC rules applicable to U.S.-incorporated MNCs. The major Administration proposal at the time the BEPS project was launched was to tax currently to the parent corporation (as subpart F income) all "excess returns" of controlled foreign subsidiaries of U.S. MNCs. U.S. DEP'T OF TREAS., GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2011 REVENUE PROPOSALS 43 (2010), available at <http://www.treasury.gov/resource-center/tax-policy/documents/general-explanations-fy2011.pdf>. Depending on the details, if enacted this rule could have moved the U.S. international tax system quite close to a true worldwide tax system. For fiscal year 2015, the Administration abandoned its excess returns proposal in favor of its current "minimum tax" proposals, which also involve strengthening CFC rules. FY 2015 GREENBOOK, *supra* note 120, at 58, 60.

<sup>131</sup> *See generally*, U.S. Tax Reform Efforts Must Be Informed by International Fight Against Base Erosion, DAILY TAX REP. (Dec. 11, 2012) (quoting then Deputy Assistant Secretary International Tax Affairs Manal Corwin),

[http://news.bna.com/dtln/DTLNBW/doc\\_display.adp?fedfid=28868017&vname=dtrnot&jd=a0d5q4q4y5&split=0](http://news.bna.com/dtln/DTLNBW/doc_display.adp?fedfid=28868017&vname=dtrnot&jd=a0d5q4q4y5&split=0); Manal Corwin, *Sense and Sensibility: The Policy and Politics of BEPS*, reprinted in TAX NOTES, Oct. 6, 2014 at 139–40.

<sup>132</sup> *C.f.* Dhammika Dharmapala, *Base Erosion and Profit Shifting: A Simple Conceptual Framework* 10 (U. of Chi. Coase-Sandor Inst. For L. & Econ. Research Paper No. 703), available at [http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2377&context=law\\_and\\_economics](http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2377&context=law_and_economics).

<sup>133</sup> *See generally* Ajay Gupta, *Investment Banks Playing Inversions from Both Sides*, 75 TAX NOTES INT'L 895 (Sept. 15, 2014); Ajay Gupta, *Market Bets Against Retroactive Anti-Inversion Legislation*, 75 TAX NOTES INT'L 1122 (Sept. 29, 2014); Amanda Athanasiou, *U.S. Drug Companies Seeing Green in Irish Inversions*, 75 TAX NOTES INT'L 351 (Aug. 4, 2014).

time.<sup>134</sup> As a result, the tax rules affecting outbound investment by an MNC create important and potentially distortive consequences for ownership structures, in addition to affecting the allocation of capital and national well-being.<sup>135</sup> Defection from any agreement on tighter CFC rules may produce substantial benefits in terms of the location of headquarters activities and highly skilled employment opportunities for the defecting jurisdiction.<sup>136</sup> As a result, other jurisdictions with sufficient market weight were not prepared to lend substantive support to the Obama administration's proposals.<sup>137</sup> Indeed, for many years, CFC rules have mainly been relaxed rather than strengthened around the world.<sup>138</sup>

Given the potential distributive consequences associated with CFC rules, the history of international financial law teaches that any effort to encourage implementation of tighter CFC rules by sovereigns would only be likely to succeed if non-implementation were to carry substantial unfavorable consequences. For example, the Basel I Accord on capital adequacy for financial institutions was in an important sense redistributive. During the Latin American debt crisis of the 1980's, the US and UK felt compelled to bail out Argentina, Brazil, and Mexico in order to indirectly rescue their own banks, which had loaned heavily to these countries, from the potential consequences of sovereign debt defaults.<sup>139</sup> Regulators in both countries then came under pressure to raise capital

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<sup>134</sup> See Daniel Shaviro, *The David R. Tillinghast Lecture: The Rising Tax Electivity of U.S. Corporate Residency* 377, 402 OXFORD UNIV. CTR. BUS. TAX (2011); see also DANIEL SHAVIRO, *FIXING U.S. INTERNATIONAL TAX TAXATION* (2014).

<sup>135</sup> See, e.g., Mihir A. Desai & Dhammika Dharmapala, *Do Strong Fences Make Strong Neighbors?*, 63 NAT'L TAX J. 723 (2010); Mihir A. Desai & James R. Hines Jr., *Evaluating International Tax Reform*, 56 NAT'L TAX J. 487 (2003); Mihir A. Desai & James R. Hines Jr., *Expectations and Expatriations: Tracing the Causes and Consequences of Corporate Inversions*, 55 NAT'L TAX J. 409 (2002).

<sup>136</sup> C.f. HM TREASURY, *CORPORATE TAX REFORM: DELIVERING A MORE COMPETITIVE SYSTEM* 14 (2010) ("Reform of the UK's Controlled Foreign Company (CFC) rules is frequently identified by UK multinational businesses as the key priority needed to improve the UK's tax competitiveness.").

<sup>137</sup> In the international financial law area, IOSCO's efforts to adopt uniform capital rules for securities firms reached a parallel demise twenty years earlier. These rules were effectively defeated by divergent domestic preferences in the U.S. and the U.K. After the 1987 market crash, the United Kingdom faced domestic pressures to raise capital adequacy standards for securities firms. Moreover, the U.K. made a strong case that doing so internationally in a coordinated fashion would reduce systemic risk. However, U.S. regulators did not face the same pressures and saw competitive threats to U.S. securities firms from movement towards consolidated supervision. Given U.S. market power, U.S. resistance alone was enough to defeat agreement at IOSCO. Verdier, *supra* note 17, at 1450.

<sup>138</sup> See e.g., Thorton Matheson, Victoria Perry & Chandara Veung, *Territorial vs. Worldwide Taxation: Implications for Developing Countries* (Int'l Monetary Fund Working Paper, October 2013), available at <http://www.imf.org/external/pubs/ft/wp/2013/wp13205.pdf>; Mike Williams, Dir., Bus. & Int'l Tax., HM Treas., remarks at *Corporate Inversions and Tax Policy*, The Brookings Institution (Jan. 23, 2015), available at [http://www.brookings.edu/~media/events/2015/01/23%20corporate%20inversions/20150123\\_corporate\\_tax\\_inversions\\_transcript.pdf](http://www.brookings.edu/~media/events/2015/01/23%20corporate%20inversions/20150123_corporate_tax_inversions_transcript.pdf). For instance, the UK government, among others, has changed its corporate tax regime over time to focus more on profits from UK activity in determining the tax base rather than attributing the worldwide income of a group to the UK in order to make the UK an attractive headquarters jurisdiction for international investment.

<sup>139</sup> See, e.g., WOLFGANG H. REINICKE, *BANKING, POLITICS AND GLOBAL FINANCE: AMERICAN COMMERCIAL BANKS AND REGULATORY CHANGE, 1980-1990*, 142 (1995).



adequacy standards for domestic banks in order to limit the opportunity for banking concerns to socialize the cost of bad loans again at a future date.<sup>140</sup> The Basel Accord effectively shifted part of the potential cost of these increased capital adequacy requirements (reduced competitiveness of U.S. and UK banking concerns internationally) onto the Japanese, French, German, and Swiss banks that were the primary competitors of U.S. and UK financial institutions at that time. The adoption of the Basel I Accord over the resistance of other countries was thus a function of relative power.<sup>141</sup> At the time, the dominance of U.S. and UK financial markets was such that by threatening to exclude noncompliant foreign banks from their markets, those two powers alone were able to overcome countervailing interests.<sup>142</sup>

However, the United States was largely alone from the beginning in pushing for tighter CFC rules. Nor did it propose a coercive device that would change the calculus for other states. Moreover, given constraints imposed by the Treaties on the Functioning of the European Union, as interpreted by the European Court of Justice, even if some European members of the G-20 had an interest in tightening CFC rules, they could not agree to any unfavorable consequences for non-implementation of CFC recommendations.<sup>143</sup> Perhaps for that reason, a little more than a year into the BEPS project, the International Tax Counsel of the United States publicly suggested that moral suasion rather than coercion was the most likely mechanism by which compliance with CFC recommendations might be obtained.<sup>144</sup> That suggestion effectively constituted an acknowledgment that the effort to establish meaningful OECD standards for tightened CFC rules was over, only halfway through the project.<sup>145</sup> In the end, the discussion draft issued by the OECD on international standards for CFC rules provides a series of caveated statements

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<sup>140</sup> SINGER, *supra* note 17, at 9.

<sup>141</sup> Verdier, *supra* note 71, at 136.

<sup>142</sup> *Id.*

<sup>143</sup> In the landmark case *Cadbury Schweppes v. Commissioner of Inland Revenue*, the European Court of Justice effectively held that CFC rules that operate automatically and do not permit a corporate taxpayer to exercise his freedom of movement within the European Union infringe on a fundamental economic freedom guaranteed by the Treaty on the Functioning of the European Union. Case C-196/04, *Cadbury Schweppes, P.L.C. v. Comm’rs of Inland Revenue*, 2006 E.C.R. 1-7995; RUTH MASON, *PRIMER ON DIRECT TAXATION IN THE EUROPEAN UNION* 309–13 (2d ed.). As a result, CFC rules for European multinationals, at least for their operations within Europe, are illegal under European law unless they are targeted at what the ECJ terms “wholly artificial arrangements.” Lillian Faulhaber, *Sovereignty, Integration, and Tax Avoidance in the European Union: Striking the Proper Balance*, 48 COLUM. J. TRANSNAT’L L. 177 (2010). The tighter CFC rules envisioned by the Obama administration in the United States likely would not pass ECJ scrutiny if imposed in a European jurisdiction with respect to activity by CFCs in other member states (or EFTA states). In this context, arguments from the United States and the OECD that CFC rules have positive spillover effects in source countries because taxpayers have less of an incentive to shift profits into low-tax jurisdictions were bound to be unavailing.

<sup>144</sup> Danielle Rolfes, Int’l Tax Counsel. U.S. Treas. Dep’t, Remarks at Georgetown University Law Center Panel: BEPS, CFC Rules, Patent Boxes, and EU Law (Oct. 2, 2014) (notes of author, who moderated the event).

<sup>145</sup> *Id.*; see also, e.g., *DBriefs Bytes Transcript*, DBRIEFS (Oct. 10, 2014), [http://www2.deloitte.com/content/dam/Deloitte/global/Documents/About-Deloitte/Dbriefs\\_bepscentral/dbriefs\\_script\\_10oct2014\\_a3.pdf](http://www2.deloitte.com/content/dam/Deloitte/global/Documents/About-Deloitte/Dbriefs_bepscentral/dbriefs_script_10oct2014_a3.pdf). See also Kristen A. Parillo, *BEPS Interest Report Will Recommend Fixed Ratio*, 148 TAX NOTES 547 (Aug. 3, 2015).

acknowledging that the policy objectives of CFC rules will vary between jurisdictions, while attempting to defend the proposition that CFC rules continue to play some role in domestic rules addressing cross-border taxation.<sup>146</sup>

#### **D. Path Dependence Matters When National Action is Sufficient**

Path dependence can also affect outcomes, particularly when substantial implementation of agreed-upon rules is possible through national action alone. In these cases, agreements supported by a strong logic of appropriateness may be effective even once major countries focus on non-aligned distributive outcomes.

Consider the OECD work intended to “neutralize the effect of hybrid mismatch arrangements” (Action 2 of the BEPS Action Plan). These arrangements involve the use of hybrid instruments or hybrid entities to produce a taxpayer-favorable inconsistency in the tax treatment of a transaction across two jurisdictions.<sup>147</sup> One example involves an entity that is treated as making a deductible payment to a related party under the laws of the payor jurisdiction but is disregarded as separate from its owner under the laws of the payee jurisdiction, such that the payment is not included in income in the payee jurisdiction.<sup>148</sup> Similarly, a financial instrument may be viewed as debt in one jurisdiction and as equity in the other. Depending on the tax laws of the jurisdictions in question, payments on the instrument could be characterized as deductible interest in the payor jurisdiction and as a non-taxable dividend in the payee jurisdiction.<sup>149</sup> The basic rationale of appropriateness underlying the hybrid mismatch initiative is to ensure matching of income and deductions across international boundaries in much the same way that such matching is often achieved within domestic income tax regimes. This “single tax principle” is at the heart of the policy coherence narrative of the BEPS project.

Agreement in principle about the appropriateness of curtailing hybrid planning was reached in 2012, before the tax treatment of the cross-border activity of multinational enterprises had morphed into a political issue worthy of attention at the G-20.<sup>150</sup> The initial outcome was largely a product of technocratic regulatory consensus among tax

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<sup>146</sup> *Public Discussion Draft, BEPS Action 3: Strengthening CFC Rules 9-14*, OECD (May 12, 2015).

<sup>147</sup> OECD/G-20 Base Erosion and Profit Shifting Project, Action 2: 2014 Deliverable Neutralising the Effect of Hybrid Mismatch Arrangements OECD PUBLISHING 8 (2014). The principal hybrid mismatches identified by the OECD are payments that are deductible under the rules of the country of the payer and not included in the income of the recipient (deduction/no inclusion outcomes) and payments that give rise to duplicate deductions as a result of a single expenditure (double deduction outcomes).

<sup>148</sup> *Id.* at 42.

<sup>149</sup> Similarly, an entity that is viewed as transparent under the laws of one jurisdiction and opaque under the laws of another jurisdiction may lead a single payment made by the hybrid entity to be deductible in two jurisdictions. The OECD project’s scope is limited to arrangements where a mismatch in treatment is caused by the hybrid element and the mismatch in tax outcomes lowers the aggregate tax paid by the parties to the arrangement. *Id.* at 10.

<sup>150</sup> ORG. ECONOMIC CO-OPERATION & DEV., HYBRID MISMATCH ARRANGEMENTS: TAX POLICY AND COMPLIANCE ISSUES 13–14 (Mar. 2012), available at [http://www.oecd.org/tax/exchange-of-tax-information/HYBRIDS\\_ENG\\_Final\\_October2012.pdf](http://www.oecd.org/tax/exchange-of-tax-information/HYBRIDS_ENG_Final_October2012.pdf).

administration professionals. The major exception to technocratic focus was the United States: President Barack Obama gave a speech that targeted hybrid arrangements of U.S. multinationals in 2009.<sup>151</sup> As a first-order matter, these arrangements reduced foreign tax rather than U.S. tax paid by U.S. MNCs,<sup>152</sup> so a focus on limiting U.S. companies' use of hybrid arrangements was arguably at odds with national interest. Indeed, eventually the Obama administration withdrew its 2009 domestic budget proposal to curtail taxpayers' ability to create hybrid entities via the "check-the-box" rules.<sup>153</sup> However, given the political direction established by the Obama administration, U.S. technocratic officials working at the OECD took positions that were consistent with both the logic of appropriateness developed in that multilateral technocratic context and the President's domestic political rhetoric. They approved guidance in March 2012 recommending that foreign sovereigns take action to change their laws to counteract the benefit of hybrid mismatches.<sup>154</sup> At this stage, expressed preferences among major markets were aligned, and distributive concerns had been put aside.

When the BEPS process was launched, the March 2012 principles were translated into a highly prescriptive BEPS output.<sup>155</sup> Eventually, practitioners made clear that in practice, implementation could disproportionately impact U.S.-based multinationals. U.S. officials began to think in terms of logics of consequences: their particular concern was that the BEPS recommendations in this area would prioritize source-country taxation and not

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<sup>151</sup> President Barack Obama, Remarks by the President on International Tax Policy Reform (May 4, 2009), available at [http://www.whitehouse.gov/the\\_press\\_office/Remarks-By-The-President-On-International-Tax-Policy-Reform](http://www.whitehouse.gov/the_press_office/Remarks-By-The-President-On-International-Tax-Policy-Reform).

<sup>152</sup> *International Tax Issues Relating to Globalization: Hearing Before Comm. of Finance*, 106th Cong. 107 (1999) (written statement of Multinational Tax Coalition), available at <http://babel.hathitrust.org/cgi/pt?id=pst.000043053551;view=1up;seq=111>. But see Edward Kleinbard, *Stateless Income*, 11 FLA. TAX REV. 699, 755-56 (2011); see also Edward Kleinbard, *The Lessons of Stateless Income*, 65 TAX LAW REV. 99 (2011).

<sup>153</sup> Compare U.S. DEP'T OF TREAS., GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2010 REVENUE PROPOSALS 28 (May 2009), available at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2010.pdf> with U.S. DEP'T OF TREAS., GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2011 REVENUE PROPOSALS (Feb. 2010), available at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2011.pdf>. That decision was consistent with a respected Treasury economist's well-read finding that the benefits of eliminating check-the-box would inure as a revenue matter largely to foreign sovereigns. Harry Grubert & Rosanne Altshuler, *Fixing the System: An Analysis of Alternative Proposals for the Reform of International Tax*, 66 NAT'L TAX J. 671, 673, 696 (2013) (arguing that "repeal of check-the-box would result in companies unwinding hybrids and sheltering income in countries with rates below the U.S. rate."). See also U.S. DEP'T OF TREAS., GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2015 REVENUE PROPOSALS 61 (Mar. 2014), available at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf> (targeting hybrid mismatches only in circumstances where U.S. deductions could be denied and therefore U.S. revenue increased).

<sup>154</sup> ORG. ECONOMIC CO-OPERATION & DEV., HYBRID MISMATCH ARRANGEMENTS: TAX POLICY AND COMPLIANCE ISSUES (March 2012), available at [http://www.oecd.org/tax/exchange-of-tax-information/HYBRIDS\\_ENG\\_Final\\_October2012.pdf](http://www.oecd.org/tax/exchange-of-tax-information/HYBRIDS_ENG_Final_October2012.pdf).

<sup>155</sup> OECD/G-20 Base Erosion and Profit Shifting Project, *Action 2: 2014 Deliverable Neutralising the Effects of Hybrid Mismatch Arrangements*, OECD PUBLISHING, available at <http://www.oecd-ilibrary.org/docserver/download/2314261e.pdf?expires=1440364950&id=id&accname=guest&checksum=8EE41D97CF974D2705FFD817152DF068>.

require countries to defer to residence-country taxation under CFC rules. Consequently, the adoption of these recommendations to curtail hybrid planning would result in U.S. MNCs paying more in taxes to foreign sovereigns rather than to the United States.<sup>156</sup> At this point, however, it was too late for U.S. officials to change course. Prior acceptance of the logic of appropriateness associated with addressing hybrid mismatches (to ensure single taxation) constrained the scope for diplomatic action by U.S. technocrats. Thereafter, countries began adopting legislation intended to implement the outcome of the OECD's work on hybrids, even before the BEPS project officially drew to a close.<sup>157</sup> The outcome demonstrates both how the logic of appropriateness matters and how path dependence affects the outcomes in international financial law-style processes when implementation is a matter of national action rather than international agreement.

### E. Mock Compliance Is One Likely Response

Compliance with international standards by nation-states (and private actors) can be superficial rather than substantive. Faced with international financial law-style standards, some nation-states may gravitate toward mock compliance.<sup>158</sup> At the most obvious level, mock compliance involves combining formalistic implementation with alternative relief for regulated actors. Mock compliance can also be achieved through systematic regulatory forbearance; informal, administrative non-enforcement; and private compliance failures that go undetected.<sup>159</sup>

For instance, after the Asian crisis of 1997–1998, Indonesia, Malaysia, South Korea, and Thailand came under intense external pressure to transform their financial regulatory regimes to comply with new international standards.<sup>160</sup> However, substantive third-party monitoring of their responses to the new international standards was difficult to achieve. As a result, each of these countries was largely able to defuse external pressure by engaging in cosmetic legal and regulatory changes that did not fundamentally alter the regime under which domestic enterprises and financial institutions functioned.<sup>161</sup>

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<sup>156</sup> Indeed, as Grubert and Altshuler observe, even if priority were given to residence country taxation of hybrid payments, in the case of the United States, given that U.S. rates are higher than the rates in almost all other jurisdictions, one would expect tax planners to unwind hybrid structures, with the result that increased tax revenues would still accrue to jurisdictions other than the U.S. See Grubert & Altshuler, *supra* note 155. See also Robert G. Rinninsland & Kenneth Lobo, *U.S.-Based Pushback on BEPS*, 1 INSIGHTS 10, 14 (2014), available at [http://publications.ruchelaw.com/new/2014-08/Insights\\_Vol\\_1\\_No\\_07\\_Master.pdf](http://publications.ruchelaw.com/new/2014-08/Insights_Vol_1_No_07_Master.pdf).

<sup>157</sup> *The Latest on BEPS—2014 in Review, A Review of OECD and Country Actions in 2014*, 3, EY (Mar. 16, 2015), <http://emergingmarkets.ey.com/the-latest-on-beps-2014-in-review/> (last accessed May 14, 2015).

<sup>158</sup> WALTER, *supra* note 17.

<sup>159</sup> *Id.* at 31–33.

<sup>160</sup> Those countries were not party to the standard-setting bodies that were tasked with crafting these standards, and had no influence on their content.

<sup>161</sup> See WALTER, *supra* note 17. Somewhat similarly, although agreement at the level of principle was reached at the FSB on central clearing mechanisms for OTC derivatives with regulation imposed by the country of residence, unilateral actions since the time of that agreement have encouraged local clearing mechanisms and greater host country regulation. See Helleiner, *supra* note 72, at 16.

Similarly, dynamic responses to the BEPS project that could be characterized as mock compliance are already starting to emerge. For instance, the Swiss Federal Council (the Swiss executive branch of government) has proposed a “Federal Law on Measures to Maintain the Competitiveness of Business Location Switzerland.”<sup>162</sup> The explicit purpose of this legislation is to repeal Swiss law facilitating tax planning of the type targeted by BEPS before the BEPS project is complete, and to simultaneously open other avenues for companies to minimize their tax burden if they locate principal company and financing activity in Switzerland. Key features of the proposed legislation included a Swiss patent box at the cantonal level and a “notional interest” deduction on so-called surplus equity of Swiss companies applicable at both the federal and cantonal levels.<sup>163</sup>

Ireland is similarly beginning tax reform that is intended to maximize competitive advantage within the broad constraints imposed by BEPS outcomes.<sup>164</sup> Belgium already has a notional interest deduction that can be used to circumvent the limitations that would come into being even if every country followed the recommendations of the OECD in the area of interest deductibility. These are just a few examples. Even if the OECD were to take steps to change international standards again to try to counter the impact of legal adaptations in Ireland, Switzerland and elsewhere, there will usually be further legislative strategies available for small open economies interested in maintaining their competitiveness for foreign direct investment. Some level of regulatory forbearance in jurisdictions interested in attracting revenue, employment, or both should also be expected, and constitutes another avenue for mock compliance.

## F. Final Observations

The lessons described above paint a realist picture. Yet in the context of international financial law, even realist analysts point out that purely consequentialist thinking faces

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<sup>162</sup> See *Switzerland Publishes Corporate Tax Reform III*, TAX INSIGHTS FROM INT’L TAX SERVS. PWC (Sept. 26, 2014), available at [http://www.pwc.com/en\\_US/us/tax-services/publications/insights/assets/pwc-switzerland-publishes-corporate-tax-reform-iii-consultation.pdf](http://www.pwc.com/en_US/us/tax-services/publications/insights/assets/pwc-switzerland-publishes-corporate-tax-reform-iii-consultation.pdf); see also *Swiss Federal Council Publishes Revised Bill Together with Dispatch (associated commentary) on Corporate Tax Reform III*, EY GLOBAL TAX ALERT (June 8, 2015), available at [http://www.ey.com/Publication/vwLUAssets/Swiss\\_Federal\\_Council\\_publishes\\_revised\\_bill\\_together\\_with\\_dispatch\\_\(associated\\_commentary\)\\_on\\_Corporate\\_Tax\\_Reform\\_III/\\$FILE/2015G\\_CM5505\\_Swiss%20FC%20publishes%20revised%20bill%20together%20with%20dispatch%20on%20Corp%20Tax%20Reform%20III.pdf](http://www.ey.com/Publication/vwLUAssets/Swiss_Federal_Council_publishes_revised_bill_together_with_dispatch_(associated_commentary)_on_Corporate_Tax_Reform_III/$FILE/2015G_CM5505_Swiss%20FC%20publishes%20revised%20bill%20together%20with%20dispatch%20on%20Corp%20Tax%20Reform%20III.pdf) (explaining 2015 revisions to the Federal Council proposal and noting that the notional interest deduction was removed but may be reintroduced as part of parliamentary debate).

<sup>163</sup> See *Switzerland Publishes Corporate Tax Reform III*, TAX INSIGHTS FROM INT’L TAX SERVS. (PricewaterhouseCoopers LLP), Sept. 26, 2014, available at [http://www.pwc.com/en\\_US/us/tax-services/publications/insights/assets/pwc-switzerland-publishes-corporate-tax-reform-iii-consultation.pdf](http://www.pwc.com/en_US/us/tax-services/publications/insights/assets/pwc-switzerland-publishes-corporate-tax-reform-iii-consultation.pdf).

<sup>164</sup> Ireland issued a “Road Map for Ireland’s Tax Competitiveness” as part of its 2015 budget. The proposal includes a new “Knowledge Development Box,” increased tax amortization for IP assets, R&D tax credit enhancements, a “seconded assignment relief program” that incentivizes non-Irish executives to move to Ireland by offering them reduced income tax rates at the individual level, and other steps intended to maximize the probability that in a post-BEPS environment multinationals will relocate both income and high-paying jobs out of high-tax jurisdictions and put them in Ireland. *Competing in a Changing World, A Roadmap for Ireland’s Tax Competitiveness*, GOV’T OF IR., DEP’T OF FINANCE (Oct. 2014), available at [budget.gov.ie/Budgets/2015/Documents/Competing\\_Changing\\_World\\_Tax\\_Road\\_Map\\_final.pdf](http://budget.gov.ie/Budgets/2015/Documents/Competing_Changing_World_Tax_Road_Map_final.pdf).

certain constraints.<sup>165</sup> Regulators may find it difficult to make an accurate ex ante assessment of the costs and benefits of agreeing to a proposed new international standard, or complying with that standard. It may not be clear to the regulator which domestic groups' interests to take into account, or which economic or political theory to use to determine how to weigh those interests. Finally, it is unclear how far-sighted regulators can be in calculating costs and benefits. To the extent regulators must comply with politicians' wishes or are heavily influenced by the political environment, they may weigh the short- or medium-term quite heavily. All these factors make outcomes difficult to predict, and more than just a consequence of the interplay of national interests and legal and procedural constraints.

Moreover, given all the uncertainty a regulator faces, debates about international standards can act as a kind of focal point. Indeed, law firms and accounting firms around the world now routinely catalogue the various national proposals that are vaguely related to outcomes of the BEPS project, even as they depart from the details thereof.<sup>166</sup> For example, numerous countries have put forth proposals to tighten interest expense limitations, even though none seem to be following the emerging BEPS recommendations in this regard. When a multilateral project is sufficiently politically salient, even an inconclusive part of the project may matter, because it can act as a locus for subsequent domestic policy debates.

### III. Breaking BEPS in Two: The Special Status of the OECD Model Treaty

Many of the limitations on coordinating international tax governance described in Part II result from the multi-step nature of building successful regimes using the international financial law model. Agreements reached internationally must be implemented domestically through legislative or regulatory action. States may have incentives to agree in principle at the international level and then fail to implement domestically.

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<sup>165</sup> WALTER, *supra* note 17.

<sup>166</sup> See e.g., *The Latest on BEPS—2014 in Review, A Review of OECD and Country Actions in 2014*, EY, Mar. 16, 2015, <http://emergingmarkets.ey.com/the-latest-on-beps-2014-in-review/> (last accessed May 14, 2015); *OECD BEPS Action Plan Taking the Pulse in the Asia Pacific Region: Survey of Participation and Action among Asia Pacific Countries*, KPMG (Sept. 2014), <http://www.kpmg.com/Global/en/services/Tax/addressing-the-changing-tax-environment/Documents/taking-the-pulse-in-the-asia-pacific-region.pdf>; BEPS Country Scorecards, available at <http://www2.deloitte.com/global/en/pages/tax/articles/beps-country-scorecards.html> (website provides updates on country activity on BEPS by regions). Just a few examples can give one a sense of the range of government activity. New laws relating to registration of providers of digital services were recently enacted by India, Israel, and Italy in relation to BEPS Action 1 (which addresses tax challenges related to the so-called “digital economy”). Italy recently legislated to deny the use of a cost-plus method for transfer pricing for entities who sell online advertisement services. Anti-hybrid rules on both inbound and outbound payments in the EU and in Australia are inspired by but not entirely consistent with the letter of the recommendations incorporated in the output of Action 2 of the BEPS project. A variety of countries have already modified thin cap rules or introduced interest caps, even though to date none have followed the approach suggested in the discussion drafts associated with Action 4 of the Action Plan. All of these national actions have been linked to discussions that took place in the BEPS project, but none follow OECD recommendations.

The OECD Model Treaty is a “soft law” instrument, and in that sense agreements to change the OECD Model Treaty are similar to agreements reached in international financial law–style processes. However, in contrast to international financial law-type agreements, changes to the OECD Model Treaty and its commentaries (the “Commentary”) impact the legal and administrative outcomes in international tax directly. Not only are the OECD Model Treaty and Commentary (together, the “OECD Model”) highly influential; in some respects changes to the OECD Model are automatically incorporated into domestic law and administrative practice in many countries around the world. As a result, agreements on and compliance with changes to the OECD Model are subject to many fewer pressures than OECD recommendations that take a form similar to international financial law.

The procedural and institutional dynamics of both the BEPS project and future multilateral efforts in international tax should therefore be analyzed by bifurcating proposed solutions based on whether or not they are Model Treaty–based. There are fundamentally different institutional dynamics for international tax efforts that rely on the bilateral tax treaty architecture as opposed to international financial law–style solutions.

The treatment of the OECD Model by both national courts and tax administrations make the negotiation of treaty-based changes to the OECD Model akin to a single-stage negotiating game among states. For Model Treaty–based changes, the political economy dynamics described in Part II may apply to negotiation of soft law at the multilateral level, but do not apply to implementation of that soft law.<sup>167</sup> Marrying the political efficacy of G-20–convened soft-law processes with the legal efficacy of changes to the OECD Model is powerful. In this regard, it is also important to recognize that most countries either have a “monist” view of law, in which international treaties are superior to domestic statutes, or are more averse to treaty overrides than the United States has

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<sup>167</sup> Indeed, in the area of substantive transfer pricing guidance, high political salience has created a political economy dynamic analogous to the one seen in recent years in international financial law. See, n. 76 - 89 and accompanying text, *supra*. Transfer pricing is a special case: it is linked to the treaties, because the arm’s length standard is part of Article 9 of the OECD Model. However, transfer pricing sits between Model Treaty–based and non-Treaty-based guidance for purposes of this article. The reason is two-fold. First, the OECD has created extensive Transfer Pricing Guidelines (running over 350 pages and expanding to almost 500 after the BEPS project) that interpret the arm’s length standard outside the Commentary. In many jurisdictions, the physical separation of the guidelines from the Commentary has led courts and tax administrations to think of the OECD Transfer Pricing Guidelines as a distinct soft law instrument with a different persuasive status than the Commentary. Second, in contrast to the Commentary, sovereigns around the world have adopted detailed domestic transfer pricing rules that address the OECD Transfer Pricing Guidelines in quite varied ways. For example, the Nigerian Income Tax Regulations specify that they are to be “applied in a manner consistent with” the OECD Transfer Pricing Guidelines “as supplemented and updated from time to time.” Income Tax (Transfer Pricing) Regulation No. (1) (2012), § 11 (Nigeria). See also Tanzania Income Tax (Transfer Pricing) Regulations (2014), § 9 (same). In contrast, for countries like the United States, Brazil, India, and China, the transfer pricing guidance process at most involves evaluating changes to the OECD Transfer Pricing Guidelines at the administrative level and determining whether or not to incorporate them into domestic law. For the purposes of this footnote, the key point is merely that the political economy dynamics described in Part II apply to negotiation of the transfer pricing guidelines, regardless of whether they do or do not apply to implementation of that soft law in any given state.

been over time.<sup>168</sup> Thus, Model Treaty-based BEPS outputs are likely to endure over time.<sup>169</sup> Moreover, the boundary between Model Treaty-based issues and other issues is also likely to be durable in the medium term. The commitment by eighty countries to a novel OECD project to amend bilateral tax treaties using a multilateral instrument only strengthens this claim.

Thus, one should anticipate that agreements reached in the BEPS project pertaining to treaty abuse, permanent establishment rules, and the treaty-based aspects of reining in hybrid planning—all of which involve changes to the OECD Model—are likely to be implemented around the world over time. This result applies even though these changes to the OECD Model have distributive consequences, and coercive or market pressures to ensure adoption of the OECD Model are not in place. In this sense, the OECD Model Treaty acts as an independent variable that affects international tax governance, and differentiates the political economy of international tax affairs from those that apply in international financial law.

In contrast, those parts of the BEPS Action Plan that are based on an international financial law-style model are more akin to a multi-stage game.<sup>170</sup> In the absence of agreed-upon coercive enforcement mechanisms, pressures to comply with agreements in these areas will come from the marketplace or from regional governance arrangements (notably the EU), or will simply be absent.<sup>171</sup> As a result, the relevance of agreements that are not Model Treaty-based within the BEPS project will be determined at the national level, in the post-BEPS period.

**A. Treaty-based Elements of the BEPS Project Are More Likely to Be Effective, and Face Fewer Pressures that Limit Agreement or Compliance**

Bilateral tax treaties are agreements between two jurisdictions to coordinate the exercise of their taxing rights as contained in their respective domestic laws and set out clear ground rules that govern tax matters relating to cross-border trade and investment.<sup>172</sup> They provide relative certainty to taxpayers regarding the threshold question of whether a taxpayer's cross-border activities will subject it to taxation by both countries, protect taxpayers from potential double taxation through the allocation of taxing rights between

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<sup>168</sup> See, e.g., John H. Jackson, *Status of Treaties in Domestic Legal Systems: A Policy Analysis*, 86 Am. J. Int'l L. 310, 314 (1992).

<sup>169</sup> Furthermore, most OECD and G-20 countries are either parliamentary democracies or autocracies. The resulting single-party control of the parliament and the administration tends to mean that if the government negotiates a tax treaty change, it does not face other significant hurdles to ratification.

<sup>170</sup> C.f. Robert Putnam, *Diplomacy and Domestic Politics: The Logic of Two-Level Games*, INTERNATIONAL ORGANIZATION, 427–460 (1988).

<sup>171</sup> Although not a focus of this paper, it is important to note that the OECD sometimes acts as an alternative venue in which Member States of the European Union debate issues of relevant to intra-EU politics. The outcome parts of the BEPS project that are not Model Treaty-based may therefore be imposed on EU Member States through mechanisms for asserting pressure that are unique to the EU, and function only vis-à-vis EU states.

<sup>172</sup> See Klaus Vogel, *Double Tax Treaties and Their Interpretation*, 4 INT'L TAX & BUS. LAW 1 (1986).



the two countries, reduce withholding taxes that are imposed at source, and include provisions addressing specialized situations and administrative cooperation between taxing authorities.<sup>173</sup> Over the course of the twentieth century, countries around the world entered into a network of almost four thousand bilateral tax treaties that address these issues.<sup>174</sup> The existing treaty network is largely based on a few model treaties. By far the most commonly used model is the OECD Model Treaty.<sup>175</sup>

The OECD Model exercises an unusual gravitational pull in shaping the legal interpretation of bilateral tax treaties within the domestic legal systems of countries around the world. The special status of the OECD Model results from three interlocked features of international tax policy, administration, and jurisprudence in a large number of states. First, at least within the OECD, tax treaty negotiators feel substantially constrained to accept model treaty provisions in their future negotiations with other sovereigns where they have not registered a reservation or observation with respect to a given OECD Model Treaty provision. Second, the manner in which domestic courts<sup>176</sup> and tax administrations<sup>177</sup> in many countries around the world treat the Commentary substantially prewires an enforcement mechanism for changes to the OECD Model Treaty,<sup>178</sup> despite its technical status as soft law. Third, the “ambulatory theory” of treaty interpretation endorsed by the OECD, as well as tax administrations and national courts in various states, means that, as a practical matter, agreements to amend the Commentary, either in conjunction with or independent of changes to the OECD Model Treaty, significantly alter the legal meaning of existing tax treaties as well as tax treaties agreed to in the future.

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<sup>173</sup> See *Tax Treaty Benefits*, IRS (2014), <http://www.irs.gov/publications/p54/ch06.html>.

<sup>174</sup> *Multilateral Instrument*, *supra* note 9. See DANIEL N. SHAVIRO, *FIXING U.S. INTERNATIONAL TAXATION* 7 (Oxford Univ. Press 2014) (highlighting the oddity of focusing on juridical double taxation by observing that a taxpayer would rather be taxed twenty times at one percent than once at thirty-five percent).

<sup>175</sup> The OECD Model can, in turn, be traced back to the work of the International Chamber of Commerce and the League of Nations in the 1920s, as well as to Model Treaties issued in 1943 and 1946 by the League of Nations. To a lesser extent, the United Nations Model Double Taxation Convention between Developed and Developing Countries (the “UN Model”) is used as a model in negotiations between developed and developing countries.

<sup>176</sup> See, e.g., Tribunal Fiscal de la Nación Argentina [TFN] [Fiscal Tribunal of Argentina], 3/11/1980, “La Industrial Paraguaya Argentina S.A. / recurso de apelación,” (Arg.) (in absence of a definition in the “ley de impuesto a los réditos”, sala C of the Argentinean Tax Court cited the definition of permanent establishment contained in the OECD Model Treaty to define the concept “permanent establishment” under Argentinian law, despite the fact that Argentina was not a member of the OECD).

<sup>177</sup> For example, the Chilean Revenue Service, during the period that Chile was a non-OECD member, issued a circular indicating that the OECD Model and Commentary’s interpretation of the concept of “beneficial owner” should be used to interpret Chile’s tax treaties because Chile intended to follow the OECD Model interpretation in this regard. Chilean Revenue Service, Circular Letter N°57/2009.

<sup>178</sup> For example, the tax treaty between Colombia and Chile, both non-OECD members at the time their treaty was negotiated, indicates that both States agree that when their treaties use the language of the OECD Model, the Commentary to the OECD Model should be considered as complementary means of interpretation of the treaty under the terms of Article 32 of the Vienna Convention on the Law of Treaties of 1969, regardless of the fact that the two countries are non-OECD members. Corte Constitucional [C.C.] [Constitutional Court], Sentencia C-5777/2009 (Colom.), available at <http://www.corteconstitucional.gov.co/RELATORIA/2009/C-577-09.htm>.

## 1. Tax Treaty Negotiators Feel Substantially Constrained

Most OECD member countries assume that the relevant OECD Model Treaty provision is the starting point for tax treaty negotiations between two states unless one of the countries involved in the negotiation has entered a reservation with respect to the provision in question.<sup>179</sup> Moreover, countries around the world rely on the OECD Model Treaty as a starting point for tax treaty negotiations, even when they are not members of the OECD.<sup>180</sup>

Indeed, it is often quite difficult for smaller jurisdictions to attempt to use something other than the OECD Model Treaty as a starting point for negotiations. For instance, Colombia, a non-OECD member, tried at one point to put forth its own model. After the negative response from Colombia's trade partners, the Colombian Model was quickly abandoned, and negotiations were restarted, generally using the OECD Model Treaty.<sup>181</sup>

## 2. Domestic Courts and National Tax Administrations Often Enforce the OECD Model

There is no single, generally accepted view on the legal status of the Commentary.<sup>182</sup> However, the Commentary is used by the national courts of many countries to interpret the meaning of their bilateral tax treaties.<sup>183</sup> These courts frequently rely on Article 31 of

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<sup>179</sup> The weight given to the OECD Model explains why countries acceding to the OECD are thorough in documenting their reservations and observations regarding the OECD Model. *See, e.g.*, Accession Agreement of Chile to the OECD, *available at* <http://www.oecd.org/chile/44381035.pdf>.

<sup>180</sup> Pasquale Pistone, *General Report, in* THE IMPACT OF THE OECD AND UN MODEL TAX CONVENTIONS ON BILATERAL TAX TREATIES 2 (Michael Lang et al. eds., 2012) [hereinafter *IMPACT*]. *See also, e.g.*, Chilean Revenue Service, Circular Letter N°8/2005 (clarifying that Chile's treaties with Brazil, Canada, Ecuador, Mexico, Norway, Peru, Poland, South Korea and Spain were based on the model prepared by the OECD, even though Chile was not a member of the OECD); Wei Cui, *China, in* *IMPACT*, at 262 ("China has ninety-one income tax treaties in effect... its first tax treaty took effect barely a quarter century ago... as China had started from a virtual tabula rasa insofar as tax treaties are concerned, however selective it has attempted to be, its borrowings from the Models inevitably took on a wholesale character." Some countries, however (notably Brazil and India) emphatically reject the idea that they rely on the OECD model to any notable extent. *See, e.g.*, Luis Eduardo Schoeri & Natalie Matos Silva, *Brazil, in* *IMPACT*, at 172.

<sup>181</sup> Natalia Quinones Cruz, *Colombia, in* *IMPACT*, *supra* note 181, at 294.

<sup>182</sup> J. Avery Jones, *The Effect of Changes in the OECD Commentary after a Treaty is Concluded*, 56 BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION 3 (2002).

<sup>183</sup> For example, the Supreme Administrative Court of Finland held that "The wording of the Commentaries, as it was at the time the treaty was negotiated between the parties of the treaty, are especially important when interpreting the tax treaty in question. However, changes made to the Commentaries thereafter are also of importance as a means of interpretation in the spirit of the Vienna Convention." KHO 2002:26, Supreme Administrative Court of Finland, *requoted and translated in* Aima, Frande, & Hellsten, *Finland, in* *IMPACT*, *supra* note 181, at 389-90. *See also* Nat'l Westminster Bank PLC v. United States, 44 Fed. Cl. 120 (Ct. Cl. 1999) (after examining the commentary to the OECD Model Treaty from which language found in the U.S.-UK tax treaty was drawn, the Court held that the IRS was not allowed to determine the income of the U.S. branch of a UK bank by substituting an IRS regulatory formula for interest expense disallowance in place of the individualized arm's length standard determination required under the treaty). Even non-OECD countries' courts rely on the Commentaries.

the Vienna Convention on the Interpretation of Treaties (Vienna Convention), for instance treating the OECD Model Treaty and Commentary as part of the context of the treaty or as providing special meaning for terms in the treaty, or as a supplementary means of interpretation of the treaty under Article 32 of the Vienna Convention. U.S. courts are an outlier in this regard; they tend to rely less extensively on the Commentary because the United States—uniquely among major sovereigns—publishes a highly detailed technical explanation of its tax treaties at the time each such treaty is sent to the United States Senate for ratification.<sup>184</sup>

Tax administrations in many OECD countries explicitly support consulting the OECD Model to determine the meaning of their own treaties.<sup>185</sup> The OECD Model Treaty and

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*See supra*, note 179. Courts in many states rely on Article 31 of the Vienna Convention on the interpretation of treaties for the proposition that bilateral tax treaties should be interpreted in light of the OECD Model Treaty and its commentaries. Many courts accept the observation that the enormous amount of work that every OECD country puts into making and changing the Commentaries suggests that states concluding tax treaties would, in the absence of an observation, intend their treaties to be interpreted in accordance with the Commentaries. As a result, the Commentaries are often accorded the status of the context or a special meaning for terms in the treaty in the sense of Articles 31(2) and (4) of the Vienna Convention on the Law of Treaties providing interpretive guidance for treaty adjudication. *Jones, supra* note 183, at 3. *But see* Michael Lang & Florian Brugger, *The Role of the OECD Commentary in Tax Treaty Interpretation*, 23 AUSTRALIAN TAX FORUM 95, 99 (2008); MICHAEL LANG, TAX TREATY INTERPRETATION 25-27 (Kluwer Law International, 2001) (criticizing the use of the OECD Model Convention Commentary as a tool of interpretation within the meaning of Article 31(2) or 31(4) of the Vienna Convention). Moreover, in states that are signatories to the Vienna Convention on the Law of Treaties, the Vienna Convention is generally viewed as reflecting customary international law. Therefore the justification for using the Commentary to interpret existing bilateral tax treaties is extended even to treaties with partner countries that have not signed the Vienna Convention. *See, e.g.*, *Thiel v. Comm’r of Taxation*, 171 CLR 338 (1990) (Austl.) (holding that “While the Model Convention and Commentaries may not strictly amount to work preparatory to the double taxation agreement between Australia and Switzerland, they are documents which form the basis for the conclusion of bilateral double taxation agreements of the kind in question and, as with treaties in pari[?] material, provide a guide to the current usage of terms by the parties. They are, therefore, a supplementary means of interpretation to which recourse may be had under Article 32 of the Vienna Convention... because the interpretation provisions of the Vienna Convention reflect the customary rules for the interpretation of treaties, it is proper to have regard to the terms of the Convention in interpreting the Agreement: even though Switzerland is not a party to that Convention”). Countries that are not signatories to the Vienna Convention, like France and the United States (which publishes its own comprehensive technical explanation for every tax treaty it signs), similarly acknowledge that the Commentary acts as a means of interpretation for tax treaties. *See, e.g.*, Memorandum of Understanding, Interpretation of the Convention, U.S.-AUSTRIA, July 20, 1996 (providing that “It is understood that provisions of the Treaty that are drafted according to the corresponding provisions of the Organization for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital shall generally be expected to have the same meaning as expressed in the OECD Commentary thereon . . . . The Commentary — as it may be revised from time to time — constitutes a means of interpretation in the sense of the Vienna Convention on the Law of Treaties of May 23, 1969.”)

<sup>184</sup> *See e.g.*, Department of the Treasury Technical Explanation of the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, U.S.-Pol., Oct. 8, 1974, 1067 U.N.T.S. 243 (technical explanation dates from 2013); Department of the Treasury Technical Explanation of the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Feb. 4, 2010 (pending).

<sup>185</sup> For instance, the Australian Taxation Office (ATO) takes the position that “the Commentaries . . .

Commentary as amended therefore influence the way tax administrators understand the meaning of their actual treaties. Indeed, tax authorities frequently seek to justify their interpretations of their own tax treaties in tax litigation as being in accordance with the Commentary.<sup>186</sup>

Importantly, the Commentary is, with surprising frequency, taken into consideration by national courts in many jurisdictions regardless of whether the text of the bilateral tax treaty in question in a given proceeding before the court exactly matches the language of the OECD Model Treaty.<sup>187</sup> The practice of using the Commentary to interpret bilateral treaties even when the language of the two instruments differs is sufficiently common across the world that some preeminent tax treaty scholars claim that it is standard practice for countries to interpret their treaties in accordance with the OECD Model Treaty and Commentary unless it is clear that a different meaning was intended.<sup>188</sup>

### 3. The “Ambulatory Theory” of Tax Treaty Interpretation in Effect Alters the Meaning of Past Agreements over Time

Finally, substantial support exists in many states for an “ambulatory” approach to tax treaty interpretation. Under the ambulatory approach, later-in-time Commentary provisions can be used to interpret tax treaties entered into before the time at which the Commentary was agreed upon. Various commentators have criticized the legal justifications for this approach.<sup>189</sup> Nevertheless, the Commentary, which has been

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provide important guidance on interpretation and application of the OECD Model and as a matter of practice will often need to be considered in interpretation of [Australian tax treaties], at least where the wording is ambiguous, which . . . is inherently more likely in treaties than in general domestic legislation.” *Interpreting Australia’s DTAs*, AUSTRALIAN TAX OFFICE, TR 2001/13, available at <http://law.at0.gov.au/atolaw/view.htm?Docid=TXR/TR200113/NAT/ATO/00001>; *Decree of the Ministry of Finance of Austria*, 27 October 1995 Z 04 0610/286-IV/4/95; AOF 284/1995 (similar). See also OECD Model Commentary, at para. 29 (“tax officials give great weight to the guidance contained in the Commentaries”).

<sup>186</sup> See, e.g., Catherine Brown & Martha O’Brien, *Canada*, in IMPACT, *supra* note 181, at 208.

<sup>187</sup> For example, the Canadian Supreme Court has described both the OECD Model Treaty and its Commentaries as a highly persuasive source of interpretation for provisions of its tax treaty with the United States, even in connection with provisions where the language of the U.S.-Canada treaty does not match the language of the OECD Model. *Crown Forest Indus. Ltd. V. Canada*, [1995] 2 S.C.R. 802 (Can.). See also Richard Vann, *Interpretation of Tax Treaties in New Holland*, LEGAL STUDIES RESEARCH PAPER NO 10/21, SYDNEY LAW SCHOOL (2010).

<sup>188</sup> F.A. ENGELEN, INTERPRETATION OF TAX TREATIES UNDER INTERNATIONAL LAW 445-7 (Amsterdam: IBFD 2004). Moreover, there is no reason to believe these practices will change in an environment characterized by higher political salience of international tax matters. Judges are relatively insulated from political pressures, and have a compelling need for detailed guidance when interpreting tax treaties, such that preexisting judicial practices involving reliance on Commentary are unlikely to be changed by heightened political awareness regard international tax matters.

<sup>189</sup> See, e.g., Jones, *supra* note 183; M. Gunkel & B. Lieber, *Abkommensrechtliche Qualifikation von Sondervegetungen*, 82 Finanz Rundschau (F.R.) 853, 858 (2000) (Ger.); C. GABARINO, MANUALE DI TASSAZIONE INTERNAZIONALE 205 (2d ed. 2008). As a matter of principle it seems clear that commentaries published after a treaty has been entered into cannot be treated as part of the intention of the original treaty negotiators, or be an agreement made in connection with the conclusion of the treaty, or contain a special meaning to which the parties had agreed.

universally endorsed by OECD states, explicitly endorses an ambulatory approach to tax treaty interpretation.<sup>190</sup> Furthermore, the Vienna Convention provides some justification for the ambulatory approach.<sup>191</sup> Indeed, some tax administrations separately affirm their support for the ambulatory approach in domestically issued guidance documents.<sup>192</sup> As a practical matter, long-held conventional wisdom provides that “tax administration is tax policy.”<sup>193</sup> Even more importantly, courts in various states routinely engage in ambulatory interpretation, using later-in-time Commentary to interpret the meaning of tax treaty provisions concluded before the Commentary language was written.<sup>194</sup> Thus, the ambulatory approach to understanding tax treaties to a large extent shapes the meaning of the law as much as the text of the treaty itself.

In sum, the deference that treaty negotiators, courts, and tax administrations of many states give to the OECD Model provides a built-in enforcement mechanism for the Model Treaty-based portions of international tax law. This enforcement mechanism is substantially more effective than the enforcement mechanisms known in international financial law, despite the fact that the OECD Model (like international financial law instruments) is a form of soft law. Moreover, mock compliance by state actors is less of a concern in international agreements reached with respect to the OECD Model than it is outside the treaty area because treaty language is fully observable, both taxpayers and tax

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<sup>190</sup> OECD (2012), *Model Tax Convention on Income and on Capital 2010 (updated 2010)*, at para. 33, OECD Publishing, available at <http://dx.doi.org/10.1787/978926417517-en>; *But see* Ellis M, *The Influence of the OECD Commentaries on Treaty Interpretation—Response to Prof Dr Klaus Vogel*, IBFD BULLETIN 2000, at 618 (“it seems to me that the OECD Fiscal Committee and the Commentary making a statement that new versions of the Model and new versions of the Commentary should be used as proper means of interpretation of older treaties remind me of Baron Münchhausen pulling himself out of a morass by his own hair. I find it very surprising that such a group of—be it authoritative—people can determine how authoritative they themselves shall be...”)

<sup>191</sup> *See Vann, supra* note 188, at 7.

<sup>192</sup> *See, e.g.,* BMF, Z 04 0610/286-IV/4/95, AOFV 284/1995 (Austrian Tax Administration); *Interpreting Australia’s DTAs*, AUSTRALIAN TAX OFFICE, TR 2001/13, at para. 108, available at <http://law.at0.gov.au/atolaw/view.htm?Docid=TXR/TR200113/NAT/ATO/00001>.

<sup>193</sup> Milton Casanegra de Jantscher, *Administering the VAT*, in VALUE ADDED TAXATION IN DEVELOPING COUNTRIES 171, 179 (M. Gillis, C. Shoup, & G. P. Sicat eds., 1990).

<sup>194</sup> For instance, the Norwegian Supreme Court explicitly justified using the current Commentary to the OECD Model in a case wherein they were interpreting a tax treaty that was concluded before that Commentary had been agreed in connection with a tax treaty with a non-OECD Member. *See* PGS, Rt. 2004, p. 957 (Utv. 2004 p. 649) (Norwegian Supreme Court) (relying on the then-current Commentary to the OECD Model to interpret an earlier tax treaty with the Ivory Coast in connection with the question of whether performing seismic and electromagnetic services could create a permanent establishment). The Canadian tax court held that later-in-time OECD documents could be used as extrinsic aids to interpretation of past tax treaties in the context of the U.S.-Canada treaties’ rules regarding beneficial ownership and the treatment of U.S. limited liability companies. *TD Securities (USA) LLC v. The Queen*, [2010] D.T.C. 1137 (Can.). In contrast, the Administrative Supreme Court of France has ruled that it is not necessary to refer to commentaries that are adopted after a given tax treaty is negotiated in interpreting the tax treaty. *See* CE Sect., Dec. 30, 2003, No. 233894, SA Andritz, available at [www.rajf.org/spip.php?article2235](http://www.rajf.org/spip.php?article2235). *See also* H. Perdriel Vaissiere & E Raingeard de law Bletiere, *France*, in IMPACT, *supra* note 181, at 429. But even in jurisdictions where courts have held that they do not take later OECD Commentaries into account, textual analysis suggests that such commentaries are often consulted simply to cope with the difficulty of some treaty interpretation questions that arise. *Id.* at 430. *See also* 78a INT’L FISCAL ASSOC., INTERPRETATION OF DOUBLE TAXATION CONVENTIONS 63-65 (1993).

administrations may rely on OECD Model-based interpretive arguments in court, and judges in most jurisdictions are genuinely independent of the administrative state. At the same time, in the face of the political imperative created by G-20 convocation and the application of international financial law-style pressures, in the BEPS project, tax treaty negotiators feel constrained from expressing their traditional hesitancy to reach agreement to changes to the OECD Model or from asserting reservations where they are disinclined to agree with a majority.<sup>195</sup> The combination of the legal efficacy traditionally associated with the OECD Model and the political efficacy associated with an international financial law-style process is what makes it so likely that the Model Treaty-based components of the BEPS project will be implemented. As a result, negotiations that result in changes to the OECD Model Treaty and Commentary in effect approach a one-stage legal game. Compliance and enforcement is relatively certain when agreement on these soft-law changes is reached. Longstanding bureaucratic processes in national tax administrations and interpretive tools used by domestic courts do much of the hard work of implementation.

## **B. Examples**

### **1. Proposed Changes to the Permanent Establishment Rules**

Changes proposed by the BEPS project to the “permanent establishment” threshold in the OECD Model Treaty provide an example of how changes to the treaty-based portions of international tax law’s “soft” architecture can become self-enforcing.

Tax treaties specify when an enterprise based in one state has a sufficient connection to another state to justify taxation by the latter state. A sufficient connection exists when an enterprise resident in one state (the “residence state”) has a “permanent establishment” in another state (the “source state”). The permanent establishment threshold must be met before the source state may tax that enterprise on active business income properly attributable to that enterprise’s activity in the source state. An important definitional approach taken in the OECD Model Treaty is to specify certain activities that do not constitute a permanent establishment. Accordingly, Article 5(4) of the OECD Model Treaty enumerates certain “specific activity exemptions” that are assumed to contribute only marginally to the profits of an enterprise, and therefore are thought not to warrant taxation by that jurisdiction. For example, Article 5(4) provides that the maintenance of a stock of goods or merchandise belonging to the enterprise, and the use of facilities solely for the purpose of storage or delivery of goods or merchandise belonging to the enterprise do not constitute a permanent establishment.<sup>196</sup> The specific activity exemption approach is intended to provide businesses with greater certainty as to when they should expect to

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<sup>195</sup> The United States is in fact threatening at this time to make a reservation on the permanent establishment rules being negotiated as part of the BEPS project. However, it is the only jurisdiction making this threat, and the importance of that threat is limited, given U.S. MNCs’ reliance on foreign-to-foreign planning, as described in Part IB.

<sup>196</sup> *Model Tax Convention on Income and on Capital* Art. 5(4)(a), (b), OECD PUBLISHING (2014), available at [http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2014\\_mtc\\_cond-2014-en#page24](http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2014_mtc_cond-2014-en#page24).

be taxed in a source state, while improving administrability by limiting the need for case-by-case determinations.

In the BEPS project, however, many countries have focused on the idea that technological progress (especially the Internet) and the globalization of business have made it easier to be heavily involved in the economic life of another jurisdiction, without meeting the historic permanent establishment threshold. As a result, the BEPS project includes proposals to modify the permanent establishment threshold as it appears in the current OECD Model Treaty. One leading proposal is to modify the definition of a permanent establishment so as to make each of the “specific activity exemptions” subject to a “preparatory and auxiliary” limitation. Under this limitation, each of the specific activity exceptions would only apply if the given activity had a “preparatory or auxiliary character” taken in the context of the business enterprise as a whole.<sup>197</sup>

At the level of multilateral negotiation of soft law, this represents a case where preferences are aligned among major economies, with one significant outlier: the United States. Outside of a G-20–convened process, it is quite likely that strident opposition from the United States would be sufficient to prevent the consensus required for adoption of such a change in the permanent establishment rules in the OECD Model Treaty.<sup>198</sup> However, G-20 convocation has given other countries the willingness and ability to force through changes to the OECD Model Treaty, even if it comes with a U.S. reservation about this provision. Moreover, the United States’ reservation is unlikely to be of much practical effect, as a result of the U.S. MNCs’ high reliance on foreign-to-foreign tax planning,<sup>199</sup> in combination with the unusual efficacy of the OECD Model.

The built-in enforcement mechanisms for the OECD Model suggest that when new PE rules are adopted in the OECD Model Treaty—as is generally expected—tax administrations and courts are likely to apply them to some significant degree, regardless of when countries modify their tax treaties to be consistent with the new OECD Model Treaty. Indeed, various governments are already claiming that the permanent establishment rules in the *current* OECD Model Treaty are consistent with the idea that the specific activity exemptions are subject to a preparatory or auxiliary limitation.<sup>200</sup>

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<sup>197</sup> See *Revised Discussion Draft BEPS Action 7: Preventing the Artificial Avoidance of PE Status*, OECD 21-22 (May 15, 2015–June 12, 2015), available at <http://www.oecd.org/tax/treaties/revised-discussion-draft-beps-action-7-pe-status.pdf>.

<sup>198</sup> Unlike almost any other state, the United States has never reserved on any Article or paragraph of the OECD Model Treaty. One way to understand this result is that, outside G-20 processes, U.S. opposition to a provision in the OECD Model Treaty was considered enough to block the “consensus” required for a change to be agreed to the Model (whereas the same was not always true of opposition from other states). In the context of the BEPS project, however, it appears that consensus will be achieved on changes to the PE provisions by allowing the United States to enter a reservation. That “solution” to achieving consensus has been used before with other states, but not with the United States.

<sup>199</sup> See discussion at note 13 and accompanying text, *infra*.

<sup>200</sup> For instance, the Israeli Tax Authority recently put out a Draft Circular that suggests that the PE exceptions provided under paragraphs a) through d) of Article 5(4) of the OECD Model Treaty are subject to the additional requirement that the activities referred to in that section are of only a “preparatory or auxiliary” nature. See Leon Harris, *Foreign Cyberspace Operators Could be Swept into Israeli Tax Net*,

Perhaps tellingly, Amazon—arguably the company most obviously affected by the addition of the preparatory and auxiliary limitation on the specific activity exemptions on the use of a facility for storing and delivering merchandise to customers—recently changed the structure of its operations in a number of European jurisdictions so as to unambiguously subject themselves to tax on a net basis on sales in those jurisdictions.<sup>201</sup> Presumably they did so after judging that the OECD Model changes would be sufficiently self-enforcing that the wiser course was to avoid audits and litigation over whether they do or do not have permanent establishments in many of the jurisdictions in which they provide customers with goods.

## 2. Proposed Changes to Combat Treaty Abuse: The Limitation on Benefits Provision

Some changes to tax treaty-based rules are sufficiently broad that it seems unlikely that these changes would be imputed into existing treaties by courts (or tax administrators) on the basis of changes to the OECD Model without an amendment to the relevant bilateral treaties. Consider, for example, the “limitation on benefits” (LoB) article being proposed as part of the BEPS project. LoB provisions are intended to determine whether a taxpayer has a sufficient nexus to a contracting state to be treated as eligible for the tax treaty benefits provided for in a given bilateral tax treaty.<sup>202</sup> LoB provisions make that determination through a series of clearly delineated and often quite complicated objective tests.<sup>203</sup> An LoB article is one alternative for addressing tax treaty abuse under a

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Worldwide Tax Daily (Apr. 7, 2015) (discussing the content of the ITA’s draft circular). *See Israeli Tax Guidance on On-line Activity of Foreign Companies*, Newsletter (MEITAR, Ramat Gan, Isr.), Apr. 2015. Government officials from jurisdictions as diverse as Germany and India have publicly articulated similar views. These claims are being made despite the fact that the “preparatory and auxiliary” language in Article 5(4)(e) and 5(4)(f) of the OECD Model Treaty quite clearly provides an additional exception to permanent establishment status, rather than a limitation on the availability of the other exceptions to permanent establishment status. The discussion of the Commentary to Article 5(4) of the OECD Model Treaty as it stood as of 2014 highlights the intended effect of the “preparatory and auxiliary” language in Art. 5(4)(e) and 5(4)(f). See paragraph 21 of the Commentary providing that “[w]here each of the activities listed in subparagraphs a) to d) is the only activity carried on at a fixed place of business, the place is deemed not to constitute a permanent establishment.” Note that this sentence was added to the Commentary in 2011 after specifically considering the question as to whether each of the exceptions in subparagraphs a) through d) should be subject to a “preparatory and auxiliary” limitation. At the time, that suggestion was rejected, and instead text was added to the Commentary to clarify that no such limitation was intended, or had ever been in place. *See Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention* OECD, at para. 74 (Oct. 12, 2011–Feb. 10, 2012) available at <http://www.oecd.org/tax/treaties/48836726.pdf>.

<sup>201</sup> See Stephanie Soong Johnston, *Amazon EU to Book Profits in Local Countries*, 78 TAX NOTES INT’L 797 (June 1, 2015); Lisa Fleisher & Sam Schechner, *Amazon Changes Tax Practices in Europe Amid Investigations*, WSJ (May 24, 2015, 7:15 PM), <http://www.wsj.com/articles/amazon-changes-tax-practices-in-europe-amid-investigations-1432480170>.

<sup>202</sup> John Bates & Alexander Rust et al., *Limitations on Benefits Articles in Income Tax Treaties: The Current State of Play*. 41 INTERTAX 395, 395 (2013).

<sup>203</sup> See, e.g., *United States Model Income Tax Convention of November 15, 2006*, art. 22 (2006); *United States Model Technical Explanation Accompanying the United States Model Income Tax Convention of November 15, 2006*, 63-73 (2006); *Revised Discussion Draft BEPS Action 6: Prevent Treaty Abuse*, OECD



“minimum standard” approach to treaty abuse that the BEPS project intends to establish.<sup>204</sup> The OECD accordingly proposes to incorporate the LoB rule as a new, independent article in the OECD Model Treaty. Given that adding an LoB to an existing tax treaty generally requires adding an entirely new treaty article that creates previously non-existent bright-line limitations on eligibility for treaty benefits, courts are unlikely to impute LoB rules into existing tax treaties in any jurisdiction, absent explicit amendment to the tax treaty in question. Ambulatory interpretation has its limits.

Nevertheless, the new “minimum standard” in the treaty abuse area is likely to be rapidly implemented by most jurisdictions. Treaty negotiators who might otherwise have reserved on the LoB, the alternative “principal purpose test” (“PPT”, see explanation below) for addressing treaty abuse, or both, generally feel constrained from doing so by the political pressure they face to agree on outputs as part of the BEPS project. At the same time, after the BEPS process is over, it is unlikely that the existing norm—that countries start negotiating from the OECD Model Treaty unless one of the countries has made an observation or reservation on that provision—will cease to apply. Instead, it seems likely that treaty negotiators will feel pressured to meet the minimum standard on treaty abuse in one way or another once they have agreed to this change in the Model Treaty.

Moreover, the alternative approach to meeting the “minimum standard” to combat treaty abuse that the OECD has agreed upon, the “principal purpose test” (PPT) proposal, is subject to ambulatory interpretation. The PPT alternative would add a rule to tax treaties providing that tax treaty benefits will be denied to a taxpayer on an item of income or capital if it is reasonable to conclude that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in the relevant circumstances would be in accordance with the object and purpose of the relevant provisions of the tax treaty.<sup>205</sup> The PPT is being described in proposed new Commentary as consistent with longstanding principles of tax treaty interpretation.<sup>206</sup> Given the ambulatory approach to treaty interpretation, courts in various jurisdictions are likely to import the PPT into existing tax treaties (unless their tax administration alternatively adopts LoB rules for the

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4-16 (May 22, 2015–June 17, 2015), available at <http://www.oecd.org/tax/treaties/revised-discussion-draft-beps-action-6-prevent-treaty-abuse.pdf>.

<sup>204</sup> See OECD/G-20 Base Erosion and Profit Shifting Project, *Action 6: 2014 Deliverable Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, OECD PUBLISHING at para. 14 (2014), available at <http://www.oecd-ilibrary.org/docserver/download/2314281e.pdf?expires=1436316471&id=id&accname=guest&checksum=78DBAE49BACA113169139A080AC0CE2E>; *Revised Discussion Draft BEPS Action 6: Prevent Treaty Abuse*, OECD, at para. 5 (May 22, 2015–June 17, 2015), available at <http://www.oecd.org/tax/treaties/revised-discussion-draft-beps-action-6-prevent-treaty-abuse.pdf>.

<sup>205</sup> OECD/G-20 Base Erosion and Profit Shifting Project, *Action 6: 2014 Deliverable Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, OECD PUBLISHING 66-67, available at <http://www.oecd-ilibrary.org/docserver/download/2314281e.pdf?expires=1436316471&id=id&accname=guest&checksum=78DBAE49BACA113169139A080AC0CE2E>.

<sup>206</sup> *Id.* at 88.

country's treaties).<sup>207</sup> Thus, the area of tax treaty abuse provides another example of how the constraints felt by tax treaty negotiators in combination with the ambulatory theory of tax treaty interpretation make the OECD Model particularly effective as a form of soft law.

### C. What About Treaty Overrides?

In the majority of countries around the world, tax treaties are, speaking very generally, legally superior to domestic law.<sup>208</sup> One consequence of the legal priority given to treaties is that the tools used to interpret those treaties implicitly receive that same priority. This legal fact is another key reason that the OECD Model is so efficacious in many countries around the world—Model Treaty-based interpretive principles used by courts to interpret bilateral tax treaties can implicitly trump domestic law, even though the OECD Model is non-legally binding instrument.

However, in many common law countries—a minority of jurisdictions globally—domestic legislation is generally required to implement treaty obligations.<sup>209</sup> In these countries, as well as other countries where treaties and statutes have no priority vis-à-vis one another, treaties are subject to repeal by later-in-time legislation.<sup>210</sup> Nevertheless, as a historical matter, in the tax area the overwhelming majority of countries in which treaty overrides are theoretically possible have remained highly averse to enacting tax treaty overrides through later-in-time domestic statutes. Indeed, in the late 1980s, when the United States enacted two tax treaty overrides, the OECD issued a report that quite

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<sup>207</sup> The potential for PPT importation is particularly high in the many countries whose tax legislation includes general anti-abuse rules that are subject to judicial interpretation. For two surveys of general anti-abuse rules in various states, see *GAAR Rising: Mapping Tax Enforcement's Evolution*, EY (Feb. 2013), available at [http://www.ey.com/Publication/vwLUAssets/GAA\\_rising/\\$FILE/GAAR\\_rising\\_1%20Feb\\_2013.pdf](http://www.ey.com/Publication/vwLUAssets/GAA_rising/$FILE/GAAR_rising_1%20Feb_2013.pdf), and *Removing the Fences: Looking Through GAAR*, PwC (Feb. 2012), available at <https://www.pwc.in/assets/pdfs/publications-2012/pwc-white-paper-on-gaar.pdf>. Both surveys highlight that in various jurisdictions general anti-abuse rules are being applied to treaty issues even though there is no explicit authorization for doing so.

<sup>208</sup> See Reuvan S. Avi-Yonah, *Tax Treaty Overrides: A Qualified Defense of U.S. Practice*, in *TAX TREATIES AND DOMESTIC LAW* 65 (Guglielmo Maisto, ed., 2006). Space does not permit me to fully describe the various ways that domestic legal systems address the relationship of treaty law to domestic statutes, or to engage with the long-standing “monist/dualist” debate regarding whether treaties should have the formal status of law in a domestic legal order without further action by a legislature that formally incorporates that treaty into the relevant domestic law. However, speaking very roughly, the majority of states take a more ‘monist’ perspective – meaning that treaties that have entered into force do not necessarily require separate implementing legislation to become part of domestic law, and usually override any inconsistent domestic legislation, whether existing or future. ANTHONY AUST, *MODERN TREATY LAW AND PRACTICE* 181-95 (2d ed. 2007).

<sup>209</sup> *Id.*

<sup>210</sup> For example, in the United States, treaties and statutes are both the law of the land, but treaties may be overridden by later-in-time statutes. See, e.g., John H. Jackson, *Status of Treaties in Domestic Legal Systems: A Policy Analysis*, 86 *Am. J. Int'l L.* 310, 314-315 (1992).

scathingly condemned such behavior, and that report received equal levels of support from common law and civil law countries alike.<sup>211</sup>

However, domestic law measures that could be characterized as tax treaty overrides were recently proposed in Australia and enacted in the UK in reaction to the BEPS project.<sup>212</sup> Officials from both governments describe these legislative actions as a response to the heightened political salience of international tax affairs. In its 2015–2016 budget, the Australian government announced that it would introduce a provision that would allow the Commissioner of Taxation to cancel the Australian tax benefits obtained in connection with an identified “scheme” to “artificially” avoid having a permanent establishment as defined in Australia’s current tax treaties.<sup>213</sup> The UK’s diverted profits tax (“DPT”) came into effect on April 1, 2015, and targets for taxation instances where, under existing permanent establishment rules, an MNC legitimately avoids a UK taxable presence, but the MNC continues to have activities in the UK in connection with the supply of goods or services to UK customers.<sup>214</sup>

Even these exceptional cases, however, suggest that the OECD Model Treaty remains efficacious. For instance, although the legislation proposed in Australia would override Australia’s tax treaties and in effect create a new PE threshold in Australia for certain large foreign MNCs, the rules proposed in that legislation are commensurate with the two leading OECD proposals for revising the OECD Model’s PE threshold as part of the BEPS project.<sup>215</sup> In other words, the Australian proposal is best characterized as an attempt to enact the BEPS project’s PE outputs without bothering to negotiate with other states about the substance of Australia’s actual bilateral tax treaties. While such an action would be a treaty override, it does not weaken (indeed, perhaps strengthens) the case that changes to the OECD Model are self-enforcing.

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<sup>211</sup> Committee on Fiscal Affairs, *Tax Treaty Overrides*, OECD (1989), reprinted in *OECD Committee on Fiscal Affairs Report on Tax Treaty Overrides*, 2 Tax Notes Int’l 25 (Jan. 1990).

<sup>212</sup> Bob Stack, the senior United States international tax official at the Department of the Treasury, made a similar observation in a heavily reported speech: “Both the UK and Australian approach use as a starting point in the application of their PE-related diverted profits approach, that goods or services are provided in their jurisdiction, and there is some activity in the jurisdiction related to the sales of those goods or services...[W]e all learned in our introductory international tax law classes that this is the very issue that is addressed directly by the PE rules in a treaty...” Robert Stack, Address at the 2015 OECD International Tax Conference (June 11, 2015) (Transcript made by the author, taking notes at the speech).

<sup>213</sup> See Exposure Draft, Tax Laws Amendment (Tax Integrity Multinational Anti-Avoidance Law) Bill 2015 (Austl.); Explanatory Memorandum, Tax Laws Amendment (Tax Integrity Multinational Anti-Avoidance Law) Bill 2015, at para. 1.15 (Austl.).

<sup>214</sup> Finance Act 2015, c. 4, §§ 77-116 (U.K.); see also *Diverted Profits Tax Client Briefing*, SKADDEN (Dec. 11, 2014), [http://www.skadden.com/newsletters/Diverted\\_Profits\\_Tax%20\\_Client\\_Briefing.pdf](http://www.skadden.com/newsletters/Diverted_Profits_Tax%20_Client_Briefing.pdf).

<sup>215</sup> Explanatory Memorandum, Tax Laws Amendment (Tax Integrity Multi-national Anti-Avoidance Law) Bill 2015 6-20 (Austl.). Indeed, when asked at a major OECD tax conference what more the Australian proposal would reach if one assumed all BEPS PE proposals were enacted into Australia’s tax treaties, Australia’s leading international tax official responded that in such a circumstance there would be no further items to address. Notes of Author in response to question posed by author at OECD-USCIB conference June 11-June 12, 2015.

The UK DPT represents a harder case. The DPT is not consistent with the parameters of the OECD’s ongoing work on the PE threshold. Moreover, under UK domestic law, taxpayers only have standing to challenge a UK tax as inconsistent with the UK’s tax treaties to the extent provided by statute, and the existing UK statute may not extend to the DPT, so recourse to tax treaties and therefore Model Treaty-based interpretive principles may not be available.<sup>216</sup> Nevertheless, closer inspection of the DPT leaves some room for doubt as to how often it will in fact be imposed. Unlike every other UK tax, the DPT is effectively electively assessed by Her Majesty’s Revenue and Customs (HMRC), so some practitioners have suggested that the DPT is a purely prophylactic measure.<sup>217</sup> Moreover, it seems likely that HMRC would hesitate to a greater degree in assessing the DPT in circumstances when the taxpayer is within the bounds of revised OECD Model Treaty PE principles than it would otherwise.<sup>218</sup> Thus, even analysis of the DPT—the exception that proves the rule—supports the idea that bifurcating analysis between Model Treaty-based and non-Model Treaty-based measures remains appropriate.

#### **D. The Multilateral Instrument and the Boundaries of the Model Treaty**

The outcome of the work on a multilateral instrument as part of the BEPS Action Plan illustrates both that the boundary between Model Treaty-based and non-Model Treaty-based parts of the international tax architecture is durable and that marrying the political efficacy of international financial law with the legal efficacy of the OECD Model Treaty process may be highly effective. As part of the BEPS Action Plan, a report entitled “Developing a Multilateral Instrument to Modify Bilateral Tax Treaties” (Multilateral Instrument Report) was delivered to the G-20 in September 2014.<sup>219</sup> In early 2015, all G-20 and OECD countries endorsed a mandate to negotiate this instrument.<sup>220</sup> This multilateral instrument, if successfully completed, will substantially streamline the

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<sup>216</sup> Dan Neidle et al., *The UK Diverted Profits Tax: Final Legislation Published*, CLIFFORD CHANCE (Mar. 25, 2015), [http://www.cliffordchance.com/briefings/2015/03/the\\_uk\\_diverted\\_profitstaxfinallegislatio.html](http://www.cliffordchance.com/briefings/2015/03/the_uk_diverted_profitstaxfinallegislatio.html) (explaining that the relevant provision of the Taxation (International and Other Provisions) Act (2010), section 6 does not refer to the DPT and likely will not be amended to provide recourse for domestic taxpayers).

<sup>217</sup> *UK Releases Details Regarding Diverted Profits Tax*, EY (Dec. 11, 2014), [http://www.ey.com/Publication/vwLUAssets/UK\\_releases\\_details\\_regarding\\_Diverted\\_Profits\\_Tax/\\$FILE/2014G\\_CM4998\\_UK%20releases%20details%20re%20DPT.pdf](http://www.ey.com/Publication/vwLUAssets/UK_releases_details_regarding_Diverted_Profits_Tax/$FILE/2014G_CM4998_UK%20releases%20details%20re%20DPT.pdf).

<sup>218</sup> Indeed, other sovereigns may take measures to retaliate against the UK DPT to the extent the UK tries to impose it beyond the boundaries of PE rules as agreed upon in the BEPS project. For instance, the UK DPT (tellingly referred to by leading UK politicians as the “Google Tax”) is widely suspected of being a discriminatory tax by U.S. practitioners and tax authorities. Section 891 of the Internal Revenue Code provides that income taxes paid by UK corporations doing business in the United States would double if the President found that a UK tax was being imposed extraterritorially or discriminatorily on U.S.-parented MNCs.

<sup>219</sup> *Multilateral Instrument*, *supra* note 9, at 10. The author was an outside consultant to the OECD in the development of this report, as well as a member of the informal group of academic experts assembled to examine the feasibility of modifying 3,800 different bilateral treaties through a single multilateral instrument.

<sup>220</sup> OECD/G-20 Base Erosion and Profit Shifting Project, *Action 15: A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measure to Tackle BEPS*, OECD PUBLISHING (2014), available at <http://www.oecd.org/ctp/beps-action-15-mandate-for-development-of-multilateral-instrument.pdf>.

process of modifying certain treaty-based rules that are common to the existing bilateral treaties of participating states. However, although the multilateral instrument may amend a very large percentage of the world's existing bilateral tax treaties to make them consistent with BEPS treaty-based recommendations, it is structured to do so without abandoning the basic bilateral structure of tax treaties, and without changing which parts of the international tax architecture are within and outside the tax treaty architecture.<sup>221</sup> Indeed, the Multilateral Instrument Report emphasizes that doing anything more would be overbroad given the overarching importance countries place on “tax sovereignty.”<sup>222</sup>

The OECD could never have studied the possibility of a multilateral instrument of this sort, let alone obtained agreement to launch such a negotiation, without the political will associated with G-20 convocation. Tax experts brought together by the League of Nations, who in the 1920s and 1930s did the initial work that underlies the OECD Model Treaty, originally conceived of a tax treaty as a multilateral instrument.<sup>223</sup> The 1963 OECD Model Treaty was similarly intended as a model for multilateral negotiations within the OECD; as late as 1977, OECD treaty documents still encouraged a multilateral approach where feasible.<sup>224</sup> Yet from then until the G-20 became involved, all groups of officials who opined on actually launching a multilateral negotiation came out against this approach.<sup>225</sup> As the Multilateral Instrument Report emphasizes, it required “strong impetus at the highest political level” to achieve “political acceptance from a critical mass of jurisdictions” for a multilateral negotiation.<sup>226</sup> When the G-20 became involved, after almost a hundred years of resistance, a negotiation to create a hard-law, multilateral tax treaty instrument began in earnest. It is instructive that even this historic multilateral tax treaty negotiating process is premised on preserving the border between Model Treaty-based measures and other parts of international tax policy.

#### IV. Conclusion

International tax law has entered a new era of multilateralism. Over the last few years, in response to unprecedented political attention to international taxation, the G-20 has acted as the primary agenda-setter for international tax diplomacy. G-20 convocation, standard-setting, and monitoring, as well as a general reliance on informal political

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<sup>221</sup> *Multilateral Instrument*, *supra* note 9, at 12-13.

<sup>222</sup> *Multilateral Instrument*, *supra* note 9, at 16. The report emphasized that “in tax matters, the concept of sovereignty underpins the stable tax framework within which governments have been able to facilitate arrangements that allowed for the benefits of globalization to flow to all market economies... Recognizing the tax sovereignty concern, the report focuses on implementing treaty measures, even though a multilateral instrument could in principle also be used to express commitments to implement domestic law measures.” *Id.* at 13.

<sup>223</sup> Report Presented by the Fiscal Comm. on the Work of the Third Session of the Committee, League of Nations Doc. C.415.M.171 1931 II (1931) (Appendix I-III).

<sup>224</sup> See Jeffrey Owen & Mary Bennett, *OECD Model Tax Convention*, OECD OBSERVER (Oct. 2008), [http://www.oecdobserver.org/news/archivestory.php/aid/2756/OECD\\_Model\\_Tax\\_Convention.html](http://www.oecdobserver.org/news/archivestory.php/aid/2756/OECD_Model_Tax_Convention.html); Klaus Vogel, *Double Tax Treaties and Their Interpretation*, 4 INT'L TAX & BUS. LAW. 1, 11 (1986).

<sup>225</sup> See Richard Vann, *A Model Tax Treaty for the Asia-Pacific Region?* 45 BULLETIN FOR INT'L FISCAL DOCUMENTATION 151-163 (Apr. 1991).

<sup>226</sup> *Multilateral Instrument*, *supra* note 9, at 10, 13.

declarations, are becoming an established part of the international tax landscape. Moreover, given the heightened political profile of international tax affairs, and the tendency for the G-20 to continue pursuing an issue once it begins to do so, there is no reason to believe that this phenomenon is temporary. Rather, we likely have a “new normal.”

The soft law created in G-20–convened processes differs in kind from the soft law that is familiar to practitioners from the OECD Model. Instead, this form of soft law is quite similar procedurally to international financial law. Past evidence suggests that successful implementation of international financial law–style economic governance requires multiple elements: agreement as to standards, monitoring that effectively determines whether standards are being met, enforcement mechanisms that ensure initial implementation by a sufficiently broad range of states, and continuing pressures that ensure ongoing compliance. Quite often, one or more of these elements is missing or fades over time.

On the other hand, the deference that treaty negotiators, courts, and tax administrations give to the OECD Model Treaty and Commentary provides a built-in enforcement mechanism that is substantially more effective than the enforcement mechanisms known in international financial law. As a result, the patterns seen in international financial law implementation are not likely to be replicated in the parts of the BEPS project that play off the tax treaty architecture. The fact that a multilateral instrument to implement OECD Model Treaty–based BEPS measures is to be negotiated only strengthens this conclusion. In the Model Treaty–based space, implementation into hard law of changes agreed to in the course of the BEPS project is likely to be rather swift.

Marrying the political efficacy of G-20–convened soft-law processes with the legal efficacy of changes to the OECD Model is powerful. The deep shadow of potential non-compliance that sits over agenda items in international financial law, or other parts of the BEPS Action Plan, does not affect Model Treaty-based measures to nearly the same extent. Whether this is a feature or a bug of the new procedural architecture for governing international tax affairs depends both on the participant’s perspective and interests and on the level of clarity reached in the amendments to the OECD Model. Certainly, if one views global consistency as a desirable end in itself, then the new procedural architecture is very effective in achieving that result. Those national actors whose goals are met by the changes to the OECD Model will also find it desirable. On the other hand, various actors may have concerns if changes to the OECD Model increase uncertainty, since most actors have at least some interest in clarifying preexisting areas of controversy. Of course, where new agreements are against national interest, particular actors will also be displeased with the results.

The boundary between Model Treaty–based and other parts of the international tax architecture is durable. Accordingly, analysis and forecasting of the future of the international tax regime should be bifurcated between those issue areas that are or can easily be incorporated into bilateral tax treaties, and those that cannot. Outside the Model Treaty–based space, as long as international tax matters remain highly politically salient,

international tax agreements are most likely to be effective if preferences are aligned and distributive problems are largely absent among the major economies. Information-sharing agreements, which come with a strong logic of appropriateness associated with transparency and can be described as producing non-rival benefits, are thus one category of agreement that is likely to be implemented. Agreements in principle may be reached in cases where incentives are not aligned among major state actors. However, for those agreements to be implemented will require the exercise of coercion by a sufficiently powerful subset of leading economies, or market pressures that allow a subset of states to impose a standard without affirmatively coercing other states—in combination with administrable monitoring mechanisms. These conditions may often be absent or fade over time.

As a result, outside the Model Treaty-based and transparency areas, post-BEPS policymaking may, ironically, be characterized by policy fragmentation along national lines, rather than a more consistent international regime. Non-implementation of OECD recommendations will help shape the environment, and policy proposals that received substantial attention in the context of BEPS may act as a locus for subsequent policy debates at the domestic level. The importance of arguments about policy coherence developed among tax regulators gathered at the OECD may decline, while the logic of consequences dominates decision-making. Where agreements in principle are reached but monitoring and enforcement mechanisms are not sufficiently binding, mock compliance by both states and private actors is likely to emerge. Agreements reached in principle and national decisions regarding implementation often will not align. Importantly, however, Model Treaty-based agreements will be spared these pressures.

Therefore, analyzing the future of the international tax regime requires breaking BEPS in two. Only then can we understand how international tax governance is likely to go forward at the multilateral level. This result should be relevant to anyone interested in international economic law. It highlights how international finance and international tax are becoming procedurally similar tasks of international economic diplomacy and governance. At the same time, it differentiates international tax from other areas of international economic regulation because of the OECD Model. In doing so, the Article provides a high-profile example of how the character of underlying legal institutions can alter the implementation prospects of international regulatory agreements.