

SYMPOSIUM ON RUTH MASON, “THE TRANSFORMATION OF INTERNATIONAL TAX”

WHAT IS UNILATERALISM IN INTERNATIONAL TAXATION?

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The Organisation for Economic Co-Operation and Development (OECD) recently emerged as the site of unprecedented, multilateral, and seemingly high-stakes negotiations about the future of international business income taxation. Judging by the political resources deployed in these negotiations, international tax has entered uncharted territory. Ruth Mason offers a timely and balanced portrayal of the OECD process so far.¹ But explanations of this process remain eminently contestable. On the one hand, international institutions that address externalities from uncoordinated actions and produce mutual benefits for participating nations can be highly stable. On the other hand, the OECD has struggled, whether in its Base Erosion and Profit Shifting (BEPS) and post-BEPS initiatives or during the pre-BEPS era, to articulate the goals for which international coordination in taxation is needed. By many accounts, recent discussions at the OECD are motivated mainly by the desire to stop foreign imposition of taxes on U.S. companies, or, as the other side of the same coin, to avert the wrath of the single hegemonic power in international tax. What is the best characterization of this conflict? I believe that understanding the underlying subject matter for international coordination, as opposed to merely the institutions that might facilitate such coordination, is required for identifying the coming transformation of international tax.

Without the Consent of the United States

Since 2017, the United States has in short succession withdrawn from the Paris Agreement on Climate Change, the Trans-Pacific Partnership, the Iran Nuclear Agreement, and myriad other multilateral agreements. The World Health Organization is only the latest international organization that the Trump administration has spurned, suffering a similar fate to other United Nations bodies, the World Trade Organization, the International Criminal Court, and NATO.² We seem to live in an age of unilateralism, with the world's most powerful country becoming the least reluctant to destroy expectations for international cooperation.

Yet in the world of international taxation, “unilateralism” has taken on the opposite meaning from what one might gather from general discourses. The term seems essentially to refer to actions taken “without the consent of the United States.” In March 2018, the European Council had proposed two directives for reforming international taxation—a longer-term proposal for allocating taxing rights according to a new notion of “significant economic presence,” which would require EU member states to renegotiate bilateral tax treaties, and a shorter-term proposal

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¹ Ruth Mason, *The Transformation of International Tax*, 114 AJIL 353 (2020).

² Alex Pascal, *Against Washington's “Great Power” Obsession*, ATLANTIC (Sept. 23, 2019).

for an EU-wide Digital Services Tax (DST) that would be consistent with existing tax treaties.³ The proposed directives failed to attract consensus, in substantial part because some member states feared that they would antagonize the United States: the digital platforms that would initially be subject to the DST comprised mostly of American companies. France, Spain, Italy, Austria, and the United Kingdom then moved towards enacting DSTs under their domestic laws, either using the 2018 European DST template or adopting similar designs.⁴ Yet these DST proposals quickly came to be known as *the* unilateral measures. They were widely demonized as threatening some longstanding status quo of international cooperation. Reading commentaries on international taxation in 2019, it was hard to avoid the impression that unilateralism was the most alarming development in the field—except that in this case the United States and its multinationals were the victims, and other countries the perpetrators.

This topsy-turvy world forms the subject of Mason's article. A first contribution of the article is to provide a compelling characterization of the international order, insofar as taxing business income is concerned, that pre-existed the OECD's BEPS initiative. Mason reminds us that at least among American tax lawyers, "international tax" has often been taken to be a misnomer: "each state makes its tax law independently of other states . . . international tax has consisted of a collection of isolated national tax regimes, connected on a piecemeal basis by bilateral tax treaties."⁵ Until just seven or eight years ago, the content of "truly" international tax consisted mostly of a Model Tax Convention maintained by the OECD. That Model Convention sports notions such as permanent establishment, arm's length transfer pricing, and avoiding double taxation—concepts and norms the significance of which may escape even the most attentive non-specialists. Mason also hints at, but does not dwell on, another important fact. The United States, through its domestic legislation, is the source of a long list of important principles and rules governing income taxation of cross-border transactions. That list includes, among others, the ideas of a foreign tax credit, controlled foreign corporations, limitations on earning stripping and conduit financing, a branch profit tax and dividend equivalent payments, and denying treaty benefits to "hybrid" entities.⁶ The United States introduced these rules regardless of whether other countries were ready to embrace them. Even in its bilateral tax treaties, the United States succeeded systematically to incorporate rules that it would asymmetrically apply to itself, such as limitations of treaty benefits.

Essentially, since the 1950s, the United States has been a hegemonic power in international income taxation. Unilateralism is second nature to the country. Not infrequently, other countries borrowed American "international tax" rules and enacted them in their own domestic laws. (It would perhaps be appropriate to put such imitative enactments under Mason's label, "coordinated unilateralism.") But at other times, the outcome was more discordant. In the years before the launch of the BEPS project, the most important and controversial development in international taxation was the U.S. decision to coerce foreign financial institutions into sharing information on foreign accounts held by American citizens.⁷ And as recently as 2017, the United States enacted a Base Erosion and Anti-Abuse Tax (BEAT), which imposed a tariff equivalent on what it regarded as excessive payments from the United States to foreign related parties. Both the policy coherence and treaty compatibility of

³ [Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence](#), COM (2018) 147 final (Mar. 21, 2018); [Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services](#), COM (2018) 148 final (Mar. 21, 2018).

⁴ For a review, see Wei Cui, *The Digital Services Tax on the Verge of Implementation*, 67(4) CANADIAN TAX J. 1135–1152 (2019). For new UK legislation, see [Finance Bill 2019-21 \(2020\)](#), Parliament: House of Commons. Bill no. 114., Part 2, § 38–71.

⁵ [Mason](#), *supra* note 1, at 353–54.

⁶ See Reuven Avi-Yonah, *Constructive Unilateralism: U.S. Leadership and International Taxation*, 42(2) INT'L TAX J. 17 (2016).

⁷ Itai Grinberg, *The Battle Over Taxing Offshore Accounts*, 60 UCLA L. REV. 304–383 (2012); Ruth Mason, *Citizenship Taxation*, S. CAL. L. REV. 89, 169 (2016).

BEAT are controversial.⁸ What is *not* controversial is that the BEAT not only was unilateral but also defied pre-existing international tax norms.⁹

In short, the international tax status quo that, by Mason's arguments, has recently been transformed was one in which developed countries' norms, and especially the hegemonic norms of the United States, shaped national expectations, but in which little explicit multilateral coordination could be found. Bilateral tax treaties constrained some actions of contracting states, but left ample room for others. This raises the question: Why has the international tax world become so sensitive to unilateralism since 2018?

What is Multilateralism for?

Mason's analysis of the BEPS initiative is inextricably tied to this issue. She argues that the BEPS process ushered in "major changes in the participants, agenda, institutions, norms, and legal instruments of international tax," while acknowledging the many critiques that have been made of the BEPS project. In a second important contribution, she also offers a neutral, even agnostic, discussion of whether the OECD can succeed to broker a global agreement regarding how to tax the digital economy. Mason's claim is that as a positive matter, a new set of institutions exist now that did not exist before. This raises the possibility that while "unilateral measures" like the European DST legislation are nothing new by reference to the pre-BEPS status quo, they represent defections from coordination under the post-BEPS regime. Whether multilateralism is the appropriate post-BEPS benchmark is thus the critical issue, both for evaluating Mason's claim that international tax is transformed, and for determining the significance of unilateralism today.

On this issue, Mason adopts a positive, as opposed to normative, narrative approach. For instance, in discussing the principles sponsored by the OECD, she reports a change from a pre-BEPS dogma of "no double taxation" to a post-BEPS slogan of "full taxation," without endorsing the soundness of either principle. The truth is that tax specialists have difficulty explaining even to themselves why these ideas are significant, or why multilateral coordination is needed to achieve them. Take the bogeyman of "double taxation". It is obvious that double taxation might have been a challenge when two countries could each tax the same corporate income at a 50 percent or higher rate—the 1950s scenario. It is less obvious what the problem is when the same income is taxed at 12 percent (or lower) in Ireland and again at 21 percent (or lower) in the United States—the scenario today. In fact, most countries adopt measures under their own domestic laws either to exempt foreign-source income from taxation, or to allow credits or deductions for foreign taxes paid. Consequently, double taxation, even when it might be a problem, is substantially alleviated by unilateral solutions.

As to the new norm of "full taxation", Mason aptly points out that we do not yet know what it means: does it mean taxation at 12 percent, 21 percent, or some higher or lower rate? Further, if "full taxation" conveys the goal to stop the abusive use of tax havens to generate "stateless income,"¹⁰ it has been persuasively argued that unilateral means often suffice to implement such a goal.¹¹ In fact, a careful reader can infer from Mason's review of the

⁸ Chris William Sanchirico, *Earnings Stripping Under the BEAT*, TAX L. REV. (forthcoming); H. David Rosenbloom & Fadi Shaheen, *The BEAT and the Treaties*, 92 TAX NOTES INT'L 53 (2018).

⁹ Pascal Saint-Amans, director of the OECD's Centre for Tax Policy and Administration, was quoted as saying that the United States, through enacting the BEAT, "passed a vote of no confidence" in the arm's length principle. Josh White, *OECD Looks Beyond the Arm's-Length Principle*, INT'L TAX REV. (Feb. 01, 2019).

¹⁰ Edward D. Kleinbard, *The Lessons of Stateless Income*, 65 TAX L. REV. 99 (2011).

¹¹ Dhammika Dharmapala, *Do Multinational Firms Use Tax Havens to the Detriment of Other Countries?* (CESifo Working Paper No. 8275, 2020).

substantive elements of BEPS that most of the BEPS measures could be, and have been, adopted by individual countries themselves.

In other words, it is not easy to rationalize the OECD tax forum as an indispensable international institution: What are the externalities of unilateral actions that must be addressed, and that countries are willing to address, through cooperation?¹² For the reasons just given, the invocation of either double taxation or double non-taxation does not answer this question. While it has long been thought that tax competition creates negative externalities, solutions to this problem have been elusive both in theory¹³ and in practice.¹⁴ The OECD certainly has not tackled tax competition in recent years. The implementation of BEPS recommendations may even intensify tax competition.¹⁵ If countries cannot agree on principles that genuinely require cooperation to implement, but can agree only on principles that do not require cooperation, it would be surprising for a transformative multilateral order to emerge.

Without knowing the benefits of cooperation under the post-BEPS OECD framework, the assertion that international taxation has been transformed becomes a purely positive claim that requires testing against alternative narratives. Although Mason acknowledges critiques of specific BEPS recommendations, she gives less attention to alternative characterizations of the BEPS process.¹⁶ Certain tensions in her narrative also generate skepticism. For instance, if, as by her account, institutionalized coordination pre-BEPS was minimal, one would not expect the OECD to be the site of deep tax policy prowess. While the OECD specialized in elaborating the language of tax treaties, this is not equivalent to “making extensive recommendations for changes to *domestic law*.”¹⁷ In that case, the claim that the OECD has a legitimate role because of its “deep technical expertise”¹⁸ sounds revisionist. Another example is the degree to which the BEPS initiative is legitimated by the Inclusive Framework. Mason presents the Inclusive Framework as a major element of international tax’s transformation. Yet in a treatment of the very same BEPS initiative published in 2016,¹⁹ the Framework was not even mentioned. This is because the Framework was only established in 2016, *after* the BEPS Action Plan was announced by the OECD and G20 in October 2015.²⁰

It is important to note these narrative tensions; when the gains from feasible cooperation are meagre, we should be aware that the push for “multilateralism” could come from interest groups in particular countries. The history of trade agreements offers ample illustrations of such possibility.²¹ The current effort led by the OECD to address

¹² See generally, Alan Sykes, *International Law*, in 1 HANDBOOK OF LAW AND ECONOMICS (A. Mitchell Polinsky & Steven Shavell eds., 2007).

¹³ Michael Keen & Kai Konrad, *The Theory of International Tax Competition and Coordination*, 5 HANDBOOK OF PUBLIC ECONOMICS ch. 5 (Alan Auerbach et al. eds., 2013).

¹⁴ See Lilian V. Faulhaber, *The Trouble with Tax Competition: From Practice to Theory*, 71 TAX L. REV. 311 (2018).

¹⁵ Richard Collier & Giorgia Maffini, *The UK International Tax: Agenda for Business and the Impact of the OECD BEPS Project* (Oxford University Centre for Business Taxation Working Paper 15/13, 2015).

¹⁶ See, e.g., Sissie Fung, *The Questionable Legitimacy of the OECD/G20 BEPS Project*, 10 ERASMUS L. REV. 76 (2017), which suggests that the OECD secretariat opportunistically interpreted G20 pronouncements as a political mandate to advance its work on BEPS, and began feeding the G20 with action plans, reports, progress updates, and other contributions of its own initiative.

¹⁷ Mason, *supra* note 1, at 369.

¹⁸ *Id.*

¹⁹ Itai Grinberg, *The New International Tax Diplomacy*, 104 GEO. L.J. 1137–1196 (2016).

²⁰ One criticism of the Inclusive Framework is thus that it was a framework for all countries in the world to implement an agenda set by the traditional OECD countries.

²¹ See, e.g., Keith E. Maskus, *Economic Development and Intellectual Property Rights: Key Analytical Results from Economics*, in 2 THE ECONOMICS OF INTELLECTUAL PROPERTY LAW (Peter Menell & David Schwartz eds., 2016).

tax challenges from digitalization of the economy also raises suspicion. As many commentators have recognized,²² this effort has morphed into one that posits only one criterion of success—whether it can shield American companies from the proliferation of DSTs.

A Transformation Underway

Nonetheless, Mason is right that developments in international tax deserve fresh attention from all students of international economic law. For quite different reasons from those she offers, I believe we now stand at the cusp of a genuine transformation of international tax.

Three new facts about international trade underlie this upcoming transformation.²³ First, digitization has vastly expanded global trade in services. Many digital services are produced and delivered at zero marginal cost, implying that producers must rely on market power to sell such services profitably. This is leading to a situation where many small countries could gainfully impose the equivalent of import tariffs on tradeable services.²⁴ Rather than competing to lower tax rates to attract capital, small countries are now likely to raise taxes on service imports used in either consumption or production.

Second, digital services can often be delivered simultaneously to multiple countries. This enhances the bargaining power of service-importing countries: “doing business elsewhere” becomes a less credible threat.

Third, much global digital commerce is asymmetrical for technological reasons. Research and development are driven by agglomeration economies. Large countries can build insurmountable advantages in generating data. This, ironically, renders the technologically powerful countries less capable of threatening retaliation. In response to tariffs on the services they export, they are limited to using tariffs on traditional, non-zero-marginal goods. This predicament arguably characterizes the United States’ situation today: if it is willing to slap an extra 25 percent tariffs on US\$1.3 billion worth of French goods just in retaliation for the DST,²⁵ what will it do when the EU counters with tariffs on American services and intellectual property?²⁶

New forms of national strategic behavior in the context of global services trade may generate new externalities, which in turn engender new rationales for international cooperation. At present, these externalities are not fully yet understood. But they may well redefine the subject matter of international taxation.

²² Peter A. Barnes & H. David Rosenbloom, *Digital Services Taxes: How Did We Get Into This Mess?*, 97 TAX NOTES INT’L 1255 (2020); Robert Goulder, *Rethinking the Taboo: Do DSTs Deserve Their Bad Rap?*, TAX NOTES INT’L (May 8, 2020).

²³ For a preliminary discussion, see *Cui*, *supra* note 4.

²⁴ In Robert Staiger & Alan Sykes, *The Economic Structure of International Trade-in-Services Agreements* (NBER Working Paper No. 22960, 2016), Staiger and Sykes argue that the structure of the General Agreement on Trade in Services can be explained if tariff-equivalents on services are impossible and physical establishments are required for trades in services. In the international taxation sphere, by contrast, momentum for reform has arisen precisely because much service trade no longer requires physical presence, and tariff-equivalents for services now abound.

²⁵ Stephanie Soong Johnston, *United States to Hit Back at French Digital Tax With New Tariffs in 2021*, TAX NOTES INT’L (July 20, 2020).

²⁶ Jakob Hanke Vela, *EU Looks to Target Big Tech in Trade War with America*, POLITICO (July 20, 2020).