

eJournal of Tax Research

Volume 2, Number 1 2004

CONTENTS

- 5 Editorial Announcement
- 6 The Cedric Sandford Medal
- 8 **Is an International Tax Organisation an Appropriate
Forum for Administering Binding Rulings and APAs**
Adrian Sawyer
- 71 Aligning Taxable Profits and Accounting Profits: Accounting
standards, legislators and judges
Judith Freedman
- 100 Towards an Electronic Filing System: A Malaysian survey
**Ming-Ling Lai, Siti Normala Sheikh Obid and Ahamed
Kameel Meera**
- 113 The Evolution of the Informal Economy and Tax Evasion in
Croatia
Katarina Ott
- 125 New Modalities in Tax Decision-Making: Applying
European experience to Australia
Yuri Grbich

Is an International Tax Organisation an Appropriate Forum for Administering Binding Rulings and APAS?⁺

Adrian Sawyer*

Abstract

This paper presents the results of ongoing research into developing a World Tax Organisation for advancing tax policy and practice. Specifically it focuses on the driving forces for such a body, including that of harmonisation and globalisation, along with forces of resistance, including that of national sovereignty. The paper reviews the contributions of various scholars and seeks to build upon their efforts, focussing particularly upon areas that could form part of the scope of this international organisation, namely binding rulings and advance pricing agreements. The paper is far from the definitive analysis of the surrounding issues; rather it is part of the author's ongoing research, including eventually developing possible operational aspects of a possible World Tax Organisation.

INTRODUCTION

With the increasing globalisation¹ of business activity, mobility of capital (and to a lesser degree individuals),² and the blurring of jurisdictional boundaries,³ the setting of domestic tax policy has taken on an increasingly international application. As a consequence of this international dimension, tax policy and practice cannot, or at least should not, be developed by a country in isolation of the international implications.⁴ Territorial tax competition, one potential outcome of international tax policies, has been criticised as an inefficient mechanism for economic activity when assessed from global perspective.⁵ International economic cooperation and policy coordination has

⁺ This is work derived from part of my SJD dissertation.

* Senior Lecturer, Department of Accountancy, Finance and Information Systems, University of Canterbury.

¹ Globalisation may be summarised as a metaphor for a way of describing a variety of non-linear processes of change on a global scale; see GORDON WALKER, *Introduction, to GLOBALIZATION AND SECURITIES REGULATION* (unpublished SJD thesis, Duke University, Draft 12/15/98), and Gordon Walker and Mark A. Fox, *Globalization: An Analytical Framework*, 3 *IND. J. GLOBAL LEGAL STUD.* 375 (1996).

² For a discussion on the implications of the mobility of capital, and to a lesser degree, of labour, see Reuven S. Avi-Yonah, *Globalization, Tax Competition and the Fiscal Crisis of the State* 113 *HARV. L. REV.* 1573 (2000).

³ See e.g. Jeffrey Owens, *Globalisation: The Implications for Tax Policies*, 14 *FISCAL STUD.* 21 (1993).

⁴ Globalisation has become the latest concept to "grab the attention" of tax commentators. It has been recognised as having a significant impact on taxation. See e.g., Vito Tanzi, *The Impact of Economic Globalization on Taxation*, 52 *BULL. FOR INT'L FISCAL DOC.* 384 (1998) and Jeffrey Owens, *Taxation within a Context of Globalization*, 52 *BULL. FOR INT'L FISCAL DOC.* 290 (1998). See also ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, *TAXING PROFITS IN A GLOBAL ECONOMY* 175-76 (1991). The Organisation for Economic Cooperation and Development is hereinafter referred to as the OECD.

⁵ See OECD, *HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE* (1998). See also Jeffrey Owens, *Emerging Issues in Taxing Business in a Global Economy*, in *TAXING INTERNATIONAL BUSINESS; EMERGING TRENDS IN APEC AND OECD ECONOMIES* 25, 42-44, (Richard Vann ed., 1997).

been suggested as important in the operation of the international monetary system,⁶ and with the growing internationalisation of business activities and investment,⁷ cooperation and coordination should also be debated in the context of international tax policy.

The international tax environment is changing rapidly.⁸ Social and economic conditions are changing almost constantly, along with a technological revolution that is challenging the traditional ways that tax systems operate to determine liability for tax. James⁹ suggests application of the STEP analysis, where relevant social, technological, economic and political factors are each examined in turn. James¹⁰ concludes that tax systems are likely to become more complex, that they will become increasingly global and more competitive.

Adopting international cooperation as the basis for setting tax policy is likely to produce benefits, and therefore international cooperation is an important theme throughout this paper.¹¹ Owens concludes with respect to the need for international cooperation¹²:

A more promising approach [than harmonizing tax systems] is to pursue multilateral convergence on three issues, with as many countries as possible involved in the process minimizing the number and size of measures in participating countries that are subject to deleterious spillover effects, agreeing on consistent and uniform responses to harmful measures elsewhere, and exploring more formal means of buttressing this understanding through international multilateral instruments.

The literature on international tax principles, globalisation, tax policy and international law within this context needs to be assimilated, synthesised and revisited in the light of developments in recent years, such as the growing importance of international transactions and derivation of income, and new challenges, such as the development of electronic commerce. Diverse views permeate throughout the pertinent literature, and some attempt at reconciliation, or at least revisiting in the context of the twenty-first century, seems warranted. This paper attempts to contribute to this enormous task to an observable degree with respect to binding rulings and advance pricing agreements (APAs). Nations are gradually moving away from their independence to forming interdependent relations with their neighbours, particularly their major trading partners.¹³ Thus, this paper, as part of a broader study, is timely from this perspective

⁶ See e.g. Jocelyn Horne and Paul R. Masson, *Scope and Limits of International Economic Cooperation and Policy Coordination*, 35 IMF STAFF PAPERS 259 (1988).

⁷ See e.g. John H. Dunning, *Introduction*, to GOVERNMENTS, GLOBALIZATION AND INTERNATIONAL BUSINESS 1, 1-28, (John H. Dunning ed., 1997).

⁸ Simon James, *The Future International Tax Environment*, 29 INT'L TAX J. 1 (1999).

⁹ *Id.* at 3.

¹⁰ *Id.* at 9.

¹¹ International cooperation on a scale greater than that currently experienced is seen as crucial to solving the fiscal problems of the twenty-first century, including the development of more multilateral tax treaties. See e.g. Jeffrey Owens, *Emerging Issues in Tax Reform: The Perspective of an International Bureaucrat*, available in LEXIS NEXIS Library, 97 TNI 245-23 (December 22, 1997). Owens emphasises the need for continual updating of the OECD's model tax convention, a coordinated response to the global communications revolution and harmful competition, and possibly harmonization of tax systems (at paras 175-178). See also Charles E. McLure, Jr., *Tax Policies for the XXIST Century*, in VISIONS OF THE TAX SYSTEMS OF THE XXIST CENTURY, 50 CONG. INT'L FISCAL ASS'N 9 (1997).

¹² Owens, *supra* note 11, at para 178.

¹³ Examples include the European Union (EU) (or European Community (EC)), the North American Free Trade Association (NAFTA), the Asia Pacific Economic Cooperative (APEC), the Association of South

and has the potential to make an important contribution to the literature and to the development of future international tax policy and practice. Development of a framework through the means of a best-fit response to key issues has the opportunity to facilitate future research and scholarship in this area.

Part of this framework necessarily involves some form of overarching international organisation to oversee and implement the proposals. In this paper, the organisation to undertake this role, a World Tax Organisation, is also used interchangeably with the title International Tax Organisation; both intended to represent the same proposed international body.

Furthermore, it is my contention that the phenomenon of cooperation has not evolved to a position whereby mutual considerations in devising, revising and implementing tax policy have been fully embraced, particularly on income that is derived across jurisdictional boundaries. A step down this path would be to include a mutually agreeable process in the areas of binding rulings and APAs that encompass business and income with cross-border implications. On the other hand, it could be argued that a mutual tax policy setting process in any area is a utopian ideal which in itself requires separate investigation and justification.¹⁴ Beyond the OECD countries, there are an immense number of developing and transition nations experiencing the implications of globalisation.¹⁵

The remainder of this paper is structured as follows. The next section provides further background to events and developments influencing tax policy worldwide, including globalisation and harmonisation. It also identifies a number of key issues and limitations associated with these concepts, including national sovereignty. Section three outlines key aspects of binding rulings and APAs, two related areas that I will argue are prime candidates for inclusion within the scope of a World Tax Organisation. Section four then discusses the potential makeup of a World Tax Organisation/International Tax Organisation (ITO) from the perspective of other scholars, interspersed with my observations. Section five provides some concluding observations.

GLOBALISATION AND INTERNATIONAL TAXATION POLICY AND PRACTICE

Tax Policy Developments – Key Issues

East Asian Nations (ASEAN), and Closer Economic Relations (CER), as between New Zealand and Australia.

¹⁴ In this paper I argue that a mutual policy process is more than a utopian ideal although its chances of success when viewed realistically are not high in the current environment. However, Weiss and Molnar have argued that international cooperation is possible and they present some possible models; see Arnold H. Weiss and Ferenc E. Molnar, *International Cooperation is Possible*, in *TAX POLICY IN THE TWENTY-FIRST CENTURY* (Herbert Stein ed., 1988).

¹⁵ For an excellent discussion of the issues and priorities for developing and transition countries in developing and refining their international tax policy, see Richard J. Vann, *International Aspects of Income Tax*, in *TAX LAW DESIGN AND DRAFTING* Vol. 2, 718, 808 (Victor Thuronyi ed., 1998).

OECD countries,¹⁶ representing the world's major developed industrial nations and several developing nations, have experienced significant changes in tax policy over the past ten to fifteen years; in fact the changes have reflected a high degree of simultaneity in implementation.¹⁷ However, in developing international tax policy, the United States is a major, if not dominant player, and has been so for decades.¹⁸ Consequently developments in the tax policy literature in the United States should prove fruitful in exploring the processes of setting international tax policy and its application in practice.¹⁹

In looking to the tax systems of the twenty-first century, a number of difficult questions need to be answered, including²⁰:

- What new problems do the future demographic and economic developments imply?
- What new tax bases will be available?

¹⁶ The 30 OECD member countries, as at the end of 1998, are: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, (Republic of) Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

¹⁷ Martin Hallerberg and Scott Basinger, *Internationalization and changes in OECD countries: The Importance of Domestic Veto Players*, 31 COMP. POL. STUD. 321 (1998). Internationalisation is cited by the authors as a major force in the downward convergence of tax rates (p. 322). The results, according to Hallerberg and Basinger, suggest that capital is mobile, seeking after favourable tax treatment (the phenomenon of tax competition). See generally KEN MESSERE, *TAX POLICY IN OECD COUNTRIES* (1993).

¹⁸ See e.g. Stanford G. Ross, *A Perspective on International Tax Policy*, 26 TAX NOTES 701 (February 18, 1985). In the context of advocating a United States tax regime that promotes consolidated worldwide income and taxes rather than focussing on nationalistic U.S. tax rules, see Stanford G. Ross, *US International Tax Policy: Where are we? Where should we be going?* 47 TAX NOTES 331 (April 16, 1990). For a more recent discussion by Ross on national versus international approaches to tax policy, see Stanford G. Ross, *National versus International Approaches to Cross-Border Tax Policy Issues*, 4 TAX NOTES INT'L 719 (April 8, 1992). Also, Ross provides a 20-year view of United States international tax; see Stanford G. Ross, *International Taxation: A 20-Year View*, 57 TAX NOTES 945 (November 12, 1992). Ross suggests that the United States international tax system is currently flawed (p. 946), and upon suggesting reforms, expresses his pessimism that reform will be achieved (p. 948). For an excellent discussion on the United States position on international taxation prior to the 1980s, see Charles I. Kingston, *The Coherence of International Taxation*, 81 COLUM. L. REV. 1,151 (1981), and for more recent developments, see Peter R. Merrill, *International Tax and Competitiveness Aspects of Fundamental Tax Reform*, in UNITED STATES INDUSTRY: RESTRUCTURING AND RENEWAL: BORDERLINE CASE: INTERNATIONAL TAX POLICY, CORPORATE RESEARCH AND DEVELOPMENT, AND INVESTMENT (James M. Poterba ed., 1997). For recent discussion on investment in the United States, see PRACTISING LAW INSTITUTE, *TAX LAW AND ESTATE PLANNING COURSE HANDBOOK SERIES, BACKGROUND ISSUES RELATING TO THE TAXATION OF FOREIGN INVESTMENT IN THE UNITED STATES* (1990), and Hugh J. Ault, *Corporate Integration, Tax Treaties and the Division of the International Tax Base: Principles and Practices*, 24 TAX L. REV. 565 (1992). Furthermore, in the context of key questions that corporations must ask when they decide to "go global", see William Zink, *Shrinking World Expands Relevance of International Tax Concepts*, 61 TAX'N FOR ACCT. 158 (1998).

¹⁹ One important facet of sound tax policy according to one scholar, is returning to general principles to ensure that there is consistency in purpose an application of international tax rules, see Barbara R. Rollinson, *Guidelines for Taxing International Capital Flows: An Economic Perspective*, 46 NAT'L. TAX J. 309 (1993).

²⁰ See International Fiscal Association, *Symposium Outline, in VISIONS OF THE TAX SYSTEMS OF THE XXIST CENTURY*, 50 CONG. INT'L FISCAL ASS'N 3 (1997). See also Mervyn King, *Tax Systems in the XXIST Century, in VISIONS OF THE TAX SYSTEMS OF THE XXIST CENTURY*, 50 CONG. INT'L FISCAL ASS'N 53 (1997). For a comparative discussion on the agenda for tax policy in the 1990s, see *Future Directions of International Tax Policy, available in LEXIS NEXIS Library*, 90 TNI 18-8 (May 2, 1990).

- What will happen with regard to existing main revenue sources – indirect taxes, labour taxation, capital taxation, and business taxation?
- What new means of control will tax administrations get and what new difficulties will they meet?
- Another commentator had observed with respect to tax policy in the twenty-first century²¹:

A way to focus attention on the importance of reforming the taxation of international income is to consider what the world will be like in the 21st century. It seems unquestionable that increasingly markets will become global, national power will equate heavily with economic power, and technology will lead to a world of faster communication and more transactions. Present tax rules based on geographic residence of taxpayers, the geographic source of income, and physical location of assets will become increasingly irrelevant to real business and economic activities. Applying these rules undoubtedly will impose an increasingly deadweight cost on commerce unless reformed.

Newer methods and better ways for countries and taxpayers to establish the amount of income and the appropriate jurisdiction to tax it are needed. There are far too few innovations in tax policy being considered today to meet the challenges of a rapidly changing world.”

McIntyre²² suggests six key guidelines for developing a coherent international income tax regime which would also be in the long-term interests of the United States. McIntyre’s guidelines may be summarised as:

- 1) employing worldwide taxation;
- 2) utilising source taxation;
- 3) allowing a foreign tax credit (or functional equivalent);
- 4) pursuing tax harmonisation;
- 5) adopting accrual taxation of foreign funds; and
- 6) employing formulary apportionment.²³

This notion of some form of international tax organisation to facilitate binding ruling and APAs forms part of the underlying thesis of this paper, and to be effective requires increased levels of tax harmonisation and possibly (but not necessarily) in the future formulary apportionment rather than the current arm’s length approach. These components are critical to enable coherent and effective international tax policy and practice to be implemented in an era of globalisation.

²¹ *Tax Policy Forum: US International Tax Policy: Where are we? Where should we be going?*, available in LEXIS NEXIS Library, 90 TNI 34-17 (1990). Emphasis added. The complexity of the international tax rules is in need of simplification, with a recent plea for action by multinationals to the Senate Finance Committee; see Tax Analysts, *Multinationals Beg Finance to Simplify International Laws*, TAX WIRE (March 11, 1999). Available at: < <http://www.tax.org/taxwire/taxwire.htm> >. (Visited March 12, 1999). For a discussion on forces that will shape tax policy in the twenty-first century, see also Vito Tanzi, *Forces that Shape Tax Policy*, in TAX POLICY IN THE 21ST CENTURY 266 (Herbert Stein ed., 1988).

²² Michael J. McIntyre, *Guidelines for Taxing International Capital Flows: The Legal Perspective*, 46 NAT’L. TAX J. 315 (1993).

²³ *Id.* at 315-6.

The internationalisation of domestic tax policy²⁴ has serious ramifications for governments as they jealously guard and protect their sovereign rights to tax their residents and income sourced in their jurisdiction²⁵ and, in some instances, their citizens.²⁶ These longstanding ideals are coming under greater pressure in the global effort by nations and tax administrations to secure the limited tax dollar.²⁷ In making this observation, the implications and spillover from the impact of globalisation, such as through moves to harmonise antitrust law²⁸ and commercial securities regulation by various international agencies²⁹ will play an important role as globalisation continues to have a profound impact upon taxation. Warren makes an important observation with respect to jurisdiction and taxation³⁰:

In developing an orderly system of taxation, each nation must decide upon which base, if any, it will choose to levy taxes. This tax base defines the limits of the nation's tax jurisdiction. Modern tax theory recognizes four conceptually different types of tax jurisdiction. Jurisdiction based on the source of income enables a nation to tax all income sourced within its borders irrespective of the taxpayer's nationality or residence. Territorial jurisdiction gives a nation the power to tax income only within its territorial limits. Residence based jurisdiction subjects all income of nation's residents to taxation, regardless of the source from which such income is derived. Finally, jurisdiction based on citizenship permits a nation to tax its citizens on all income earned throughout the world.

Jurisdiction is also a pivotal factor in the debate over whether income is effectively connected to a particular country so as to enable that country to tax the resulting income or consumption.³¹ Focusing on functional business tests and normative

²⁴ By domestic tax policy I am referring to tax policy developed for the purposes of a particular country in order to tax its residents and, to a lesser degree, non-residents on income sourced in that country, where that country is fully utilising its sovereign right to adopt its own tax system, such as a worldwide or territorial basis for ascertaining jurisdiction. For a discussion on territorial and worldwide tax systems, see ADRIAN OGLEY, *PRINCIPLES OF INTERNATIONAL TAX - A MULTINATIONAL PERSPECTIVE*, 22-25 (1993).

²⁵ For a discussion on jurisdiction, see Anthonie Knoseter, *TAXATION IN THE UNITED STATES AND EUROPE: THEORY AND PRACTICE*, 159-162 (Anthonie Knoseter ed., 1993).

²⁶ One example is the United States. Citizenship is advocated as important for simplifying the international jurisdiction issues associated with the United States transfer taxes, see Robert J. Misesy, *Simplifying International Jurisdiction for United States Transfer Taxes: Retain Citizenship and Replace Domicile with the Green Card Test*, 76 MARQ. L. REV. 73 (1992).

²⁷ See e.g. Avi-Yonah, *supra* note 2.

²⁸ See Eleanor M. Fox, *Harmonization of Law and Procedures in a Globalised World: Why, What and How?*, 60 ANTITRUST L. J. 593 (1992).

²⁹ For a discussion of globalisation and its impact on securities regulation, see WALKER, *supra* note 1, and Walker and Fox, *supra* note 1.

³⁰ Ronald M. Warren, *Investment in United States Property by Controlled Foreign Corporations: A Proposal for Reform*, 19 RUTGERS L. J. 367, 368-9 (1988).

³¹ For a discussion on importance of the force of attraction rules in the United States in order to ascertain whether income is effectively connected with a trade or business in the United States, see Harvey P. Dale, *Effectively Connected Income*, 42 TAX L. REV. 689 (1987). Dale provides an historical review and suggests (p. 749) three "modest" recommendations, including that the force of attraction principle be abolished from the Internal Revenue Code, that the new source rules be applied enabling use of the foreign tax credit, and for clarification of deductions, expenses and losses that are not sourced, but rather allocated or apportioned. For a discussion on valued-added tax (VAT) harmonisation and jurisdiction issues, see generally Craig A. Hart, *The European Community's Value-Added Tax System: Analysis of the New Transitional regime and Prospects for Further Harmonization*, 12 INT'L TAX & BUS. LAW. 1 (1994).

principles, rather than legal definitions, is advocated as the preferable manner to determine who is liable to pay United States taxes.³²

Currently there are numerous other international policy issues which need to be resolved in the twenty-first century. For example, such issues encompass dealing with changes in demographics, which in itself creates a series of sub-issues, including inducing greater demand for increased user charges, emergence of an austerity environment, international factor mobility and the growing integration of the world economy, and virtual computerisation of all transactions.³³

Tax policy and international trade³⁴

A further approach to viewing international tax policy and its application is that of recasting it in parallel with the theory of international trade. Slemrod identifies two major advantages from this approach.³⁵ The first is that tax policy has at least as large an effect on the flow of goods across countries, the location of productive activity and the gains from trade as do trade policy instruments.³⁶ Secondly, reasoning applied in trade (free trade and costs of protectionism) is relatively non controversial among economists and therefore, argues Slemrod, should enable the debate to progress in the context of international taxation.³⁷

Tax policy and globalisation

It is an opportune time to undertake a study that examines the impact that globalisation is having on domestic economies and the world economy. Such a study would be enormous to say the least, and thus only small portions can be handled at any one time.

Economic globalisation is a historical process, the result of human innovation and technological progress.³⁸ It refers to the increasing integration of economies around the world, particularly through trade and financial flows. The term sometimes also refers to the movement of people (labour) and knowledge (technology) across international borders. There are also broader cultural, political and environmental dimensions of globalisation that are not covered in this paper.

³² See Yoseph M. Edrey, *Taxation of International Activity: FDAP, ECI and the Dual Capacity of an Employee as a Taxpayer*, 15 VA. TAX REV. 653, 670-1 (1996). Edrey proposes his approach in the context of 26 I.R.C. §871(a) (1986) for income from sources within the United States. For a discussion of the improved consistency and reflection of sound tax principles for the income source of isolated sales in 26 IRC §865 (1986), see Carlo Garbarino, *A Study of the International Tax Policy Process: Defining the Rules for Sourcing Income from Isolated Sales of Goods*, 29 HARV. INT'L L. J. 393 (1988). Several problems in application to non-residents are suggested by Garbarino.

³³ See James M. Poterba, *Tax Policy in the Twenty-First Century*, in TAXATION TO 2000 AND BEYOND (Richard M. Bird and Jack M. Mintz eds., Canadian Tax Paper No. 93, 1992) and HERBERT STEIN (ed.), TAX POLICY IN THE TWENTY-FIRST CENTURY (1988).

³⁴ A detailed discussion on international trade is beyond the scope of this paper although institutions such as the World Trading Organisation will feature as part of the consideration of models for a world tax organisation.

³⁵ Joel B. Slemrod, *Free Trade and Protectionist Taxation*, available in LEXIS NEXIS Library, 94 TNI 63-28 (April 1, 1994). Slemrod concludes that the impact of international tax policy on the functioning of capital markets will increasingly arise as a central concern for policymakers. Slemrod also observes that harmonising of corporate tax rates via multilateral means should be pursued.

³⁶ *Id.* at 471.

³⁷ *Id.* at 471.

³⁸ International Monetary Fund, GLOBALIZATION: THREAT OR OPPORTUNITY? (April 12, 2000; Corrected January 2002). Available from <http://www.imf.org/external/np/exr/ib/2000/041200.htm#II> (visited 17 February 2004).

At its most basic, there is nothing mysterious about globalisation. The term has come into common usage since the 1980s, reflecting technological advances that have made it easier and quicker to complete international transactions - both trade and financial flows. It refers to an extension beyond national borders of the same market forces that have operated for centuries at all levels of human economic activity - village markets, urban industries, or financial centres.

The concept or phenomena of globalisation³⁹ has implications not only in the context of its impact on trade and business, but also with respect to its impact on nation states and people, especially cultural groupings. One of the critical issues affecting international taxation currently is that globalisation has now become a tax problem rather than merely an issue for financial markets.⁴⁰

Globalisation requires, or perhaps forces, a high degree of consensus policy and appropriate mechanisms to cater for the innovations that it has spawned, such as in the internationalisation of financial markets.⁴¹ Globalisation clearly brings pressure to bear on traditional tax principles,⁴² and is an issue that confronts tax policymakers for three principle reasons.⁴³ First, globalisation offers firms and businesses more freedom over where they locate. The improvement in capital mobility with globalisation of financial markets facilitates this freedom. With the ascendancy of residence-based taxation (or locale of a permanent establishment⁴⁴), businesses can choose to operate from tax havens or countries with lower corporate tax rates with greater ease.⁴⁵

Second, globalisation makes it hard to ascertain where a corporation or enterprise should pay tax, regardless of where it is based. This applies particularly to multinational enterprises that can exploit transfer pricing⁴⁶ rules to their advantage, subject to the vigilance of revenue authorities. Electronic commerce facilitates manipulation of this uncertainty by hampering the ability to verify the accuracy of profits and locale of sales.⁴⁷

Third, globalisation has made it easier for individuals, especially skilled professionals, to take the benefit, for example, of earning consultancy income overseas and saving or investing their income on a global scale. In essence, globalisation increases the level of competition for what appears to be a potentially decreasing tax base in higher tax

³⁹ For the present purposes, globalisation is defined as a metaphor for a way of describing a variety of non-linear processes of change on a global scale; see WALKER, *supra* note 1 and Walker and Fox, *supra* note 1.

⁴⁰ See Avi-Yonah, *supra* note 2, Owens, *supra* note 3, and Tanzi, *supra* note 4.

⁴¹ See generally WALKER, *supra* note 1. See generally, LORRAINE EDEN, *TAXING MULTATIONALS: TRANSFER PRICING AND CORPORATE INCOME TAXATION IN NORTH AMERICA* (1998) (globalisation in the context multinational enterprises and financial markets).

⁴² See Joel Slemrod, *Tax Principles in our International Economy*, in *WORLD TAX REFORM: CASE STUDIES OF DEVELOPED AND DEVELOPING COUNTRIES* (Michael J. Boskin and Charles E. McLure, Jr. eds., 1990).

⁴³ See *Disappearing Taxes: The tap runs dry*, *ECONOMIST*, May 31, 1997, at 19-21.

⁴⁴ See generally ARVID A. SKAAR, *PERMANENT ESTABLISHMENT: EROSION OF A TAX TREATY PRINCIPLE* (1991).

⁴⁵ See *Disappearing Taxes: The tap runs dry*, *supra* note 43, at 19-21.

⁴⁶ Transfer pricing refers to the problem of allocating profits among the parts or members of a corporate group. It typically involves shifting income to lower tax jurisdictions to lower the tax burden for the group as a whole. See Richard J. Vann, *International Aspects of Income Tax*, in *TAX LAW DESIGN AND DRAFTING* Vol. 2, 718, 808 (Victor Thuronyi ed., 1998), at 781. See also JILL C. PAGAN AND J SCOTT WILKIE, *TRANSFER PRICING STRATEGY IN A GLOBAL ECONOMY* (1993).

⁴⁷ *Disappearing Taxes: The tap runs dry*, *supra* note 43, at 21.

jurisdictions. Such competition may be dominated by the larger players through cooperative oligopolies (implemented by way of modified tax treaties) or through misuse of a dominant position, where powerful tax havens promote the benefits of their services to a larger group of potential clients.⁴⁸

An appreciation of the implications of globalisation is vitally important to developing (international) tax policy.⁴⁹ Globalisation may be contrasted with the notions of internationalisation⁵⁰ and regionalisation,⁵¹ both of which have received attention in the literature.⁵²

Globalisation, Internationalisation or Regionalisation?

Delbrück defines internationalisation as "... a means to enable nation-states to satisfy the national interest in areas where they are incapable of doing so on their own."⁵³ He also introduces the concept of renationalisation in the context of ethnic and religious conflict since the end of the Cold War. Delbrück also suggests renationalisation is present in the European Union.⁵⁴

According to Stace⁵⁵ there are three waves of internationalisation that may be observed: the commodity exporter phase of the 1940s-1970s, the global opportunist phase of the 1980s (characterised by financial deregulation), and the exporter and insider phase of the 1990s (looking beyond national boundaries, and taking advantage of technology and utilising natural advantages). Stace goes on to contrast internationalisation and globalisation, in relation to firms, in the following manner⁵⁶:

⁴⁸ *Id.*

⁴⁹ Luc Hinnekens, *Territoriality-Based Taxation in an Increasingly Common Market and Globalizing Economy: Nightmare and Challenge of International Taxation in this New Age*, E.C. TAX REV. 156 (1993).

⁵⁰ See e.g. Hallerberg and Basinger, *supra* note 17.

⁵¹ See e.g. TAKATOSHI ITO AND ANNE O. KRUEGER, REGIONALISM VERSUS MULTILATERAL TRADE ARRANGEMENTS, (Takatoshi Ito and Anne O. Krueger eds., National Bureau of Economic Research Seminar on Economics, Vol 6, 1997), Allen J. Morrison and Kendall Roth, *The Regional Solution: An Alternative to Globalization*, 1 TRANSNAT'L CORP. 37 (1992), and KENICHI OHMAE, THE END OF THE NATION STATE: THE RISE OF REGIONAL ECONOMIES (1995).

⁵² For a useful discussion of these terms, see WALKER, *supra* note 1.

⁵³ Jost Delbrück, *Globalization of Law, Politics and Markets – Implications for Domestic Law – A European Perspective*, 1 IND. J. GLOBAL LEGAL STUD. 9 (1993), at 11. This is part of a feature on globalisation, the outcome of a symposium held at Indiana University School of Law in 1993. The other papers presented and published in volume 1 of the *Indiana Journal of Global Legal Studies* on point are: Alfred C. Aman, Jr., *Introduction*, 1 IND. J. GLOBAL LEGAL STUD. 1 (1993); Martin Shapiro, *The Globalization of Law*, 1 IND. J. GLOBAL LEGAL STUD. 37 (1993); S. Tamer Cavusgil, *Globalization of Markets and its Impact on Domestic Institutions*, 1 IND. J. GLOBAL LEGAL STUD. 83 (1993); and William J. Davey, *European Integration: Reflections on its Limits and Effects*, 1 IND. J. GLOBAL LEGAL STUD. 185 (1993). See also David P. Fidler, *International Law and Global Public Health*, 48 U. KAN. L. REV. 1, 9 (1999) (discussing globalisation in the context of global public health and the World Health Organization). See also RAMESH MISHRA, GLOBALIZATION AND THE WELFARE STATE 15-16 (1999), at 3-4. With internationalisation, nation states remain the principal units for economic activity through international aspects of the economy, with trade and multinational enterprises of increasing importance to economic activity.

⁵⁴ Delbrück, *Id.* at 10-11. The European Union is hereafter the E.U.

⁵⁵ DOUG STACE, REACHING OUT FROM DOWN UNDER: BUILDING COMPETENCE FOR GLOBAL MARKETS, Ch. 1 (1997).

⁵⁶ *Id.* at 18. MISHRA, *supra* note 53, at 4, refers to globalisation proper as to a situation where distinct national economies cease to exist in that they are subsumed and rearticulated into the system by international processes and transactions. Mishra does not believe that the world is currently experiencing globalisation proper but rather internationalisation, although he uses the term globalisation to incorporate internationalisation; *Id.* at 4.

Internationalization: Cross national flows of goods and services effected by enterprises by either export/import or direct investments abroad involving operations in one or a number of countries. Globalisation: A more advanced form of internationalisation involving the increasing spread of economic activities across national and regional borders, characterized by global products, global innovation and global competition.

Globalisation may also be compared to nationalism, which can be seen as both a reaction against globalisation and is a product of globalisation.⁵⁷ In this regard Harris states⁵⁸:

Globalisation forces a rethinking of the role of the nation state, its degree of autonomy in setting policies, and the degree to which national economics can usefully be analysed as separate units. It may well be that inter-national economics may become obsolete and be replaced by a focus on either the regional (time zone) economy or the global economy.

Regionalism involves a significant degree of geographical proximity and a high degree of economic interdependence to be successful. It involves a process of growing informal linkages and transactions derived primarily from economic activity but involving social and political interconnectedness.⁵⁹ Regionalism may involve a regional awareness or identity, interstate cooperation, state-promoted regional economic integration, or regional cohesion.⁶⁰ Regionalisation rather than full embracing of globalisation may be the preferable approach for United States Multi-National Enterprises (MNEs), although this recommendation was offered during the early period of financial globalisation, that is, the early 1990s.⁶¹

Globalisation and taxation generally

As noted previously, globalisation has a far reaching impact beyond just financial instruments and commercial securities regulation; it extends to the taxation treatment of such instruments, and to the derivation of income and transactions involving goods and services.⁶² As such, tax policy issues require resolution beyond the ability that any one nation has to conclude unilaterally, if global efficiency is to be maximised.⁶³

⁵⁷ Nationalism is also an ideology, a movement, and is clearly related to international relations as the moral and normative basis for the system of states in justifying secession and territorial claims; see FRED HALLIDAY, *Nationalism*, in THE GLOBALIZATION OF WORLD POLITICS 15 (J. Bayliss and S. Smith eds. 1997). Halliday also questions whether we are moving into a post-nationalist age, and observes that nationalism has not disappeared; it fact it has benefited from globalisation as in part from resentment over globalization and through adjustment to continue to be relevant (*Id.* at 371-2).

⁵⁸ R. G. Harris, *Globalisation, trade and income*, 26 CAN. J. ECON. 773 (1993), cited in STACE, *supra* note 55, at 18.

⁵⁹ See FIONA BUTLER, *Regionalism and Integration*, in BAYLIS AND SMITH, *supra* note 57, at 410. For further discussion on regionalisation within the world economy, see JEFFREY A. FRANKEL (ED.), THE REGIONALIZATION OF THE WORLD ECONOMY, (1998).

⁶⁰ *Id.* at 410-11.

⁶¹ See Morrison and Roth, *supra* n 51.

⁶² For a discussion on the taxation of financial instruments and derivatives in particular, see Reuven S. Avi-Yonah and Linda Z. Swartz, *U.S. International Tax Treatment of Financial Derivatives*, 14 TAX NOTES INT'L 787 (1997).

⁶³ In addition to maximizing efficiency, other fundamental principles such as certainty, simplicity, equity, etc, should also be considered. The world economy has become the area of interest and focal point of activity rather than individual sovereign jurisdictions viewed in isolation.

Tanzi⁶⁴ observes that the connection between globalisation and taxation is particularly complex because of its interconnection with tax competition and because of the large number of actors involved. Globalisation increases the scope for tax competition because it provides countries with an opportunity to export part of their tax burden to other countries. Some countries will use or even abuse this opportunity. Tanzi also notes that tax competition may magnify the inevitable effects of globalisation.⁶⁵ However, the complexity of the likely reactions of the countries makes the end result difficult to forecast.

Importantly, Tanzi contends that the fact that there is no world organization with the explicit responsibility to provide a sort of surveillance on the behaviour of countries in tax matters makes tax competition more likely.⁶⁶ Tanzi reiterates that tax competition is not always a good thing. In fact it may create difficulties for countries by⁶⁷:

- eventually leading to lower tax revenue;
- by changing the structure of tax systems in directions not desired by policymakers; and
- by reducing the progressivity of tax systems thus making them less equitable.

Harmonisation

Tax harmonisation may be viewed as one point on a continuum, which has total competition between nations to encourage investment in their jurisdiction at one extreme and complete harmonisation through identical tax systems (whether or not centrally administered) by all countries at the other extreme.⁶⁸ Countries may exhibit degrees of harmonisation or competition within their tax system. Harmonisation is a much debated issue, especially in the context of the E.U., where it has been fundamental to developing consistent indirect tax policy between member nations, but failed to gather any significant toehold for direct taxation.⁶⁹ One major factor in the reluctance for nations to harmonise taxes is that this impinges upon their sovereignty to set their own tax rates and base as considered necessary to meet the revenue needs and expenditure program set by the government.⁷⁰ This continuum is represented in

⁶⁴ VITO TANZI, GLOBALIZATION, TAX COMPETITION AND THE FUTURE OF TAX SYSTEMS, 4 (IMF Working Paper WP/96/141, 1996), at 20.

⁶⁵ *Id.*

⁶⁶ Tanzi has suggested elsewhere that a World Tax Organisation may be necessary. See Vito Tanzi, "Does the World Need a World Tax Organization?", paper presented at the 52nd Congress of the International Institute of Public Finance, Tel-Aviv, August 26-29, 1996. See also VITO TANZI, "Forces that Shape Tax Policy" in TAX POLICY IN THE XXI CENTURY, in Herbert Stein (ed.) (1988).

⁶⁷ Tanzi, *supra* n 64.

⁶⁸ For a definition of harmonisation, see e.g. Simon James and Lynne Oats, *Tax Harmonization and the Case of Corporate Taxation*, 8 REVENUE L. J. 36 (1998) and Simon James, *Tax Harmonization: What Does it Mean and What Form Should it Take?*, unpublished paper (1999). See also, Simon James, *Can we harmonise our views on European harmonisation?* 54 BULL. FOR INT'L FISCAL. DOC. 263 (2000).

⁶⁹ Part of the reason for the failure with direct tax harmonisation in the E.U. is the lack of a directive to do so in the Treaty of Rome forming the European Community; see TREATY OF ROME, Mar. 25, 1957, art. 99, 298 U.N.T.S. 11. Art. 99 mandates that signatories harmonise their indirect tax systems in order to achieve the free movement of goods and services within the common market. There is no equivalent article covering direct taxes although attempts have been made to find some basis for harmonising direct taxation in the E.U. The members of the unexpanded E.U. include Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom. For a discussion on why taxes should be harmonised, in the context of the E.U., see Jeff Bowman, *Harmonisation of Direct Taxation within the European Community: Some implications for Australia*, 19 AUST. TAX REV. 256 (1990), at 256-8.

⁷⁰ Sovereignty is discussed in a later section of this paper; see section 2.7.

Figure 1 below, which contains an example of each major point on the continuum currently in operation.

Figure 1: Competition/Harmonisation Continuum

<i>Competition</i>		<i>Cooperation</i>		<i>Harmonisation</i>	
<i>Unregulated</i>	<i>Regulated</i>	<i>Regional or Partial</i>	<i>Global or Full</i>	<i>Regional or Partial</i>	<i>Global or Full</i>
Tax havens	Anti-trust Global trading of securities	OECD NAFTA APEC/ASEAN	GATT/WTO U.N.	E.U.	???

Tax competition may be defined as “competition between different tax jurisdictions to encourage businesses and individuals to locate in their areas.”⁷¹ Debate continues over whether competition is desirable (it is certainly a fundamental concept underlying the free market system for global trading in goods and services and financial instruments), although a consensus has emerged in OECD nations at least, that competition, in the area of taxation at least, can be harmful and measures should be put into place to counter the distortions that arise.⁷²

Tax cooperation, from an international perspective, represents a position lying between the extremes of this continuum, whereby nations work together for their mutual benefit but stop short of imposing obligations upon each other to operate identical tax systems. Cooperation is evident in the work of the OECD for its 30 member nations, and perhaps the most extreme form of cooperation (that falls short of harmonisation) currently is the E.U.’s direct taxation initiatives, especially in relation to corporate taxation.⁷³ The largest example of cooperation on an international scale to date is between the original 134 nations (now over 180 nations) that ratified the General Agreement on Trade and Tariffs of 1994⁷⁴ and the concurrent creation of the World Trade Organisation in 1995.⁷⁵ While harmonisation is not expected to progress significantly, the case for increased tax cooperation is clear.⁷⁶

A further approach, tax unification, is discussed in the context of the E.U. by Hinnekens.⁷⁷ Tax unification is an advanced stage of tax harmonisation, which could

⁷¹ See Simon James, *The Future International Tax Environment*, 29 INT’L TAX J. 1, 9 (1999) (defining competition).

⁷² OECD, HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE (1998).

⁷³ See COMMISSION OF THE EUROPEAN COMMUNITIES, REPORT OF THE COMMITTEE OF INDEPENDENT EXPERTS ON COMPANY TAXATION (1992), [hereinafter the RUDING REPORT].

⁷⁴ Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Dec. 15, 1993, LEGAL INSTRUMENTS –RESULTS OF THE URUGUAY ROUND vol. 1 (1994), 33 I.L.M. 1 (1994). [Hereinafter referred to as the GATT].

⁷⁵ Marrakesh Agreement Establishing the World Trade Organization, LEGAL INSTRUMENTS-RESULTS OF THE URUGUAY ROUND, vol. 1 (1994) 33 I.L.M. 13 (1994). [Hereinafter referred to as the WTO.]

⁷⁶ James, *supra* note 71, at 9.

⁷⁷ Luc Hinnekens, *The Monti Report: The uphill task of harmonizing direct tax systems of EC member states*, 1 EC TAX REV 31 (1997), at 42-3. Hinnekens also uses tax coordination rather than tax cooperation and tax approximation (*Id.* at 43-45). See also RAMON J. JEFFERY, THE IMPACT OF STATE SOVEREIGNTY ON GLOBAL TRADE AND INTERNATIONAL TAXATION: SERIES ON INTERNATIONAL TAXATION:

be carried out in the E.U. through a supra-national European (Corporation) Tax. Such a proposal is dismissed by Hinnekens as falling outside the European Community's objectives and, in reality, is impossible to achieve in the context of the proposals I develop in this paper.

A hurdle in making further progress in the E.U. over direct tax harmonisation has been the absence of specific harmonisation requirements in the European Treaty.⁷⁸ A further frustration in some instances is the requirement for unanimous agreement.⁷⁹ In regional groupings which extend beyond one particular agreement, unanimity is more important than with only a single agreement that is left open for ratification and binding only on those that ratify⁸⁰ (assuming sufficient countries ratify the agreement to allow the agreement to be effective).⁸¹ Some form of super-majority endorsement procedure⁸² is recommended over a simple majority (greater than 50 percent) or a slow ratification approach (such as until unanimous ratification occurs).

Tax havens have been raised as an obstacle to establishing a unanimous agreement in the context of how they create unfair competition.⁸³ However, tax havens are extremely unlikely to be a party to any agreement in setting tax policy, given their reluctance to enter tax treaties in many instances.⁸⁴ However, certain OECD member countries that offer significant tax concessions, such as Ireland, Luxembourg and Sweden, are possible participants or signatories to the proposed international agreement.⁸⁵ Furthermore, it will be important to have transition and developing nations that are able to meet the criteria of an advanced and stable tax system, to be members of this international tax policy setting agreement.

Tax policy and coordination

Markets promote efficiency through competition and the division of labour - the specialisation that allows people and economies to focus on what they do best. Global markets offer greater opportunity for people to tap into more and larger markets around the world. It means that they can have access to more capital flows, technology, cheaper imports, and larger export markets. But markets do not necessarily ensure that the benefits of increased efficiency are shared by all. Countries

NO 23, (1999), at 133-168 (discussing the need for tax coordination in the E.U. and the rest of the (developed) world).

⁷⁸ TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Feb. 7, 1992, O.J. (C 224) 1 (1992), [1992] 1 C.M.L.R. 573 (1992) [hereinafter referred to as the EC TREATY]. The EC TREATY, however, provides for indirect tax harmonization between member nations. See BEN TERRA AND PETER WATTEL, EUROPEAN TAX LAW, (2 ed., 1997). For a discussion of a recent recommendation for harmonisation of direct taxes within the E.U., see the RUDING REPORT, *supra* note 73.

⁷⁹ In the OECD this is overcome by members abstaining from voting rather than vetoing the arrangement, such as with the agreement over harmful competition; see OECD, *supra* note 5. In the E.U., the decision for several countries, including the United Kingdom, not to join, however, did not prevent monetary union from taking effect on January 1, 1999.

⁸⁰ For instance, the OECD's mutual assistance agreement; see OECD, MULTILATERAL CONVENTION ON ADMINISTRATIVE ASSISTANCE IN TAX MATTERS (1995).

⁸¹ One instance of where this has been a "failure" within the OECD is the multilateral agreement on information sharing; see OECD, *id*; but relative success with the OECD's discussion paper on curbing harmful tax competition; see OECD, *supra* note 5.

⁸² A majority vote in the range of 75 to 80 percent would be necessary for ratification.

⁸³ See OECD, *supra* note 5, on harmful tax competition.

⁸⁴ For a discussion on United States tax haven activity, see GARY C. HUFBAUER AND JOANNA M. VAN ROOIJ, U.S. TAXATION OF INTERNATIONAL INCOME: BLUEPRINT FOR REFORM, ch. 3 (1992), at 152-6.

⁸⁵ For instance, Luxembourg and Switzerland abstained rather than voted against and therefore would prevent the release of the OECD's report on harmful competition; see OECD, *supra* note 5.

must be prepared to embrace the policies needed, and in the case of the poorest countries may need the support of the international community as they do so.

Commentators have also suggested that the current approach to handling international tax issues through bilateral treaties is outdated and inefficient,⁸⁶ reinforced by the philosophy behind the first League of Nations Model Treaty,⁸⁷ and as subsequently developed by the OECD. The OECD's contributions initially were in an era when the U.S. was a primarily an exporter of capital, preferring capital export neutrality and a residence-based taxation approach.⁸⁸

Owens⁸⁹ considers the option of co-ordination or 'peaceful co-existence'. Here the objective is to have tax systems which are responsive to market forces, which can reflect the specific situation found in each country and which at the same time do not interact in ways which adversely affect the international allocation of resources. Co-ordination, argues Owens,⁹⁰ can play a useful role in preventing large countries taking unilateral actions which impose costs on other countries, particularly on small, open economies. Only by co-ordination, contends Owens,⁹¹ can a certain degree of national autonomy be maintained in tax policy. The question is, can this be achieved and if so, how? Owens aptly suggests that any new initiatives should build upon the existing instruments and existing institutions, including the current large network of tax treaties.

Owens suggests that the following initiatives could be added to assist with coordination:⁹²

- 1) *Developing guidelines for the use of tax incentives.* This would require agreement on what constitutes a tax incentive, how its cost should be measured, and its likely effects. The [New Independent States] (NIS), the eastern European countries, the EC and NAFTA countries - or more ambitiously the OECD countries - would be in a position to implement such agreements. A second option would be to encourage the development of internationally comparable tax expenditure accounts so that cross-country comparisons of the significance of deviations from the normal corporate tax regimes could be evaluated. Thirdly,

⁸⁶ See e.g. Richard J. Vann, *A Model Tax Treaty for the Asian-Pacific Region* (Part 1 and 2), 45 BULL. INT'L FISCAL DOC. 99, 103 (1991), 45 BULL. INT'L FISCAL DOC. 151 (1991), and John Azzi, *Tackling Tax Treaty Tensions: Time to Think about an International Tax Court*, 52 BULL. INT'L FISCAL DOC. 344, 349-50 (1998).

⁸⁷ *Report Presented by the Comm. Of Technical Experts on Double Taxation and Tax Evasion*, League of Nations Doc. C216 M.85 1927 II (1927), and see e.g. Michael J. Gratez and Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 DUKE L. J. 1021 (1997), for a discussion of this treaty.

⁸⁸ For a discussion on capital export neutrality versus capital import neutrality, see GARY C. HUFBAUER AND JOANNA M. VAN ROOIJ, U.S. TAXATION OF INTERNATIONAL INCOME: BLUEPRINT FOR REFORM, ch. 3 (1992), and Daniel J. Frisch, *The Economies of International Tax Policy: Some Old and New Approaches*, 47 TAX NOTES 581 (1990). Capital export neutrality refers to a system where a resident of a country will be taxed at a given rate regardless of where the income is generated, see C. Neil Stephens, *A Progressive Analysis of the Efficiencies of Capital Import Neutrality*, 30 LAW & POL'Y INT'L BUS. 159, 161 (1998). This may be compared to capital import neutrality, which is a system where a resident of a country will not be taxed at a given rate regardless of where the income is generated. Taxpayers are taxed based on the source of their income, that is, only the country where the income is generated has taxing authority over the income, see Stephens, *Id.* at 163.

⁸⁹ Owens, *supra* n 3 at 41-44.

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.*

countries could be encouraged to move from tax allowances and holidays towards tax credits since this would improve the transparency of the subsidies (although cash grants would be even more transparent). Fourthly, the international community could try to develop common guidelines for the types of tax incentives which would be eligible for tax-sparing provisions in countries which do not have the exemption system in their tax treaties (although another solution would be to follow the United States approach which denies tax sparing altogether).

- 2) *Convergence of taxes on income and capital.* The OECD and other international organisations should encourage a gradual convergence of the income tax regimes in developed countries by:
 - a) Monitoring developments and trying to get agreement on the economic and other effects of different taxing techniques; and
 - b) Examining new developments, particularly in financial markets, with the aim of reaching an international consensus on how these developments should be treated for tax purposes and thereby pre-empting national legislation.
- 3) *New guidelines for allocating income and expenses within an MNE.* The implementation of the guidelines should be monitored and backed up by new forms of co-operation such as simultaneous examinations and advance transfer pricing agreements.
- 4) *Facilitating exchange of information.* A new framework should be put in place to facilitate the exchange of information and other assistance measures on a multilateral basis. In a global economy, even an extensive network of bilateral treaties is a second-best solution to a multilateral approach which provides a uniform application and interpretation of provisions.
- 5) *Compulsory arbitration.* The mutual agreement procedure set out in Article 25 of the OECD Model Tax Convention is time-consuming for both taxpayers and tax administrators and there are a very small number of cases where no agreement is reached. It is also unclear how far businesses avoid using this procedure because of these problems. Owens states that this raises the question of whether we can go beyond this article to establish a compulsory arbitration procedure and a multinational arbitration body (similar to the GATT panels).
- 6) *From bilateralism to multilateralism.* It is unlikely that countries would accept replacing the existing bilateral treaty network with a series of multilateral treaties. There are, however, a number of measures which could improve the operation of the existing bilateral treaty network, either by providing for more uniform provision or for a more uniform interpretation. These include:
 - encouraging OECD and other countries to follow more closely the provisions in the OECD model;
 - within regional groupings and also at the level of the OECD, developing the concept of multilateral pre-negotiating sessions for bilateral discussions;
 - examining the feasibility of putting certain Articles (e.g. non-discrimination) onto a multilateral basis;
 - buttressing the status of the OECD commentaries by giving them greater legal force;
 - examining ways of having a multilateral adaptation of treaties to changes in national legislation (e.g. multilateral exchanges of letters, protocols, etc.);

- bringing in non-member countries to the discussion of the OECD's Committee on Fiscal Affairs so that they obtain a better understanding of the interpretation of the OECD model and have an impact on its ongoing revision.
- 7) Developing effective mechanisms for taxing interest payments received by non-residents. These are two interrelated ways to approach this problem, according to Owens. The first is to develop an effective exchange of information programme encompassing all countries (and not just the OECD countries) which are major financial centres. The second approach would be to develop a generalised withholding tax regime that would apply to all interest payments to individuals.

Owens emphasises that the challenge that policymakers face in this new interdependent environment, both in the old and new democracies, is to design tax policies that will improve the allocation of capital, reinforce market-oriented behaviour and lead to higher living standards for all. An international framework exists to achieve this co-ordination but the existing institutions should be given a wider mandate to develop some of the instruments referred to above, to monitor their implementation, and in the case of the OECD to reach out to non-member countries, particularly the Asian and Latin American countries which are now major players in the world economy.⁹³ Owens notes that it remains unclear as to whether national governments are prepared to see this framework strengthened so that national policies are determined within a multilateral framework. Only with such coordination can small and not-so-small economies reap the benefits of a global market system but maintain a high degree of economic sovereignty.⁹⁴

Owens concludes that to develop procedures for a co-existence of divergent tax systems is the challenge that faces tax policymakers in the twenty-first century. If they fail to respond to the challenge, they may find that a "little tax competition" is far more constraining than a "small amount of coordination".⁹⁵

Tax policy and treaties

Tax policy is determined by processes adapted to fit the aspirations of tax policymakers working under the delegated authority of government officials, usually with the interests of the sovereign nation foremost.⁹⁶ Only recently has some noticeable similarity in approach for devising and revising tax policy emerged, particularly in OECD countries through adoption of the OECD Model Tax Convention on Income and on Capital,⁹⁷ the OECD's Multilateral Convention on Administrative

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ For a discussion on tax policy processes in several nations, see Adrian J. Sawyer, *Broadening the Scope of Consultation and Strategic Focus in Tax Policy Formulation: Some Recent Developments*, 2 N.Z. J. TAX'N L. & POL'Y 17 (1996).

⁹⁷ OECD MODEL TAX CONVENTION ON INCOME AND ON CAPITAL (1995) [hereinafter OECD MODEL TAX CONVENTION].

Assistance in Tax Matters,⁹⁸ and the OECD's Transfer Pricing Guidelines.⁹⁹ Similar convergence is arising in the E.U., especially in the area of consumption taxes.¹⁰⁰

Currently there are three major model tax convention models, namely the OECD's Model Tax Convention,¹⁰¹ the United Nations Model Tax Convention¹⁰² and the United States Model Tax Convention.¹⁰³ While this study focuses on international tax policy issues, it is also important to appreciate that international tax policy is traditionally a product of domestic tax policy processes and efforts to arrive at some degree of international cooperation and agreement.¹⁰⁴ Important concepts in international taxation policy development include residence,¹⁰⁵ source,¹⁰⁶ the taxation of residents compared to non-residents,¹⁰⁷ destination and origin as consumption tax principles relating to jurisdiction,¹⁰⁸ the importance of neutrality and other traditional tax principles.¹⁰⁹ Other fundamental concepts warranting further exposition include harmonisation, cooperation and competition,¹¹⁰ and their impact upon sovereignty,¹¹¹

⁹⁸ COUNCIL OF EUROPE AND OECD, EXPLANATORY REPORT ON THE CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS, (1989). See also OECD, *supra* n 80.

⁹⁹ OECD, TRANSFER PRICING GUIDELINES FOR MULTILATERAL ENTERPRISES AND TAX ADMINISTRATIONS (1995).

¹⁰⁰ See various reports and commentaries on the results of the Ruding Committee Report (RUDING REPORT, *supra* n 73). Commentaries on this report include: Jens Blumenberg and Richard G. Minor, *Ruding Committee Report Unveiled: New Measures Proposed for Company Taxes in EC*, 4 TAX NOTES INT'L 563 (March 23, 1992); Michael Daly, *Harmonization of Corporate Taxes in a Single European Market: Recent Developments and Prospects*, 40 CAN. TAX J. 1051 (1992); and Maarten J. Ellis, *Direct Taxation in the European Community: An Irresistible Force Meets an Immovable Object*, 28 WAKE FOREST L. REV. 51 (1993). See also in this regard, MALCOLM GAMMIE AND BILL ROBERTSON, *Beyond 1992: A European Tax System: Institute for Fiscal Studies' Commentary No. 13.*, in PROCEEDINGS OF THE FOURTH INSTITUTE FOR FISCAL STUDIES RESIDENTIAL CONFERENCE, (Malcolm Gammie and Bill Robertson eds., 1989).

¹⁰¹ OECD MODEL TAX CONVENTION, *supra* note 97.

¹⁰² U.N. DEP'T OF INT'L ECONOMICS & SOCIAL AFFAIRS, UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES at 243, U.N. Doc. ST/ESA/102, U.N. Sales No. E.80.xvi.3 (1980) [hereinafter U.N. MODEL TAX CONVENTION].

¹⁰³ UNITED STATES MODEL INCOME TAX CONVENTION OF September 20, 1996 [Hereinafter referred to as U.S. MODEL TAX CONVENTION]. See in particular, the commentary by RICHARD L. DOERNBERG AND KEES VAN RAAD, 1996 US INCOME TAX CONVENTION: ANALYSIS, COMMENTARY AND COMPARISON (1997).

¹⁰⁴ See e.g. Sawyer, *supra* note 96.

¹⁰⁵ See e.g., RICHARD L. DOERNBERG, INTERNATIONAL TAXATION 19-20 (2d ed. 1993), at 19-20, and Vann, *supra* note 46, at 729.

¹⁰⁶ See Vann, *supra* note 46, at 734. See also Robert A. Green, *The Future of Source-Based Taxation of the Income of Multi-National Enterprises*, 79 CORNELL L. REV. 18 (1993), for a discussion on the future of source as a concept with application to MNEs. For a discussion on some of the problems in tax treaties relating to source, see John F. Avery Jones et al., *Tax Treaty Problems Relating to Source*, BRIT. TAX REV. 222 (1998).

¹⁰⁷ See e.g. DOERNBERG, *supra* note 105.

¹⁰⁸ See e.g. Luc Hinnekens, *The Challenges of Applying VAT and Income Tax Territoriality Concepts and Rules to International Electronic Commerce*, 26 INTERTAX 52 (1998) and Adrian Ogley, *VAT and Telecommunications Services in the European Union*, 14 TAX NOTES INT'L 1155 (April 7, 1997), discussing these concepts in the context of electronic commerce.

¹⁰⁹ For an excellent discussion on the role of source and residence principles and other important tax principles in international taxation for the twenty-first century, see Donald J.S. Breen, *Here or There? The Source and Residence Principles of International Tax*, in TAXATION TO 2000 AND BEYOND 303 (Richard M. Bird and Jack M. Mintz eds., Canadian Tax Paper No. 93, 1992).

¹¹⁰ See James, *supra* note 8, for a discussion on what is meant by harmonisation, and cooperation, as compared to competition.

¹¹¹ Sovereignty has political and cultural connotations which are relevant to this paper. Politically, sovereignty holds that the exercise of political authority can only take place within clearly defined territorial boundaries and that the territorial integrity of the modern nation-state is untouchable; see

and the role of tax treaties in protecting and relaxing sovereignty in an attempt to arrive at a consensus between signatories.¹¹² Culture is a further variable requiring consideration.¹¹³

Sovereignty – A key inhibiting factor

Crucial limitations or inhibitors to effectively implementing a multilateral agreement or treaty of the nature envisioned by this study exist, including a number of constitutional and jurisprudential concerns that could arise should a country be prepared to forgo or place restrictions on its sovereign rights to determine tax policy.¹¹⁴ Furthermore, the traditionally held stance that tax policy may be utilised to implement national social policy goals restricts the willingness of nations to give up further control over their tax system.¹¹⁵

Sovereignty¹¹⁶ has been raised in the context of international trade¹¹⁷ and regionalism,¹¹⁸ globalisation,¹¹⁹ subsidiarity in the E.U.,¹²⁰ and taxation.¹²¹ A related issue is that of how cultural differences between nations act as an inhibitor to closer harmonisation between nations.¹²²

In relation to taxation, sovereignty may be viewed as "... the power of a sovereign to affect the rights of persons, whether by legislation, by executive decree, or by the

Daniel Salée, *NAFTA, Quebec and the Boundaries of Cultural Sovereignty; The Challenge of Identity in the Era of Sovereignty*, in JOINING TOGETHER, STANDING APART: NATIONAL IDENTITIES AFTER NAFTA 73, 81, (Dorinda G. Dallmeyer ed., 1997). Cultural sovereignty may refer to groups of people within a nation-state or the nation-state itself (or a region), but this is increasingly becoming pluralistic; see *Id.* at 75.

¹¹² Bilateral tax treaties create numerous interpretation difficulties, a multilateral treaty is not dissimilar in this respect; see e.g. Russell K. Osgood, *Interpreting Tax Treaties in Canada, The United States and the United Kingdom*, 17 CORNELL INT'L L. J. 255 (1984). See also, PHILIP E. POSTLEWAITE, AND TAMARA L. FRANTZEN, INTERNATIONAL TAXATION: UNITED STATES TAX TREATIES, (1993), and Julie A. Roin, *Rethinking Tax Treaties in a Strategic World with Disparate Tax Systems*, 81 VA. L. REV. 1753 (1995).

¹¹³ See e.g. Salée, *supra* n 111, and Grant Richardson and Roman Lanis, *Harmonizing Taxation Law within APEC: A Fiscal and Cultural Analysis*, 50 BULL. FOR INT'L FISCAL DOC. 430 (1996).

¹¹⁴ For a discussion of how international organisations impact upon national sovereignty, see Lori Fisler Damrosch, "Sovereignty" and International Organizations, 3 U.C. DAVIS L. REV. 159 (1997).

¹¹⁵ See e.g. H. David Rosenbloom, *Sovereignty and the Regulation of International Business in the Tax Area*, 20 CAN.-U.S. L. J. 267 (1994). In the context of the European Community, see RUDING REPORT, *supra* note 73.

¹¹⁶ Here I am referring to sovereignty in the context of jurisdiction in disputes, where nations frequently assert national sovereignty over their territory, see Alan M. Simon and Spencer Weber Waller, *Essay: A Theory of Economic Sovereignty: An Alternative to Extraterritorial Jurisdictional Disputes*, 22 STAN. J. INT'L L. 337 (1986).

¹¹⁷ See Horacio A. Gregeria-Naon, *Sovereignty and Regionalism*, 27 LAW. & POL'Y INT'L BUS. 1073 (1996), and Ivo Van Bael, *Comments on "Sovereignty and Regionalism"*, 27 LAW. & POL'Y INT'L BUS. 1181 (1996) and Gary N. Horlick, *Sovereignty and International Trade Regulation*, 20 CANADA-U.S. L. J. 57 (1994).

¹¹⁸ See Gregeria-Naon, *supra* note 117.

¹¹⁹ See Philip R. Trimble, *Globalization, International Institutions, and the Erosion of National Sovereignty and Democracy*, 95 MICH. L. REV. 1944 (1997).

¹²⁰ See e.g. Paul D. Marquardt, *Subsidiarity and Sovereignty in the European Union*, 18 FORDHAM INT'L L. J. 616 (1994) and B.H. Ter Kuile, *Legal aspects of fiscal sovereignty within the internal market*, INTERTAX 503 (1991).

¹²¹ Rosenbloom, *supra* n 115.

¹²² See Richardson and Lanis, *supra* n 113, and Grant Richardson, Roman Lanis and Frank Clarke, *Cultural Impediments to the Harmonization of National Taxation Systems: The European Union Experience*, unpublished paper (1998). See also Daniel Salée, *supra* note 111.

judgment of a court... ”, and may be termed jurisdiction.¹²³ Sovereignty is the bundle of rights that go to make up the nation state, and is therefore analogous to statehood. The sovereign state is bound by its own constitution (internal dimension) and international law (external dimension).¹²⁴ Jurisdiction, on the other hand, refers to a state’s right of regulation manifested in its judicial, administrative and legislative competence. It is a subset of sovereignty and therefore increased jurisdiction cannot extend a nation’s sovereignty.¹²⁵ Jurisdiction has both personal¹²⁶ and territorial¹²⁷ bases. The territorial basis was created in a geographical context of physical nation states, a concept which now fails to represent the new integrated or globalised economy.¹²⁸ Sovereignty in relation to the power to tax has been interpreted to mean that in the absence of an agreement or treaty arrangements, the courts of one country will not recognise or enforce revenue judgments or orders made by the courts of other countries.¹²⁹ This position is under considerable pressure and threat from the increasingly globalised economy and the Internet.

Sovereignty creates a puzzle in that the sovereignty of a nation-state on the one hand figures importantly in the descriptions of, and prescriptions for, global political change.¹³⁰ By way of contrast, sovereignty, as a result of the contemporary realities of global affairs has, according to Lee, become irrelevant, an anachronistic notion. Global economic integration is the most significant factor that has restricted or perhaps rendered nonexistent the sovereignty of states.¹³¹ Nevertheless, Lee attempts to solve the puzzle how sovereignty can be both continually important and increasingly irrelevant to an understanding of world affairs. In the course of his argument, Lee presents sovereignty as four types of power, which are represented in Figure 2 below¹³²:

Figure 2: Mode of Power (or Sovereignty)

Locus of power (or sovereignty)	<i>De jure</i>	<i>De facto</i>
Officials	Legal power (sovereignty)	Coercive power (sovereignty)
Populace	Electoral power	Civil power

¹²³ Joseph H. Beale, *The Jurisdiction of a Sovereign State*, 26 HARV. L. REV. 241, 241 (1923). Beale only considers sovereignty and jurisdiction in the traditional physical realm, which at the time of his analysis, was the dominant perspective. While a sovereign’s jurisdiction would be limited to its territory, it could extend beyond that with the agreement with the sovereign of the other territory.

¹²⁴ Dale Pinto, *Globalisation and the Twilight of Fiscal Sovereignty: Is it the End of the Nation State?*, PROCEEDINGS OF THE 10TH ANNUAL AUSTRALASIAN TAX TEACHERS ASSOCIATION CONFERENCE (Sydney: Aust, Monash U., Feb. 2000), at 7. This study has since been published and updated; see Dale Pinto, *Through the World’s Eye: Governance in a Globalised World*, 9(3) MURDOCH U. ELEC. J. L. (September 2002).

¹²⁵ *Id.* at 7.

¹²⁶ Nationality or domicile of person, which forms the basis of residence in taxation.

¹²⁷ Traditionally regulation over persons and things within the geographical (or legal) boundaries of a state; the source basis of taxation.

¹²⁸ Pinto, *supra* note 124, at 8-9.

¹²⁹ *Id.* at 12. See generally Adrian J. Sawyer, *Enforcing New Zealand’s Tax Laws via International Tax Recovery Agreements*, 54 BULL. FOR INT’L FISCAL DOC. 34 (2000).

¹³⁰ Stephen Lee, *A Puzzle of Sovereignty*, 27 CAL. W. INT’L L. J. 241 (1997).

¹³¹ *See Id.* at 241-2.

¹³² *Id.* at 250.

	(sovereignty)	(sovereignty)
--	---------------	---------------

One interesting issue raised by another scholar in this area is that even if sovereignty is lost by a nation, is it necessarily lost irrevocably because someone else gains it?¹³³ Sovereignty is not a universally defined concept, a fact which contributes to the debate over the impact that globalisation is having on sovereignty, especially within its legal and political dimensions.¹³⁴ It can be argued that no sovereign states remain any more in Western Europe (the E.U. in particular), but this does not mean there is a sovereign European Community in their place.¹³⁵ The implication of this argument for rethinking jurisprudence and legal philosophy, however, is beyond the scope of this paper. Notwithstanding the argument that sovereign states no longer exist, sovereignty, or what is left of it, is jealously guarded (or raised in opposition to proposals for change), for example, by the European Member states when it comes to direct tax harmonisation¹³⁶ and to jurisdiction.¹³⁷ Therefore sovereignty remains a hurdle to be overcome if the proposed international tax policy setting and dispute resolution process is ever to become a practical reality.

In relation to the social impact of globalisation, there is a necessary trade-off between globalisation and sovereignty, which Rugman has illustrated by the following matrix, as set out in Figure 3¹³⁸:

Figure 3: Globalisation and Sovereignty

		Sovereignty	
		Low	High
Globalisation	High	1	3
		2	4

¹³³ See Neil MacCormick, *Beyond the Sovereign State*, 56 MOD. L. REV. 1, 11 (1993).

¹³⁴ See generally, *Id.*

¹³⁵ See *Id.* at 16.

¹³⁶ For instance, proposals for harmonizing direct taxation in the E.U. were largely rejected by the European Commission; for a discussion of the recommendations for change and accompanying comments, see RUDING REPORT, *supra* note 73. See also, M. Daly, *Annex 9A: Tax Coordination and Competition in Canada: Some Lessons for the European Community*, in the RUDING REPORT, at 383; P. Thalmann, *Annex 9B: Tax Coordination and Competition in Switzerland*, in the RUDING REPORT, at 397; Joann E. Weiner, *Annex 9C: Tax Coordination and Competition in the United States of America*, in the RUDING REPORT, at 417; Albert J. Rädler, *Annex 10A: Harmonization of Corporate Income Tax Systems within the European Community*, in the RUDING REPORT, at 439; and K. Messere, *Annex 10B: Dissenting View on the EC Corporation Tax System as Proposed in Annex 10A*, in the RUDING REPORT, at 461.

¹³⁷ See JEFFERY, *supra* note 77, at 25-60 (discussing sovereignty, jurisdiction and their interaction under international law, including fiscal jurisdiction;) see also *Id.* at 117-131, (discussing extraterritorial enforcement of revenue laws, such as by way of tax recovery agreements).

¹³⁸ ALAN M. RUGMAN, *Drawing the Border for a Multinational Enterprise and a Nation-State*, in LORRAINE EDEN AND EVAN H. POTTER (eds.), *MULTINATIONALS IN THE GLOBAL POLITICAL ECONOMY* 84-100, 86 (1993), at 89-91. The shaded area in quadrant 3 represents the current area where the problems of globalisation and sovereignty co-exist.

Low

--	--

Progress towards instigating some form of mutual policy process and international tax organisation will be challenged by obstacles and enhanced through various facilitating factors. To gain an appreciation of these obstacles requires a comprehensive review of the general constitutional, jurisprudential and in particular, the sovereignty environment, predominantly in OECD countries. A comprehensive analysis is beyond the scope of this paper. Jurisdictional preferences currently provided through national revenue statutes will need to be accommodated for in some manner if they are not to be an insurmountable hurdle to developing policy that maximises global revenue from an efficiency perspective.¹³⁹

It is anticipated that any recommendations culminating in a mutual tax policy setting process and appropriate form(s) of institution to resolve disputes associated with this process are expected to be contentious. To fully develop the proposals the necessary form of regulation or scope of a collective authority that is appropriate to facilitating a mutual approach, in the context of globalisation, need to be investigated. Furthermore, development of any policy and organisation is anticipated to require treaty modifications.¹⁴⁰ Not surprisingly, tax treaties and their interpretation will be a major factor in developing aspect of this study further, including multilateral treaties and the problems associated with arriving at an agreement.¹⁴¹

Determining a consistent tax base for application of tax policy is also important, (but beyond the scope of this paper), although consistency in tax policy, I would argue, extends beyond merely having a consistent tax base, to areas such as information disclosure and sharing, and employing fundamental principles consistently, such a taxation on a source or a residence basis. One further issue is whether any policy should have retroactive effect in particular defined circumstances.¹⁴²

¹³⁹ See *Id.* for a further discussion of taxation as a social expenditure and revenue raising instrument and national sovereignty.

¹⁴⁰ See Julie A. Roin, *Rethinking Tax Treaties in a Strategic World with Disparate Tax Systems*, 81 VA. L. REV. 1753 (1995). One area in which revision may currently be required is the non-discrimination rules; see Robert A. Green, *The Troubled Rule of Non-discrimination in Taxing Foreign Direct Investment*, 26 LAW & POL'Y INT'L BUS. 113 (1994). See also, H. David Rosenbloom, *Toward a New Tax Treaty Policy for a New Decade*, 9 AM. J. TAX POL'Y 77 (1991). One further advantage with a multilateral agreement is that treaty-shopping for the most favourable tax treatment should be reduced; see Mimi E. Gild, *Tax Treaty Shopping: Changes in U.S. Approach to Limitation on Benefits Provisions in Developing Country Treaties*, 30 VA. J. INT'L L. 553 (1990). Placing too much weight on tax treaties as they are currently employed can be futile – instances of domestic legislative override abound where inconsistent legislation is enacted after a treaty has been negotiated and ratified; the U.S. is especially “guilty” of this practice. See e.g. Committee on U.S. Activities of Foreign Taxpayers and Foreign Activities of U.S. Taxpayers of the New York State Bar Association Section of Taxation, *Legislative Overrides of Tax Treaties*, 37 TAX NOTES 931 (November 30, 1987), reprinted in TAX ANALYSTS, SELECTED READINGS ON TAX POLICY: 25 YEARS OF TAX NOTES, 434 (1997).

¹⁴¹ Several approaches have been applied to investigating how agreements may be arrived at or how disputes may arise, including the prisoners' dilemma, brinkmanship, and political grandstanding. For an example of the first, see the discussion in Robert D. Cooter, Symposium: *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U. PA L. REV. 1643 (1986).

¹⁴² For a discussion of the impact of retroactive taxation from an Australian and New Zealand perspective, see Warwick W. Anderson and Adrian J. Sawyer, *Legislative Complexity: The Need for Appropriate Variables and Some Likely Candidates*, 3 N.Z. J. TAX'N L. & POL'Y, 3 (1997) (providing a New Zealand comparative analysis to a prior Australian study).

Importance of globalisation for international tax policy

Lessard and Gagnon state:¹⁴³

The accelerated pace of globalisation of the world's economy is certainly the single most important factor explaining the rise in the importance afforded to international tax compliance issues. Rapid globalisation affects tax compliance issues in a number of ways. Multinational corporations are enlarging their web of subsidiaries and have increasingly complex international structures, while small and medium-sized businesses are becoming more import- and export-oriented in order to survive in the highly competitive global marketplace. Entrepreneurs, professionals, and highly skilled employees are increasingly receptive to opportunities offered to them abroad and are therefore more mobile than ever before. The foregoing has led to an increase in the proportion of corporate and individual taxpayers having an international exposure and, hence, access to international tax-planning opportunities to reduce their overall tax burden.

Globalisation has been facilitated by rapid technological changes which are rendering traditional fiscal sourcing rules obsolete. Online sales and marketing activities are diminishing the need for a permanent local sales work force, and reducing the number of circumstances where firms must maintain permanent establishments. Improvements made to telecommunications have undermined the importance of physical location for financial intermediaries. This has led to the establishment of international financial centres in places which would have simply been unthinkable in the past (such as Ireland and Barbados) in order to benefit from the fiscal advantages offered by those jurisdictions.”

Tanzi examines the impact of globalisation on taxation, including the growth in tax competition and how this may impact upon the future of taxation¹⁴⁴:

The benefits from the process of globalisation are many and some are obvious:

- a) world resources are better allocated; thus, output and standards of living rise;
- b) because of the greater access to foreign goods, individuals enjoy a greater range of choice in goods and services;
- c) because the cost of travel has fallen significantly (in time and money), many individuals are able to visit far away places;
- d) the amount and range of information available to individuals has increased enormously while the cost of getting information has fallen dramatically.

Tanzi goes on to observe¹⁴⁵:

The significance of these benefits [from the process of globalisation] can be easily appreciated. But, as is often the case, these developments also bring some negative aspects. Globalisation can create or aggravate, potential problems. It is, thus, important to control these negative developments so that they are prevented from becoming large enough to cast a bad light on the process of globalisation and to provoke policies aimed at reversing the recent trends. ...

¹⁴³ PIERRE A. LESSARD AND CHARLES C. GAGNON, *International Tax Compliance*, PROCEEDINGS OF THE 48TH TAX CONFERENCE (Can. Tax Foundation) 39:1-34, 1 (1996).

¹⁴⁴ Tanzi, *supra* n 64, at 4.

¹⁴⁵ *Id.* at 4. Emphasis added.

Globalisation implies that many national policies come to have effects beyond a country's borders. It, thus, tends to create frictions between the developments described above and traditional, national policies or institutions which, to a large extent, still reflect the closed-economy environment and thinking that existed when they were first developed or created. ...

The tax systems of many countries came into existence or developed at a time when trade among countries was greatly controlled and limited and when large capital movements were almost non-existent. ...

In the environment described above the application of what is sometimes called the "territoriality principle," which gives a country the right to tax all incomes and activities within its territory, did not cause conflict or difficulty. Tax policies by any one country could be pursued without much concern or much thought about how they would affect other countries. Equally, the tax policies of other countries were of only marginal, if any, interest to a country's policymakers because they did not affect the behaviour of its citizens. ...

Globalisation and the progressive integration of world economies have been changing all this. In the present environment the actions of many governments have come to be greatly constrained or influenced by the actions of other governments, and spillover-effects across frontiers generated by taxation have become common and important."

Tanzi concludes his study by stating¹⁴⁶:

The connection between globalisation and taxation is particularly complex because of its interconnection with tax competition and because of the large number of actors. Globalisation increases the scope for tax competition because it provides countries with an opportunity to export part of their tax burden to other countries. Some countries will use or even abuse this opportunity. Tax competition may magnify the inevitable effects of globalisation. However, the complexity of the likely reactions of the countries makes the end result difficult to forecast. The fact that there is no world organization with the explicit responsibility to provide a sort of surveillance on the behaviour of countries in tax matters makes tax competition more likely.

The world is waking up to the realization that tax competition is not always a good thing. In fact it may create difficulties for countries by (a) eventually leading to lower tax revenue; (b) by changing the structure of tax systems in directions not desired by policymakers; and (c) by reducing the progressivity of tax systems thus making them less equitable.

...The limited evidence available indicates that so far the effect of globalisation and tax competition on total¹⁴⁷ tax revenue has been limited. However, the impact on tax structures¹⁴⁸ is more evident. This impact is likely to accelerate with the passing of time. It is only a question of time before the level of taxation begins to reflect the forces at work.

¹⁴⁶ *Id.* at 20-21. Emphasis added. The issue of the absence of a world organization to undertake surveillance of countries with respect to tax competition is revisited by Tanzi. See also, VITO TANZI, *Is there a Need for a World Tax Organization?*, in ASSAF RAZIN AND EFRAIM SAKA (EDS.), *THE ECONOMICS OF GLOBALIZATION: POLICY PERSPECTIVES FROM PUBLIC ECONOMICS* 173 (1999) (discussing the possible role of a General Agreement on Trade, Tariffs and Taxes (GATT) as part of the WTO).

¹⁴⁷ Emphasis in original.

¹⁴⁸ Emphasis in original.

Globalisation is clearly highlighting the debate over the desirability of tax competition. Avi-Yonah argues, in this regard, that¹⁴⁹:

[t]he mobility of capital is linked to tax competition, in which sovereign countries lower their tax rates on income earned by foreigners within their borders in order to attract both portfolio and direct investment. ... Thus, globalisation and tax competition lead to a fiscal crisis for countries that wish to continue to provide social insurance to their citizens at the same time that demographic factors and the increased income inequality, job insecurity, and income volatility that result from globalisation render such social insurance more necessary. The result is increasing pressure to limit globalisation (e.g., by re-introducing exchange controls) which risks reducing world welfare.

Avi-Yonah argues that if both globalisation and social insurance are to be maintained, it is necessary to cut the intermediate link by limiting tax competition in a way that is congruent with maintaining the ability of democratic states to determine the desirable size of their government.¹⁵⁰

Pinto observes, in relation to the impact that globalisation is having on taxation policy, that¹⁵¹:

Leaving considerations of intensified tax competition aside, the sheer speed and borderless mobility of transactions in the globalise economy has called into question the ability to apply traditional transactional analysis inherent in transfer pricing laws. With no national borders, work on the same project can be undertaken in several countries, with intranets allowing the sharing of information. These new collaborative opportunities produce many challenges in applying traditional methods underlying transfer pricing rules. While globalisation and electronic commerce may not necessarily present any unique problems for transfer pricing, the growth of electronic commerce will be likely to make some of the transfer pricing problems more common.

Tax treaty concepts (such as permanent establishment) are also challenged by globalisation and new technologies. The combination of the Internet and globalisation has allowed taxpayers to operate internationally for low cost, 24 hours a day, 7 days a week. Global communication systems will see an increase in cross-border activities and may dispense with the need for businesses to maintain a sales force or distribution network to do business in a country. In a business sense, this means that simple and cheap access to global markets will be available and the barriers of distance and location have disappeared. In a legal sense, this puts pressure on concepts such as 'permanent establishment' contained in most double tax agreements that Australia has entered into.

In relation to the jurisdiction to tax, jurisdiction has traditionally been based on geographical territorial connections. Generally, therefore, entities or individuals need to be geographically located (resident) or the source of income needs to be located in a country for jurisdiction to be asserted. Practical jurisdiction depends on an identified taxpayer (and also assets) being located in a jurisdiction. While it may be argued that jurisdictional rules have always been a problem for revenue authorities, they have

¹⁴⁹ Avi-Yonah, *supra* note 2, at 1. Emphasis added.

¹⁵⁰ *Id.* at 1.

¹⁵¹ Pinto, *supra* note 124, at 14. Emphasis added.

been relatively contained, but now even smaller organisations can trade and bank globally, and location and identity become more difficult to determine.

Pinto goes on to observe¹⁵²:

In sum, the absence of borders and the lack of border controls undermines the jurisdictional rules of source and residency as they are currently formulated and applied. This is because transactions on the Internet occur everywhere, but nowhere in particular, or as one writer has put it ‘the trouble with cyberspace ... is that there’s no “there” there.

A related problem posed by globalisation and the Internet is the anonymity it offers and the difficulty of isolating where a transaction occurs.

...More pressure is brought to bear on tax laws by the intangible nature of many goods and services that can be delivered via the Internet. This challenges traditional rules relating to the characterisation of income as it blurs distinctions between the sale of goods, provision of services and royalties. This in turn impacts on source rules underlying various taxation regimes.

... Apart from differences between tax rates and tax bases that may produce distortions in the patterns of production and trade, the integration of the world economy produces other problems. One problem is that it becomes more difficult to determine which country is entitled to tax a particular transaction and a related difficulty is that practical enforcement can also be problematic, especially if an entity has no physical presence or assets in a jurisdiction in which it transacts its business.

...In conclusion, it may be stated that current tax systems of many countries reflect a period (before, during and immediately after the Second World War) when economies were closed and capital movements were much more limited. Today, the assumption of a closed economy has become increasingly anachronistic.

The Internet’s capacity to transform the world into global communities may see the displacement of some national law, as technology reduces the significance of sovereignty.

Electronic commerce is difficult to contain within geographically defined trade areas and frontier-based regulatory regimes. In a period of economic nationalism, laws were prima facie territorial and this reflected the general correspondence between physical space and law space. That is, geographical borders make sense in a physical world. In an integrated economy, however, territorial-based laws come under pressure, as geographical borders have little significance.

Globalisation has also created greater interdependency which in turn will have profound implications for tax systems. Owens identifies three key implications of this interdependency, namely¹⁵³:

¹⁵² *Id.* at 15-16. Emphasis added. Footnote references omitted. For further discussion on the implications of electronic commerce for governments and revenue authorities, and the administration of the tax system, see generally Adrian J. Sawyer, *Electronic Commerce: International Policy Implications for Revenue Authorities and Governments*, 19 VA TAX REV. 74 (1999).

¹⁵³ Owens, *supra* n 3, at 23. Emphasis added. Owens then examines the impact of international tax competition and mobile resources, competition for the tax base (the arm’s length price versus apportionment debate), and then outlines some options for governments.

- The base for taxes on income and wealth will become more geographically mobile and therefore more sensitive to tax differentials. This, in turn, will lead to a greater danger of tax competition between countries, with each country trying to attract a larger share of the global tax base.
- It will become more difficult to determine and to collect taxes on activities which take place outside a country's tax jurisdiction. This is not just a question of the volume of cross-border transactions increasing, but of their changing nature.
- The ways in which tax administrations carry out their 'business' will change. New technologies open up new ways of assessing and collecting taxes, and for co-operation between tax authorities in different countries.

Owens outlines his recommended options for governments to deal with the impact of globalisation of taxation policy and revenues, emphasising three key choices: entering into a process of full harmonisation of tax systems; allowing competitive forces to determine the design of each country's tax system; or undertaking greater coordination between the tax policies followed by countries.¹⁵⁴

Writing more recently, Owens is optimistic about the likelihood of a positive outcome from globalisation, although he identifies risks that such an outcome may not materialise.¹⁵⁵ For instance¹⁵⁶:

- *globalisation could lose its momentum* (such as the recent setback in Seattle [for the recent round of GATT talks]), particularly if the United States and Europe fail to provide the required leadership;
- *new barriers*, some of which may be tax barriers, *may be erected between financial markets*, increasing the cost of capital or denying access to innovative financial products;
- *regional blocks will become inward-looking*, leading to a rise in tensions between them;
- *citizens and government will revolt against the dominance of big business*; and
- *the nation state will be strengthened.*"

The implications for tax administrations, from Owens' perspective, assuming governments accept the challenges of globalisation, are¹⁵⁷:

- the rules that were developed in the physical economy may be seen as inappropriate for the virtual economy;
- governments would need to decide how to share the international tax base associated with the increasing number of very large multinational enterprises that dominate the world economy;

¹⁵⁴ *Id.* at 39.

¹⁵⁵ Jeffrey Owens, *Tax Administrations in the New Millennium*, 20 TAX NOTES INT'L 95 (Jan. 3, 2000). Emphasis added.

¹⁵⁶ *Id.* at 97.

¹⁵⁷ *Id.* at 97. Emphasis added.

- at the other extreme governments would also have to deal with the increase in the number of small and medium-sized enterprises engaged in international electronic trade;
- as consumers increasingly engage in cross-border electronic commerce, governments would find themselves having to adapt their consumption tax systems to this new global market place;
- tax administrations and policymakers would have to accept that many of the traditional concepts embedded in their tax systems are undermined by financial innovations (distinctions between debt and equity, between different sources of income);
- the new global environment may force countries to compete aggressively for investment that is increasingly footloose;
- individuals and corporations would exploit easier access to tax havens;
- governments may have to confront aggressive global tax planning on the part of corporations and individuals; tax minimization becomes just another entrepreneurial activity;
- highly paid wealth creators demand favourable personal income tax regimes before they are prepared to locate in a country; as executives become more mobile, issues arise on the tax treatment of their pensions; and
- issues would also arise on how to coordinate the interaction between European Union Value-added tax (VAT) systems, non-European Union VAT systems, and sales tax systems so as to avoid international double taxation or non-taxation.

Owens also identifies other emerging issues arising from globalisation, including the debate over transfer pricing or formulary apportionment,¹⁵⁸ global asymmetries arising from open financial markets, challenges to tax treaties and competent authority procedures,¹⁵⁹ ethical issues (such as harmful tax competition), the implications of taxation in cyberspace which require international consensus, and greater levels of international tax information exchanges.¹⁶⁰

Globalisation presents opportunities and challenges for global tax planning.¹⁶¹ In particular it necessitates consideration of finance costs (such as location of debt), capital structures (use of cross-border entities), provision of services (such as managerial and technical services provided cross-border) and product flows (inter-company sale and purchase transactions between high and low tax jurisdictions).

Thus globalisation, in conjunction with the growth in the internationalisation of financial markets and MNEs, requires tax authorities and governments to find new ways to balance the maintenance of their national tax revenues and their unwillingness to harm the international competitiveness of their domestic business systems.¹⁶² In

¹⁵⁸ A detailed discussion of this debate is beyond the scope of this paper. However, see section 2.9 of the paper for a summary of some of the key issues of the debate.

¹⁵⁹ This could include the possibility of a model OECD VAT treaty and the emergence of multilateral rather than the current tax treaties.

¹⁶⁰ Owens, *supra* note 155, at 97-104.

¹⁶¹ Allan R. Lanthier, *Taxation: Global Planning*, 131 CA MAG. 32 (Nov. 1998).

¹⁶² ASSAF RAZIN AND JOEL SLEMROD, *Introduction*, in ASSAF RAZIN AND JOEL SLEMROD (EDS), *TAXATION IN THE GLOBAL ECONOMY* 1-10 (1990).

the United States at least, reform of the current approach towards international tax policy is needed.¹⁶³

International tax policy must be revisited in the light of the impact that financial globalisation, in particular, is having on income generation and consumption. Furthermore, the international aspects of domestic tax policy must also be revisited. Wilkinson observes in relation to the impact of globalisation on tax policy that¹⁶⁴:

[I]n essence, the suggestion is that it is becoming progressively difficult for individual nations to pursue tax strategies without due reference to the implications of such policies in an international context. This is not to say that anything like an appropriate level of attention has been paid to international tax issues in the past. On the contrary, as pointed out by Ault and Bradford (1990)¹⁶⁵ in respect of the US situation, all too frequently: “International tax policy has been something of a stepchild in the tax legislative process. The international aspects of domestic tax changes are often considered only late in the day and without full examination.

Even beyond the need for countries to pay appropriate attention to the international implications of their tax policies is the fact that globalisation is progressively curtailing national fiscal sovereignty. Choice over tax policy alternatives is essentially being eroded. A discussion of tax reform issues at a symposium of OECD and non-OECD countries on tax reform was reported by Anderson (1990)¹⁶⁶ as indicating that:

While many of the recent reforms can be explained by domestic considerations, participants generally attached considerable importance to international factors. Tax distortions can be tolerated for much longer periods in a purely domestic context, perhaps because governments find the costs acceptable compared with the costs and disruption associated with reforms. However, with increasing internationalisation of economies and greater capital mobility, countries have also become more fiscally interdependent.

In a similar vein, Bird (1989)¹⁶⁷ has stated: “the existence of important capital flows, and their apparent sensitivity to national budgetary policy, inevitably constrains to some extent the freedom of national policy-makers to decide their own tax system.

Both Australia and New Zealand are facing the fiscal policy pressures brought about by globalisation along with many other OECD member nations. Therefore, what should be the role of international tax policy in the context of globalisation? It is well known that “The Art of Taxation consists of plucking the goose to obtain the largest number of feathers but with the minimum of hissing.”¹⁶⁸ In the context of electronic

¹⁶³ HUGH J AULT AND DAVID F. BRADFORD, *Taxing International Income: An Analysis of the U.S. System and its Economic Premises*, in *Id.* at 11-54.

¹⁶⁴ Brett Wilkinson, *Dividend Imputation in the Context of Globalisation: Extension of the New Zealand Foreign Investor Tax Credit Regime to Non-Resident Direct Investors*, 51 BULL. FOR INT'L FISCAL DOC. 363, 364 (1997). Emphasis added.

¹⁶⁵ AULT AND BRADFORD, *supra* note 163, at 11. Emphasis added.

¹⁶⁶ P. ANDERSON, *Overview of discussion on tax reform*, in OECD, TAXATION AND INTERNATIONAL CAPITAL FLOWS: A SYMPOSIUM OF OECD AND NON-OECD COUNTRIES 27-32, at 28 (1990), cited in Wilkinson, *supra* note 164.

¹⁶⁷ RICHARD M. BIRD, *International aspects of tax reform in Australia*, in JOHN G. HEAD (ED.), AUSTRALIAN TAX REFORM IN RETROSPECT AND PROSPECT 161-183 (1989), cited in Wilkinson, *supra* note 164.

¹⁶⁸ Attributed to Louis XIV's treasurer, and cited as Colbert's definition of taxation.

commerce, Pinto¹⁶⁹ refines this adage by stating: “In a globalised economy, the problem lies not in obtaining the greatest amount of feathers, but in getting hold of any at all, for the goose is more elusive than ever.”

According to Spence,¹⁷⁰ the first role of international tax policy should be to protect national tax revenues (via adequately taxing profits once and allocating that tax in a sensible manner to each revenue authority), while the second should be not to get in the way of the operation of the world economy based on open markets (a tax system which is fiscally neutral and which minimises distortions).¹⁷¹ As far as the international tax system is performing, in Spence’s view,¹⁷² it has a reasonable track record in the light of its history. However, the international tax system is a product of history, where tax policy and laws generally commenced from the proposition of dealing with domestic corporations and income, and then were modified to deal with the international implications, albeit with the appearance of an afterthought.¹⁷³ Spence’s prescription for the only practical way forward is to¹⁷⁴:

... build on the existing international framework. A step-by-step approach, which develops the current international standards on the principles which should apply to the taxation of international business, and which increases the effectiveness with which those international standards are applied in practice, by working through the essential detail, by adapting the rules to match up with commercial and business developments, and by getting tax authorities worldwide to apply the rules in a reasonably consistent fashion.

A blending of national and international tax policies is considered the most appropriate way to deal with the implications of globalisation, with national policies requiring increased modification to take account of changing international conditions.¹⁷⁵ Writing in early 1992, Ross¹⁷⁶ provides support for greater multilateral approaches to international tax relations, with measures similar to GATT considered to be necessary to deal with cross border issues, perhaps building upon OECD and E.U. initiatives such as the Convention for Mutual Administrative Assistance in Tax Matters.¹⁷⁷

Is national tax policy viable in the face of globalisation? This is the question that Mintz¹⁷⁸ seeks to answer in relation to how nation states may respond to globalisation.

¹⁶⁹ Pinto, *supra* note 124, at 16.

¹⁷⁰ Ian Spence, *Globalization of Transnational Business: The Challenge for International Tax Policy*, 25 INTERTAX 143 (1997).

¹⁷¹ *Id.* at 143.

¹⁷² *Id.* at 144.

¹⁷³ See also TANZI, *supra* note 146, at 20-21.

¹⁷⁴ Spence, *supra* note 170, at 146. Emphasis added. Spence, while not going as far as advocating an international organisation to undertake this task, however, in my view, overly endorses the OECD’s involvement in creating international standards that have proved tolerably robust and that the OECD has brought about a consensus in its transfer pricing guidelines. The arm’s length approach is far from settled in terms of the ongoing debate with formula apportionment, and that there are significant nations outside of the OECD that do not adhere to the OECD’s standards, such as China and Russia (former U.S.S.R.).

¹⁷⁵ Stanford G. Ross, *National versus International Approaches to Cross-Border Tax Issues*, 54 TAX NOTES 589 (1992).

¹⁷⁶ *Id.* at 593.

¹⁷⁷ COUNCIL OF EUROPE AND OECD, EXPLANATORY REPORT ON THE CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS, (STRASBOURG: Germany, Council of Europe, 1989).

¹⁷⁸ Jack M. Mintz, *Is National Tax Policy Viable in the Face of Global Competition?*, 19 TAX NOTES INT’L 99 (1999).

Mintz acknowledges that globalisation can make it more difficult to impose taxes on income and value-added taxes (VATs) with the difficulties in determining source and place of income for cross-border transactions.¹⁷⁹ Globalisation is identified to raise numerous implications for tax policy, including base erosion for very mobile tax bases facing high tax rates, preferences taxing industries with high economic rents, determining where mobile income is earned, the place where VAT transactions occur, reductions in withholding taxes on interest, royalties and fees, significant cross-border movement of employees, the taxation of financial services and the growth in electronic commerce.¹⁸⁰

This situation, in Mintz's view, necessitates some form of coordinated action from governments to reduce inefficiencies arising from tax exportation (setting too high taxes, affecting primarily non-residents) and tax competition (movement of income and taxpayers to other jurisdictions with lower rates).¹⁸¹

Mintz sets out five possible responses for governments to approach the effects of globalisation on tax policy¹⁸²:

- 1) Stop globalisation - the 'Island' mentality - an approach which countries are unlikely to take and is extremely risky for their future economic productivity;
- 2) Reduce the size of Government - a step back to the past. This is expected to occur if tax policies are not coordinated internationally through governments improving their efficiency and cutting back public services in response to lower tax revenues.
- 3) Change the tax mix, through greater reliance on less mobile tax bases (such as consumption and labour).
- 4) Globalise taxes with major trading partners through greater international coordination or harmonization, including possibly a global tax base and allocation process.¹⁸³
- 5) Creating a national advantage in global markets, such as through a coordinated national action plan, more competition, and a level playing field for the private sector.

One major effect of globalisation, in conjunction with liberalisation, is that while there may be improved resource allocation and prosperity around most of the world, the opportunities for tax evasion and avoidance have widened. This is particularly noticeable for income derived from profits, interest and dividends, which reflect a particularly mobile tax base, namely capital.¹⁸⁴ Globalisation has also changed the

¹⁷⁹ *Id.* at 100.

¹⁸⁰ *Id.* at 100-101.

¹⁸¹ *Id.* at 101.

¹⁸² *Id.* at 102-105. Emphasis added.

¹⁸³ This issue forms part of the intended role for an international organisation to monitor and implement international tax policy and for dispute resolution.

¹⁸⁴ See Steven Clarke and Flip de Kam, *OECD taxes revisited*, 214 OECD OBSERVER 28 (1998). See also Sven Steinmo, *The End of Redistribution? International Pressures and Domestic Tax Policy Choices*, 37 CHALLENGE 9 (1994), referring to the situation created by globalisation whereby the ease and availability of the exit option for those with large incomes and capital resources has dramatically increased, necessitating changes in tax structures and the level of intervention by governments. However, contrary to this view, Swank provides empirical evidence in his econometric study that there is little evidence to support the traditional view and that the direct effects of globalisation of capital

approach for tax advisers in providing advice to their clients, with the emphasis moving from the generalist to the extremely specialist with regard to international taxation.¹⁸⁵

Other issues

Other prominent issues that arise in the context of international tax policy and some form of international body include the importance of distinguishing between commitments between nations to maintain taxes at a certain level or to raise (or lower) taxes (or to alter an existing tax system),¹⁸⁶ and available methods of allocating tax revenues.¹⁸⁷ In regard to allocating tax revenues between jurisdictions,¹⁸⁸ two contrasting approaches should be examined (which have attracted widespread controversy and divided tax scholars and commentators¹⁸⁹), namely the current arm's length price (typically used in transfer pricing¹⁹⁰) and the unitary/formulary apportionment model (adopted by most states in the United States¹⁹¹ and in the

markets are associated with slightly higher business taxes and a diminution of tax policy responsiveness to the conditions that underpin investment; see Duane Swank, *Funding the Welfare State: Globalization and the Taxation of Business in Advanced Market Economies*, 46 POL. STUD. 671, 690-1 (1998). There is no evidence of any need to retrench social spending and public good provision; see *Id.* at 671.

¹⁸⁵ See Walter F. O'Connor, *Editor's Note*, 21 INT'L TAX J. iii (1995).

¹⁸⁶ Important in this respect are the directives on indirect tax in the E.U.; for a general discussion, see Barbara Crutchfield George et al., *The Dilemma of the European Union: Balancing the Power of the Supranational EU Entity Against the Sovereignty of its Independent Member Nations*, 9 PACE INT'L L. REV. 111 (1997), Sijbren Cnossen, *Company Taxes in the European Union: Criteria and Options for Reform*, 17 FISCAL STUD. 67 (1996), and Joann M. Weiner, *Company Tax Reform Efforts in the European Union*, 90 NAT'L TAX ASS'N CONF. 163 (1998).

¹⁸⁷ See e.g. Weiner, *supra* note 186.

¹⁸⁸ The argument I refer to here is that cooperation is preferable to competition in ascertaining allocation of revenue between nations as it is expected to produce overall higher levels of revenue that may be allocated between more nations than when left to competitive forces. See e.g. Alex Easson, *The Tax Competition Controversy*, 18 TAX NOTES INT'L 371 (1999) and Ravi Kanbur and Michael Keen, *Jeux Sans Frontières: Tax Competition and Tax Coordination when Countries Differ in Size*, 83 AM. ECON. REV. 877 (1993).

¹⁸⁹ See e.g. Mark B. Baker, *Redefining Taxation of International Entities: The Unitary Controversy (A Constitutional Approach)*, 14 DEN. J INT'L L. & POL'Y 35 (1985). This controversy has continued for the last twenty to twenty-five years.

¹⁹⁰ See e.g. Frances M. Horner, *International Cooperation and Understanding: What's New About the OECD's Transfer Pricing Guidelines*, 50 U. MIAMI L. REV. 577 (1996) and Reuven S. Avi-Yonah, *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation*, 15 VA. TAX REV. 89 (1995). See also JILL C. PAGAN AND J SCOTT WILKIE, *TRANSFER PRICING STRATEGY IN A GLOBAL ECONOMY* (1993), and Carl F. Steiss and Luc Blanchette, *The International Transfer-Pricing Debate*, 43 CAN. TAX J. 1566 (1995).

¹⁹¹ See e.g. Reuven S. Avi-Yonah, *Slicing the Shadow: A Proposal for Updating United States International Taxation*, 58 TAX NOTES 1511 (March 15, 1993). Avi-Yonah's suggestion is to solely use the sales component of the formula applying for state allocation of tax revenues. One unanswered question is whether this could be applied to a case study subject, such as electronic commerce. See also, Richard L. Doernberg, *Electronic Commerce and International Tax Sharing*, 16 TAX NOTES INT'L 1013 (March 30, 1998). With respect to formulary apportionment, see also Kevin K. Leung, *Taxing Global Trading: An Appropriate Testing Ground for Apportionment?*, 1 MINN. J. GLOBAL TRADE 201 (1992). For further discussion on the unitary method, see Frank Church and Richard D. Pomp, *The Unitary Method: Thirteen Questions and Answers*, 10 TAX NOTES 891 (June 16, 1980), reprinted in TAX ANALYSTS, *SELECTED READINGS ON TAX POLICY: 25 YEARS OF TAX NOTES*, 407 (1997). One further variation in apportionment is application of the national tax base theory to dividing the world tax base. This approach is proposed by Palmer, see Robert L. Palmer, *Toward Unilateral Coherence in Determining Jurisdiction to Tax Income*, 30 HARV. INT'L L. J. 1 (1989). For a study on proposals for dealing with the implications of electronic commerce, including that of multilateral agreements, see Pinto, *supra* n 124.

Canadian provinces¹⁹²).¹⁹³ Unitary taxation has been promoted by at least one commentator as the key to international tax harmony.¹⁹⁴ Issues that require resolution in adopting an international formulary apportionment can draw upon the existing experience of using unitary taxation.¹⁹⁵ The debate over which approach to determining allocation of income is beyond the scope of this paper – rather it is assumed that the arm's length price approach is to be maintained for the indefinite future.

Importance of the subject matter

I have outlined above in summary form the impact that globalisation is having on trade and business, and that the internationalisation of the world has changed the manner in which business is conducted. I also argued that investments are now made on an international scale, where national or territorial limits are no longer a dominant factor. Global trading¹⁹⁶ and the growth in multinational corporations¹⁹⁷ have in combination blurred the traditional tax concept of jurisdiction as it relates in particular to the source of income and residence of the taxpayer.¹⁹⁸ Competition for the tax dollar has the potential to accelerate the “race to the bottom”¹⁹⁹ in terms of lower tax rates and on occasions increased exclusions of income from the tax base or greater deferral (and provision for more deductions and allocations), especially for highly mobile capital and the growing numbers of upwardly mobile and highly skilled labour.²⁰⁰

¹⁹² See e.g. M. Daly, *Annex 9A: Tax Coordination and Competition in Canada: Some Lessons for the European Community*, in COMMISSION OF THE EUROPEAN COMMUNITIES, REPORT OF THE COMMITTEE OF INDEPENDENT EXPERTS ON COMPANY TAXATION 383, (1992).

¹⁹³ See e.g. Richard M. Hammer, *Will the Arm's Length Standard Stand the Test of Time? The Specter of Apportionment*, in ESSAYS ON INTERNATIONAL TAXATION 201-212 (Herbert H. Alpert and Kees van Raad eds., 1993). See also Michael J. McIntyre, *Contrasting Methodologies: A Systematic Presentation of the Differences between an Arm's Length/Source-Rule System and a Combined-Reporting/Formulary-Apportionment System*, in 87 NAT'L TAX ASS'N CONF. 226 (Frederick D. Stocker and Janet L. Staton eds., 1995), and Richard D. Pomp and Michael J. McIntyre, *Double Trouble: Double Taxation Aspects of Formulary Apportionment in the International Context*, in 87 NAT'L TAX ASS'N CONF. 236 (Frederick D. Stocker and Janet L. Staton eds., 1995).

¹⁹⁴ Lance C. Tyson, *Unitary Apportioning: A Key to Global Tax Harmony*, 22 INT'L TAX J. 35 (1996).

¹⁹⁵ Joann M. Weiner, *Using the Experience in the U.S. States to Evaluate Issues in Implementing Formula Apportionment at the International Level*, 14 TAX NOTES INT'L 2113 (1996). In addition, the national tax base theory developed by Palmer will be evaluated as a further alternative; see Robert Palmer, *Toward Unilateral Coherence in Determining Jurisdiction to Tax Income*, 30 HARV. INT'L L. J. 1 (1989).

¹⁹⁶ See OECD, *THE TAXATION OF GLOBAL TRADING OF FINANCIAL INSTRUMENTS* (1998), and Charles Thelen Plambeck, *The Taxation Implications of Global Trading*, 48 TAX NOTES 1143 (1990).

¹⁹⁷ See e.g. MARTIN FELDSTEIN ET AL., *THE EFFECTS OF TAXATION ON MULTINATIONAL CORPORATIONS* 153-177, (Martin Feldstein et al. eds., National Bureau of Economic Research Project Report, 1995).

¹⁹⁸ For a discussion on source and residence principles, see e.g. DOERNBERG, *supra* n 105.

¹⁹⁹ The race to the bottom concept comes from corporation law, with the typical example being the state of Delaware providing the most flexible corporate incorporation statute in the United States, attracting a disproportionate number of corporate officials choosing this state for incorporation. “Race to the bottom” in the tax area is represented in the outcome of competition between countries (or states within a country, such as in the United States) whereby tax rates are driven lower in an effort to attract more capital investment and skilled labour. See e.g. ERNST AND YOUNG, *THE FUTURE OF CORPORATE TAX IN THE EUROPEAN COMMUNITY* 41-44, (1991), and the RUDING REPORT, *supra* note 73.

²⁰⁰ See generally AVI-YONAH, *supra* note 2.

Traditional concepts and principles have changed in other fields such as finance, with global trading and efforts towards implementing multilateral agreements,²⁰¹ and trade, with the conclusion of the General Agreement on Trade and Tariffs (GATT)²⁰² in 1994, along with the establishment of the World Trade Organisation (WTO) in 1995²⁰³ to determine and resolve disputes over international trade in goods and services. Scholars have recognised the need for not only the United States international tax system to be reformed, but that internationally tax systems must face the challenges of the twenty-first century and beyond.²⁰⁴

In recognising the impact of globalisation on economic and social activity, another related development is the technological advances brought about through the Internet²⁰⁵ and electronic commerce.²⁰⁶ These social, technological, economic, and political developments, forming part of James' STEP analysis,²⁰⁷ create new tax challenges which must be addressed.²⁰⁸ This paper examines in part these

²⁰¹ See OECD, *THE TAXATION OF GLOBAL TRADING OF FINANCIAL INSTRUMENTS* (1998).

²⁰² Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Dec. 15, 1993, LEGAL INSTRUMENTS –RESULTS OF THE URUGUAY ROUND vol. 1 (1994), 33 I.L.M. 1 (1994). [hereinafter referred to as the GATT].

²⁰³ Marrakesh Agreement Establishing the World Trade Organization, LEGAL INSTRUMENTS-RESULTS OF THE URUGUAY ROUND, vol. 1 (1994) 33 I.L.M. 13 (1994). [hereinafter referred to as the WTO.]

²⁰⁴ See Stanford G. Ross, *A Perspective on International Tax Policy*, 26 TAX NOTES 701 (1985); In the context of advocating a United States tax regime that promotes consolidated worldwide income and taxes rather than focussing on nationalistic U.S. tax rules, see Stanford G. Ross, *US International Tax Policy: Where are we? Where should we be going?* 47 TAX NOTES 331 (1990). For a more recent discussion by Ross on national versus international approaches to tax policy, see Stanford G. Ross, *National versus International Approaches to Cross-Border Tax Policy Issues*, 4 TAX NOTES INT'L 719 (1992). Also, Ross also provides a 20-year view of United States international tax; see Stanford G. Ross, *International Taxation: A 20-Year View*, 57 TAX NOTES 945 (1992). Ross suggests that the United States international tax system is currently flawed (p. 946), and upon suggesting reforms, expresses his pessimism that reform will be achieved (p. 948). For an excellent discussion on the United States position on international taxation prior to the 1980s, see Charles I. Kingston, *The Coherence of International Taxation*, 81 COLUM. L. REV. 1,151 (1981), and for more recent developments, see Peter R. Merrill, *International Tax and Competitiveness Aspects of Fundamental Tax Reform*, in UNITED STATES INDUSTRY: RESTRUCTURING AND RENEWAL: BORDERLINE CASE: INTERNATIONAL TAX POLICY, CORPORATE RESEARCH AND DEVELOPMENT, AND INVESTMENT (James M. Poterba ed., 1997). For recent discussion on investment in the United States, see PRACTISING LAW INSTITUTE, TAX LAW AND ESTATE PLANNING COURSE HANDBOOK SERIES, BACKGROUND ISSUES RELATING TO THE TAXATION OF FOREIGN INVESTMENT IN THE UNITED STATES (1990), and Hugh J. Ault, *Corporate Integration, Tax Treaties and the Division of the International Tax Base: Principles and Practices*, 24 TAX L. REV. 565 (1992). Furthermore, in the context of key questions that corporations must ask when they decide to “go global”, see William Zink, *Shrinking World Expands Relevance of International Tax Concepts*, 61 TAX'N FOR ACCT. 158 (1998).

²⁰⁵ The Internet is a global information system [initially developed in the United States] that is logically linked together using TCP/IP protocols. The Internet provides electronic communication between users and access to gateways to other networks. There are three methods to access hosts over the Internet: they are telnet, FTP [File Transfer Protocol] and HTTP [Hypertext Transfer Protocol]. The Internet consists of thousands of independent, interconnected networks that span the globe. It is a global “network of networks” that connects more than 3 million computers. The Internet is a virtual space in which users send and receive e-mail, log on to remote computer (telnet), browse databases of information, World wide web, and send and receive files (FTP); see Ian W. Wallschutzky, *The Implications of Electronic Commerce for the Australian Income Tax System*, in TAX ADMINISTRATION: FACING THE CHALLENGES OF THE FUTURE 33, 50 (Chris Evans & Abe Greenbaum eds., 1998).

²⁰⁶ A comprehensive exposition of the tax implications of electronic commerce arising from this new technology ushered in by the Internet, see RICHARD L. DOERNBERG AND LUC HINNEKENS, *ELECTRONIC COMMERCE AND INTERNATIONAL TAXATION* (1999).

²⁰⁷ See James, *supra* note 8, at 3.

²⁰⁸ For an excellent early overview of the implications of globalisation on tax policies, see Owens, *supra* note 3.

developments and the challenges they create, and in doing so, develops possible approaches, in the context of binding rulings and advance pricing agreements, to formulating an international tax policy setting and enforcement mechanism for the twenty-first century where the global marketplace is the focus.

BINDING RULINGS AND ADVANCE PRICING AGREEMENTS (APAS)

Binding Rulings

Taxpayers frequently desire foreknowledge of the tax consequences of transactions either before the associated arrangements become unconditional, or at least before a tax return is filed and a tax position is taken concerning the arrangement. Such a system may enhance efficiency of business operations within a complex tax system, provide greater certainty for taxpayers and improve the administrative processes of government.²⁰⁹

Binding rulings normally have as the provisions of greater certainty to taxpayers and businesses as one of their major purposes rather than acting as some form of legislative power to the tax authorities that issue them. A growing number of countries have introduced or formalised their rulings systems rather than relying on administrative processes operated at the discretion of the tax authority. Essentially a binding ruling is a statement of the revenue authority's interpretation and application of tax laws to an arrangement, which is binding on the revenue authority in terms of the future application of the tax laws but not normally on the applicant.²¹⁰

The purpose of the New Zealand binding rulings regime is encapsulated in the legislation, a feature of the new philosophy behind New Zealand's legislative drafting style in the 1990s. Other countries that have developed binding rulings regimes have done so for similar reasons, along with recognising the benefits from following approaches taken overseas. Binding rulings in New Zealand are intended to provide taxpayers with certainty about the way that the Commissioner will apply taxation laws.²¹¹ In the discussion document that initially outlined the Government's proposals, two categories of certainty were identified: transaction certainty and compliance certainty.²¹² Transaction certainty was described as the form of business certainty that arises when taxpayers know in advance the tax treatment of their proposed transactions. Compliance certainty is the reassurance given to taxpayers that the arrangement will not be subject to a higher tax liability provided the terms of the arrangement are no different to that contemplated by the ruling. The second major purpose behind introducing binding rulings in New Zealand was to assist taxpayers in meeting their obligations under the law.²¹³

The purpose of this paper is not to provide an exhaustive analysis of binding rulings regimes; there is a considerable and growing literature on the topic.²¹⁴ However, one

²⁰⁹ See ADRIAN SAWYER, *Binding Rulings: A Comparative Perspective* in THE INTERNATIONAL TAXATION SYSTEM 291-315 (Andy Lymer and John Hasseldine eds. 2002).

²¹⁰ *Id.*

²¹¹ See section 91A Tax Administration Act 1994 (New Zealand).

²¹² NEW ZEALAND GOVERNMENT, *BINDING RULINGS ON TAXATION: A DISCUSSION DOCUMENT ON THE PROPOSED REGIME*, (1994).

²¹³ *Id.* at 5.

²¹⁴ In relation to New Zealand and Australia, see e.g., Wayne Mapp, *Binding Rulings*, 2 N.Z. J. TAX'N L. & POL'Y 139 (1996); Adrian J Sawyer, *Binding Tax Rulings: The New Zealand Experience*, 26 AUST. TAX REV.11 (1997); Adrian J Sawyer, *What are the Lessons for Australia from New Zealand's First Comprehensive Remedial Review of its Binding Rulings Regime?* 29 AUST. TAX REV. 133 (2000); and

aspect of binding rulings analysis that is highly relevant to this study is the results from comparative analyses of binding rulings regimes, such that the resulting similarities and differences will be an indicator of the level of effort required to gain a degree of harmonisation of binding rulings and advance pricing agreement practices.²¹⁵

In a study conducted by Sawyer in 2001²¹⁶ a brief comparative analysis of private rulings systems in twenty seven nations is provided,²¹⁷ with the private rulings systems in Australia, Canada, Sweden, United Kingdom and United States the main focus of comparison with the New Zealand regime. Sawyer concludes that there is surprisingly little in common between the regimes reviewed, apart from instances of one country/jurisdiction modelling its regime on that of another and adopting some of its features, or from mere coincidence.²¹⁸

The reason for such differences in regimes is frequently a side effect of historical practice, or merely a result of the freedom of choice or national sovereignty that each nation has to run its tax system.²¹⁹ However, such differences have implications for individuals and businesses that conduct business domestically, and more importantly, internationally, where the forces of globalisation are encouraging (or perhaps pressuring) convergence in many areas of business law, trade, and in various aspects of taxation law. Major differences in binding rulings regimes will create uncertainty when undertaking business activity.

A major hurdle to having an international system for recognising and developing rulings across borders is for consistency in domestic rulings systems. A majority of the regimes that were reviewed by Sawyer²²⁰ had a formal binding ruling regime in place as compared to a non-binding (or administrative) regime. However, those in Group One and Group Two were both split 1:1, with a clear majority of 2:1 having a formal system in Group Three jurisdictions.²²¹

In a subsequent study, Sawyer concludes²²²:

From the analysis undertaken by the International Report²²³ it could be argued that if there were no costs incurred as part of the trade-off with a comprehensive rulings model, then an expanded ruling system drawing upon the favourable aspects of the Australian and New Zealand systems (the

ADRIAN J. SAWYER, AN INTERNATIONAL COMPARISON OF BINDING RULINGS REGIMES: A REPORT FOR THE ADJUDICATION AND RULINGS DIVISION OF THE INLAND REVENUE DEPARTMENT (2001) (Hereinafter referred to as IRD Study).

²¹⁵ See Sawyer, *supra* n 209.

²¹⁶ See IRD Study, *supra* n 214.

²¹⁷ **Group One:** Australia, Canada, New Zealand, Sweden, United Kingdom and United States - the six major regimes, forming the first tier for analysis. **Group Two:** Belgium, Denmark, Finland, France, Hong Kong, India, (Republic of South) Korea, Mexico, the Netherlands and South Africa. These ten countries formed the second tier for analysis. **Group Three:** Germany, Hungary, Iceland, Ireland, Israel, Italy, Pakistan, the Philippines, Portugal, Spain and Switzerland. Interesting features of the regimes in these eleven countries formed the third tier for analysis.

²¹⁸ See IRD Study, *supra* n 214.

²¹⁹ Refer to section 2.7 of this paper for a discussion on the issues surrounding sovereignty.

²²⁰ See IRD Study, *supra* n 214.

²²¹ *Id.* For a brief description of these groups, see note 217 above.

²²² Adrian J. Sawyer, *Comparing New Zealand's Private Rulings System and its Features with a Selection of International Private Rulings Systems – What is There in Common?*, 5 J. AUST. TAX'N 440, 463-4 (2002).

²²³ See IRD Study, *supra* n 214.

former providing a comprehensive, free, ruling system with a full range of appeal options in the case of an adverse ruling, the latter a comprehensive, efficient user pays system without any access to an appeal facility for unfavourable rulings), might be a model for consideration for any country seeking to implement a new regime or overhaul its existing regime. Key considerations in any trade-off include the risks to the revenue, the level of resourcing required, and the need to maintain consistency in dealing with all applications for rulings. However, models in other countries also offer interesting features that could be considered in the New Zealand and Australian contexts.

Thus a major hurdle to be overcome is an improvement in the level of harmonisation of domestic regimes such that it is feasible to develop consistent application of binding rulings across jurisdictions. While this would require considerable effort and persuasion for nations to modify their systems, it is a necessary path to be followed if the proposals in this paper are to come to fruition. Hence, the above comment by Sawyer²²⁴ could be extended to suggest that the Australian and New Zealand binding rulings regimes could form the basis for harmonising other regimes.

Romano suggests that a centralisation of certain functions of the national rulings authorities in the E.U. with respect to advance tax rulings of relevance to European Community tax law would be a positive step.²²⁵ Romano further suggests that such a central body could function as a supervisory body on rulings policy, a collector of certain types of rulings requests and as a distribution centre of these requests amongst the competent offices. He also raises the possibility of a two-tier rulings procedure for certain European Community tax law issues of general interest for European investors, with a national authority of first instance and a central European authority as second instance.²²⁶ While this would be regional (i.e. the E.U.), the proposal has merit and could be considered in more broad terms such as for OECD members or wider still, such as to all U.N. members.

Romano concludes²²⁷:

From the analysis of advance tax rulings systems conducted throughout this dissertation, it would seem highly beneficial to have a harmonized advance tax rulings system at a domestic level throughout the European Union. Whether or not this would be politically acceptable is something that warrants further investigation.

- From a legal point of view, the advantages of a harmonization of advance tax rulings systems in the EU Member States are the following:
- to obtain a higher degree of certainty in the interpretation and application of tax law provisions;
- to have greater consistency and uniformity in the application and interpretation of the law;

²²⁴ Sawyer, *supra* n 222, at 463.

²²⁵ CARLO ROMANO, ADVANCE TAX RULINGS AND PRINCIPLES OF LAW: TOWARDS A EUROPEAN TAX RULINGS SYSTEM? 4 IBFD Doctoral Series (2002), at 471-2. Romano also defines what is meant by an advance ruling for his study (see p 485).

²²⁶ *Id.* at 470-2.

²²⁷ *Id.* at 499.

- to enhance the transparency of the decision-making process of the tax authorities in such a way as to improve the perception of the fairness of the tax obligations by taxpayers and thus tax compliance;
- to foster compliance with tax law and administrative practice;
- to improve the functioning of the self-assessment and self-reporting systems;
- to reduce tax litigation;
- to give the tax administrations the possibility to gather information from taxpayers; and
- to avoid harmful tax competition regimes and practices.

With further moves towards harmonising the E.U.'s corporate income taxes, Romano argues that it is necessary to ascertain the feasibility and opportunity to set up an advance tax rulings system, initially at the E.U. level.²²⁸

Advance Pricing Agreements (APAs) and transfer pricing

An advance pricing agreement (APA) is an advance agreement on transfer pricing methodologies entered into between a multinational taxpayer and at least one government's tax administration.²²⁹ In the case of the United States, an APA is essentially a contract with the Internal Revenue Service (IRS) which sets forth a methodology for evaluating whether transfer prices are arms length and will, therefore, be respected by the IRS. The heart of the APA request is the proposed transfer pricing method. This is the method the taxpayer proposes to determine an arm's length pricing that is consistent with the legislative requirements.²³⁰

Importantly, an APA is an agreement by the interested parties (related taxpayers and tax authorities) in usually at least two different countries, which commits both sides to a particular transfer pricing methodology. It assures that, barring unforeseen circumstances or a misrepresentation of the facts, the tax authorities will not subsequently challenge the positions taken.²³¹

APAs can be unilateral, bilateral or multilateral. Only bilateral and multilateral APAs (where two or more countries are involved) can provide legal certainty as to how the tax authorities of countries involved consider the taxpayer-specific application of a transfer pricing method.²³² In the case of a bilateral or multilateral APA, a second agreement is made between the competent authorities of countries which are affected by the covered transaction. This second agreement is normally based on the mutual agreement provision of tax treaties between the jurisdictions.

Several complicating factors arise when there are unilaterally issued APAs, namely on what basis, under what requirements, and with what effect APAs can be requested and issued. In this respect, it is necessary to differentiate between an APA issued

²²⁸ *Id.* at 499.

²²⁹ Kenneth W. Gideon, Bryan Stone, Robert B Stack and David J Charles, *Advance Pricing Agreements*, 8 INT'L TAX REV. 9 (1996).

²³⁰ *Id.* at 10.

²³¹ See Frans W. Blok, *The Netherlands*, 9 INT'L TAX REV. 53 (1997).

²³² See Alexander Voegele and Markus Brem, *Do APAs prevent disputes?* 14 INT'L TAX REV. 35 (2002/3).

“unilaterally” by one tax authorities or through bilateral cooperation with foreign tax authorities.²³³

A further complicating factor with APAs generally is the discrepancy between business-world transfer pricing and tax-world transfer pricing. Business-world transfer pricing is a multi-entity issue where many routine and non-routine functions are performed in several jurisdictions along the value chain of the multinational. Tax-world transfer pricing in the form of the OECD Model Tax Convention,²³⁴ the OECD Transfer Pricing Guidelines,²³⁵ and the country-specific treaties and regulations is based on a simplified concept where two controlled entities exchange goods or services between two countries.

Durst²³⁶ argues that APAs are useful primarily for taxpayers with transfer pricing issues that already have come to the attention of government authorities, or are very likely to do so in the future. APAs are also useful for taxpayers with a special need for financial statement certainty. Because APAs can offer revenue authorities savings as well as taxpayers, some countries have been particularly keen to grant APAs in the more complex areas of transfer pricing. Durst observes that bilateral APAs between the US and Canada are becoming increasingly commonplace and both fiscal authorities have been pushing for their use.²³⁷

The ultimate goal of the APA process is to arrive at an agreement over three things²³⁸:

- inter-company transactions and businesses of the multinational taxpayer (affiliated parties involved, transactions, functions, risks, assets);
- most appropriate TPM to these transactions; and
- type of arm's-length results expected after applying the agreement.

Thus APAs aim to reduce uncertainty through enhancing the predictability of the tax treatment of international transactions.

In terms of the steps in obtaining an APA, for the United States APA process these are the pre-filing conference (an informal meeting with the IRS to discuss transfer pricing issues), the APA request itself, the transfer pricing methodologies sought, and negotiation with the IRS.²³⁹ With respect to the United Kingdom, there have been recent developments expanding the APA procedure.²⁴⁰

²³³ Rosemarie Portner, *Advance pricing agreements: Domestic Aspects and treaty issues*, 36 EUR. TAX'N 50 (1996).

²³⁴ OECD, *supra* n 97.

²³⁵ OECD, *supra* n 99.

²³⁶ Mike Durst, *APAs: A personal view*, 26 TAX PLAN. REV. 9 (1999).

²³⁷ *Id.*

²³⁸ See Vogele and Brem, *supra* n 232.

²³⁹ See Gideon *et al.*, *supra* n 229. For an early survey on various countries employing the APAS procedure, see Nathan Boidman, *The Effect of the APA and other US Transfer Pricing Initiatives in Canada and Other Countries*, 44 TAX EXEC. 254 (1992), discussing Canada, Australia, France, Germany, Italy, Japan, Netherlands, the United Kingdom and the United States. See also Nathan Boidman, *The Roles of Advance Rulings in International Transfer Pricing*, 39 CAN. TAX J. 1563 (1991). For a discussion on the limited Finnish provisions, see Eric Sandelin and Mikko Palmu, *Finland*, 10 INT'L TAX REV. 55 (2002).

²⁴⁰ Fiona Bayliss, *Advance Pricing Agreements: What will they offer?*, 40 EUR. TAX'N 229 (2000). Bayliss discusses the United Kingdom's new advance pricing agreement (APA) regime in general, looks at how the Inland Revenue intends to conduct the APA process, and considers whether various concerns

The major components of a request for an APA in the United States are²⁴¹:

- general background;
- factual content;
- legal content;
- current apportionment method;
- base of proposed apportionment method;
- explanation of proposed apportionment method;
- conformity with “clear reflection” and “arm’s length” method;
- cost sharing arrangements;
- coordination with domestic law;
- coordination with treaty countries;
- term and assumptions;
- perjury statement;
- signatures;
- copies and mailing;
- user fees; and
- notification to the field.

Gramlich and Moller outline some of the factors that managers of a multinational firm should consider when deciding whether or not to request an APA.²⁴² The process by which a taxpayer requests an APA is described. The authors then present a model for deciding whether or not to obtain an APA, including undertaking a cost-benefit analysis. Various situations are discussed in which taxpayers should and should not consider obtaining an APA. Factors supporting obtaining an APA include: producing a lower tax liability, reducing firm (and shareholder) risk, obtaining the benefit of a competitor’s recently defended transfer pricing method, reducing tension during an audit when the transfer pricing method is stalemated, or exercising control over the transfer pricing method discussion.²⁴³

Two other possible avenues that the APA mechanism could be extended to cover, and which in the case of the second would fit well within an international tax organisation, is resolving domestic transfer pricing issues (that is, pricing within one jurisdiction) and resolution of the existence or otherwise of a permanent establishment.²⁴⁴

expressed during the consultation period have been addressed. With increasingly complex transfer pricing legislation to comply with, businesses will surely welcome the offer of the new United Kingdom APA regime and the opportunity to plan their tax compliance with greater certainty. The United Kingdom has expanded into the provision of APAs in more recent times.

²⁴¹ Nathan Boidman, *Canadian Perspective on IRS Proposal for Inter-company Rulings*, 19 TAX MGMT INT’L REV. 355, 359 (1990).

²⁴² Jeffrey D. Gramlich and Ulrik Gorm Moller, *The Decision to Request an APA*, 24 TAX MGMT INT’L REV. 13 (1997).

²⁴³ *Id.* at 15-17.

²⁴⁴ See Sean F. Foley and Paul B. Burns, *The APA Program as a Model for Successful Alternative Dispute Resolution*, 32 TAX MGMT INT’L REV. 451 (2003). For a discussion on permanent establishment, see SKAAR, *supra* n 44.

Binding (Advance) Rulings v APAs

While advance rulings on transfer pricing are essentially the same creature as an advanced pricing agreement on transfer pricing, there are some differences. Romano provides a succinct summary of the key similarities and differences between APAs and advance rulings²⁴⁵:

An advance pricing agreement (APA), being an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria for the determination of the transfer pricing for those transactions over a fixed period of time, is to be distinguished from advance tax rulings for many aspects.

An APA providing taxpayers with certainty about how transfer pricing rules apply to future transactions may be unilateral, bilateral or multilateral. In contrast, advance tax rulings are unilateral in nature, and they are, therefore, generally granted without informing or involving other interested jurisdictions. ... In addition, advance rulings and APAs differ in their legal nature. APAs are generally regarded as agreements between one or more tax authorities and taxpayers, whereas advance rulings should be considered as one-sided statements by the tax administrations. Although in an APA a taxpayer is also not always seen as a party to the procedure, his agreement is required. No APA may be implemented without the approval of the taxpayer, whereas advance rulings are valid regardless of the consent of the applicant. Apart from a few procedural guarantees (conferences, etc.), mainly based on the right of the taxpayers to be heard, the participation of the taxpayer in an advance rulings procedure is often limited to the initial phase of the process.

Finally, as a consequence of their different legal nature, APAs may also be distinguished from advance rulings on the basis of their effects. APAs are generally binding on the tax authorities, and sometimes on taxpayers, whereas advance rulings may have binding effects on tax authorities but rarely on taxpayers. Moreover, an APA, whether unilateral, bilateral or multilateral, differs from an advance ruling principally because it deals with factual matters more than it deals with the interpretation and application of the law and is aimed at resolving all the transactions or categories of transactions related to the taxpayer in cross-border situations. Conversely, an advance ruling request normally refers to one or more specific transactions.

Thus, while there are a number of differences between binding rulings and APAs, both have a high degree of similarity, justifying their joint consideration for inclusion within the scope of a World Tax Organisation.

AN INTERNATIONAL (WORLD) TAX ORGANISATION

Prior to undertaking a discussion on the possible composition, powers and scope of such an organisation, a first step that has been proposed by a number of scholars is some form of multilateral tax agreement or convention.

Multilateral Tax Agreement/Convention

McIntyre²⁴⁶ argues that the point of a model tax convention is to promote cooperation and coordination among sovereign states with respect to certain fiscal matters. He

²⁴⁵ Romano, *supra* n 225, at 486.

²⁴⁶ Michael J. McIntyre, *Options for Greater International Coordination and Cooperation in the Tax Treaty Area*, 56 BULL. FOR INT'L FISCAL DOC. 250 (2002).

acknowledges that some people may object to such cooperation and coordination, believing that governments should engage in a high level of tax competition and should eschew most cooperative efforts. The principle issue addressed by McIntyre is how to promote greater intergovernmental cooperation and coordination on the assumption that these twin goals are worthy ones for governments to pursue.

In promoting the notion of a multilateral treaty, it might be considered:

- a) As a full or partial replacement for the series of bilateral treaties now used by many countries, or
- b) As a mechanism for amending (updating) existing bilateral treaties to reflect changes in or additions to the OECD Model Tax Convention²⁴⁷ or UN Model Treaty²⁴⁸ (or some other model), as approved by the body in charge of that particular model.

McIntyre²⁴⁹ argues that political feasibility of a multilateral tax treaty as a replacement for bilateral treaties may depend significantly on the size of the group of countries that conclude such a treaty. For a small group of countries with similar tax systems (for example, the Nordic countries²⁵⁰), a multilateral treaty seems to be more feasible than a multilateral treaty applicable to all countries in the world that have tax treaties.

A multilateral tax treaty that is limited in scope also may be more acceptable politically. It may be possible, for example, to have a multilateral treaty that deals with many issues arising in a tax treaty but leaves a small number of sensitive issues for bilateral negotiations. A multilateral treaty among a small number of countries with closely integrated economies might also permit greater experimentation.

Some of the possible advantages of a multilateral tax treaty presented by McIntyre are²⁵¹:

- a) *Mechanism for revising treaties promptly.* If a multilateral tax treaty is developed by an international organization, that organization could make periodical revisions of the treaty to deal with the inevitable emerging issues and the inevitable tax avoidance schemes. Presumably, some procedure would have to be established for ratifying the revised treaty because most countries would not forfeit their right to reject a revised treaty. ...
- b) *Simplification.* A uniform tax treaty applicable to many countries may be easier to interpret and apply than the current non-uniform bilateral treaties. There is also likely to be increased consistency in interpretation and increased certainty in application. In some cases, novel rules inserted into a bilateral treaty can give rise to interpretation and/or application problems. In theory, the same degree of uniformity might be achieved through a series of identical bilateral treaties.
- c) *Solving triangular issues.* Some triangular issues that may arise as a result of the strict bilateral approach of the existing (bilateral) treaties can be solved more effectively by a multilateral treaty.

²⁴⁷ OECD MODEL TAX Convention, *supra* n 97.

²⁴⁸ UN MODEL Treaty, *supra* n 102.

²⁴⁹ McIntyre, *supra* n 246, at 251.

²⁵⁰ Odd Hengsie, *The Nordic Multilateral Tax Treaties – for the Avoidance of Double Taxation and on Mutual Assistance*, 55 BULL. FOR INT'L FISCAL DOC. 371 (2002).

²⁵¹ McIntyre, *supra* n 246, at 256-7. Emphasis added.

- d) *Reduced negotiating time.* Bilateral treaties take a year or more to negotiate. A multilateral treaty offers the prospect of avoiding the need for separate negotiations with each country. This advantage is of particular importance to small countries that do not have an abundance of resources.
- e) *Reduced treaty shopping.* A multilateral treaty would provide for uniform treatment of all residents of the participating states. Treaty shopping to get the best deal among the applicable treaties would be eliminated. Of course, the problem of persons from non-treaty states improperly obtaining benefits would not be solved merely by having a multilateral treaty.

Some of the possible disadvantages of a multilateral treaty are²⁵²:

- a) *Special provisions.* In some cases, a country may not be willing to enter into a multilateral treaty unless it retains the right to make special arrangements with some of its important trading partners. The simplification gains that might be obtained from a uniform multilateral treaty might be lost if many countries entered into side arrangements. Indeed, it is possible that a multilateral treaty, after its adornment with many side arrangements, could be more complex to interpret than the current set of bilateral treaties.
- b) *Ossification.* A multilateral treaty, in practice, may become difficult to amend. Bilateral treaties are already difficult to amend, and they involve only two parties. If a multilateral treaty ossifies, it is likely to do more harm than good.
- c) *Reduced flexibility.* By its nature, a multilateral treaty is less flexible in dealing with the particular circumstances of countries than a bilateral treaty. For example, it seems unlikely that a multilateral treaty could be used to define the taxes of particular countries which qualify as creditable income taxes for treaty purposes.
- d) *Capture by powerful countries or special interests.* There is an increased risk that a multilateral treaty would be written to protect the interests of the powerful - powerful countries or powerful interest groups - at the expense of others. Such a capture of an international tax treaty by the powerful may not be inevitable, but serious steps would need to be taken to prevent it from happening.

A consensus approach

Avi-Yonah has had the following to say with respect to consensus on tax policy²⁵³:

The case for reaching consensus on the enforcement of residence-based taxation and determination of the source for active income is at least as strong today as the case for consensus on the general structure in 1923 [with the formation of the League of Nations]. Compared with 1923, the world's economy is much more integrated, international capital flows much larger, and MNEs make a much up a much higher proportion of world GDP. Moreover, consensus is necessary to avoid serious under-taxation of individuals (in the case of backup withholding of portfolio income) and MNEs (in the case of allocating active income to its source). Both developed and developing countries have much to gain and little to lose from reaching agreement, and significant revenue is lost by all concerned from failing to do so.

²⁵² *Id.* at 257. Emphasis added.

²⁵³ Reuven S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301, 1350 (1996). Avi-Yonah briefly discusses how such a consensus may be reached, drawing upon the recent international trade talks as an example (i.e. the GATT). Then he explores how simplification of the international tax regime may occur once a consensus is reached.

A consensus approach is desirable, and further discussion and debate over a mutual tax policy process is worthwhile and should be productive.²⁵⁴ The best-fit response recommended by this study is that a consistent policy setting approach will be conducive to a more equitable and efficient outcome in both absolute and relative terms, along with satisfying many of the other key principles of evaluating tax policy.²⁵⁵

In particular, my proposed international agreement could be extended beyond binding rulings and APAs to encompass an agreed process for ascertaining jurisdiction and allocation of revenue (possibly even incorporating a variation on the formulary apportionment concept and unitary taxation with respect to multinational enterprises), as well as a limited consensus on maintaining the essential characteristics of income taxes on corporations and international income of mobile individuals (with respect to the tax base determination), and consumption taxation (especially VAT and GST). Freedom to vary rates on individuals' income (and to a much lesser degree on the income of corporations), is permitted to reflect the realities of retaining a 'thread' of

²⁵⁴ However, it has been argued that harmonisation may be futile, at least in the context of commercial law. Nevertheless, it is quite a different issue as to whether harmonisation of tax policy development is feasible. It is reasonable to debate whether this argument could be extended to income taxation; see Paul B. Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 VA. J. INT'L L. 743 (1999).

²⁵⁵ Equity (or fairness) is traditionally presented as representing two dimensions, although this is not universally accepted by scholars. Horizontal equity is measured by whether everyone with the same ability to pay tax, pays the same amount of tax. Vertical equity occurs when those with a greater ability to pay, pay proportionally more tax, preferably on a progressive scale. Certainty refers to taxpayers being able to ascertain their liability to a tax clearly and unambiguously, and administrators and policy-makers being able to predict revenue flows with a high degree of accuracy. Convenience is related to simplicity in that it is argued that taxes should be assessed, levied and paid in the simplest manner. Economy in operation (administrative efficiency) places an obligation on both government and tax administrations to facilitate a tax collection process that enables taxes to be both cost effective to collect and not impose a heavy compliance obligation on taxpayers (with administrative costs kept to a minimum). For further discussion of these principles, see e.g. SALLY M. JONES & RAY. M. SOMMERFELD, *FEDERAL TAXES AND MANAGEMENT DECISIONS* 11 (1995).

The core concept of neutrality involves setting tax policy that neither favours or disfavors a particular form of business activity or method for concluding a transaction, such that resources are not allocated in a manner other than that which will enable their most efficient utilization. Economically similar transactions should be treated similarly so as not to interfere with choice. See also, Douglas A. Kahn, *The Two Faces of Tax Neutrality: Do they Interact or are they Mutually Exclusive?*, 18 N. KY. L. REV. 1 (1990) for a discussion on neutrality, and Julie A. Roin, *The Grand Illusion: A Neutral System for the Taxation of International Transactions*, 75 VA. L. REV. 919 (1989).

Another scholar argues that efficiency, in the context of anti-deferral reform, should be the key principle for reforming the taxation of Foreign Personal Holding Companies; See John McDonald, *Anti-Deferral Deferred: A Proposal for the Reform of International Tax Law*, 16 N.W. J. INT'L L. & BUS. 248, 283 (1995). See also, Robert J. Peroni, *Back to the Future: A Path to Progressive Reform of the United States International Income Tax Rules*, 51 U. MIAMI L. REV. 975 (1997), and two commentaries, the first by David R. Tillinghast, *Comments on Professor Peroni's paper on Reform of the United States International Income Tax Rules*, 51 U. MIAMI L. REV. 1013 (1997), and Stanley I. Langbein, *The Future of Capital Export Neutrality: A Comment on Robert Peroni's Path to Progressive Reform of the United States International Tax Rules*, 51 U. MIAMI L. REV. 1019 (1997).

One further possible solution worthy of further exploration is whether greater fairness in international taxation will arise through inter-nation equity, using economic allegiance theory; see Nancy H. Kaufman, *Fairness and the Taxation of International Income*, 29 LAW & POL'Y INT'L BUS. 145, 202 (1998). The original proponents of inter-nation equity were Richard A. Musgrave and Peggy B. Musgrave, *Inter-nation equity*, in *ESSAYS IN HONOR OF CARL S. SHOUP* (Richard M. Bird and John G. Head eds., 1972).

sovereignty in this globalised environment, although economic theory would suggest complete harmonisation of base and rates in appropriate circumstances is optimal.²⁵⁶

Furthermore, new taxes which have a measurable international impact, I would argue, should be carefully debated before they are implemented, preferably with at least some international discussion and possible consensus on their application. It would be helpful in this respect to undertake a review of the similarities in tax policy reform in recent years.

Any model or mutual approach to developing international tax policy and dispute resolution should borrow from existing models for international policy setting and dispute resolution in other domains (with appropriate modifications), such as trade, along with recognising how they have gained a level of consensus and yet restrict or impinge upon national sovereignty.²⁵⁷ Restrictions or impositions upon national sovereignty are worthy of debate in situations where such restrictions promote the greater interest of all countries concerned, when viewed from a global rather than an individualistic national perspective.²⁵⁸ For instance, restrictions occur in the context of global trade in goods and services through the General Agreement on Tariffs and Trade (GATT)²⁵⁹ and the General Agreement on Trade in Services (GATS).²⁶⁰ Furthermore, there are sovereignty restrictions in certain regional trading blocs, such as the current movement towards harmonisation of tax policy, monetary policy and social policies in the E.U., and in North America, through the North American Free Trade Agreement.²⁶¹ Other examples include development of further multilateral tax conventions, particularly those by the OECD,²⁶² the Nordic countries,²⁶³ and the Caribbean Community.²⁶⁴

²⁵⁶ See e.g. Michael Keen, *The Welfare Economics of Tax Co-ordination in the European Community: A Survey*, 14 FISCAL STUD. 15 (1993), and Michael Devereux, *The Ruding Committee Report: An Economic Assessment*, 13 FISCAL STUD. 96 (1992). See also Alan M. Simon and Spencer Weber Waller, *Essay: A Theory of Economic Sovereignty: An Alternative to Extraterritorial Jurisdictional Disputes*, 22 STAN. J. INT'L L. 337 (1986).

²⁵⁷ See the discussion on sovereignty in section 2.7 of this paper.

²⁵⁸ See e.g. VITO TANZI, *TAXING IN AN INTEGRATING WORLD*, ch. 2 (1994), Preface.

²⁵⁹ GATT, *supra* note 202.

²⁶⁰ General Agreement on Trade in Services, Dec. 15, 1993, Marrakesh Agreement Establishing the World Trade Organization, Annex 1x, LEGAL INSTRUMENTS-RESULTS OF THE URUGUAY ROUND, vol. 1 (1994) 33 I.L.M. 44 (1994). [hereinafter referred to as the GATS].

²⁶¹ North American Free Trade Agreement, Dec. 8-17, 32 I.L.M. 289, 32 I.L.M. 605 [hereinafter referred to as NAFTA]. See e.g. Arthur J. Cockfield, *Tax Integration under NAFTA: Resolving the Conflict between Economic and Sovereign Interests*, 34 STAN. J. INT'L L. 39 (1998); Brian J. Arnold and Neil H. Harris, *NAFTA and the Taxation of Corporate Investment: A View from within NAFTA*, 49 TAX L. REV. 529 (1994); H. David Rosenbloom, *Commentary: What's Trade got to do with it?*, 49 TAX L. REV. 593 (1994); Alvin C. Warren, Jr., *Commentary: Alternatives for International Corporate Tax Reform*, 49 TAX L. REV. 599 (1994); Paul R. McDaniel, *Formulary Taxation in the North American Free Trade Zone*, 49 TAX L. REV. 691 (1994); Richard M. Bird, *Commentary: A View from the North*, 49 TAX L. REV. 745 (1994); John S. Brown, *Commentary: Formulary Taxation and NAFTA*, 49 TAX L. REV. 759 (1994); Michael J. McIntyre, *Commentary: The Design of Tax Rules for the North American Free Trade Alliance*, 49 TAX L. REV. 769 (1994); and Richard D. Pomp, *Commentary: Issues in the Design of Formulary Apportionment in the Context of NAFTA*, 49 TAX L. REV. 795 (1994).

²⁶² Such as the OECD's convention on information sharing (mutual assistance); see OECD, *supra* n 177, and the proposed OECD agreement on investment, OECD – DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS, THE MAI NEGOTIATING TEXT (AS AT 24 APRIL, 1998) (1998). Available at < <http://www.oecd.org> >. OECD - DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS, COMMENTARY ON THE MAI NEGOTIATING TEXT (1998). Available at < <http://www.oecd.org> >. (Visited 24 April, 1998).

When an international agreement is concluded, it is vital that there be an effective enforcement mechanism in place and a process by which to resolve disputes; an agreement is only effective to the extent that it is enforceable (by legal or informal means).²⁶⁵ An argument can be made that in borrowing from existing enforcement models, the costs associated with “reinventing the wheel” may be avoided. Enforcement models in the literature which may prove valuable as precedents include the World Trade Organisation (WTO),²⁶⁶ the Organisation for Economic Cooperation and Development (OECD),²⁶⁷ the United Nations (U.N.),²⁶⁸ the International Monetary Fund (IMF),²⁶⁹ and the North American Free Trade Agreement (NAFTA) body.²⁷⁰ However, several other options have been proposed by commentators, including an International Tax Court²⁷¹ and of most importance to this study, Tanzi’s World Tax Organisation.²⁷² A World or International Tax Organisation is a critical part of the thesis of this paper.

²⁶³ CONVENTION BETWEEN THE NORDIC COUNTRIES FOR THE AVOIDANCE OF DOUBLE TAXATION WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL (Denmark, Faroe Islands, Finland, Iceland, Norway, Sweden: 1996). Hereinafter referred to as CONVENTION BETWEEN THE NORDIC COUNTRIES. For a discussion of the agreement see Peter Birch Sørensen, *From the Global Income Tax to the Dual Income Tax: Recent Tax Reforms in the Nordic Countries*, 1 INT’L TAX & PUB. FIN. 57 (1994). See also Hengsie, *supra* n 250.

²⁶⁴ AGREEMENT AMONG THE GOVERNMENTS OF THE MEMBER STATES OF THE CARIBBEAN COMMUNITY FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME, PROFITS OR GAINS AND CAPITAL GAINS AND FOR THE ENCOURAGEMENT OF REGIONAL TRADE AND INVESTMENT (1994). Hereinafter referred to as the CARICOM CONVENTION. For a discussion of the agreement, see Hubb M. M. Bierlaagh, *The CARICOM Income Tax Agreement for the Avoidance of (Double) Taxation?*, 54 BULL. FOR INT’L FISCAL DOC. 99 (2000).

²⁶⁵ See e.g. Gustaf Lindencrona, *How to resolve international tax disputes? New approaches to an old problem*, INTERTAX 266 (1990). The analysis will consider proceedings between two or more states and between state(s) and private individuals and organizations.

²⁶⁶ See WORLD TRADE ORGANIZATION, *THE WTO DISPUTE SETTLEMENT PROCEDURES; A COLLECTION OF THE LEGAL TEXTS* (1995). See also Robert A. Green, *Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes*, 23 YALE J. INT’L L. 79 (1998). [Hereinafter referred to as Antilegalistic Approaches]. In the context of the WTO and its disputes settlement role, see e.g. Robert E. Hudec, *The New WTO Dispute Settlement Procedure: An Overview of the First Three Years*, 8 MINN. J. GLOBAL TRADE 1 (1999). See also General Agreement on Tariffs and Trade – Multilateral Trade Negotiations (The Uruguay Round) Understanding on Rules and Procedures Governing the Settlement of Disputes, Dec. 15, 1993, LEGAL INSTRUMENTS-RESULTS OF THE URUGUAY ROUND, vol. 1 (1994) 33 I.L.M. 112 (1994).

²⁶⁷ The OECD has been suggested due to its proactive role in developing international model agreements in the area of taxation, although this only extends to its 30 members and the OECD does not have a formal dispute resolution mechanism since it is based upon member cooperation and consensus.

²⁶⁸ The United Nations offers the widest coverage in terms of membership and as the successor to the League of Nations, has been involved in international tax treaty efforts (see U.N. MODEL TAX CONVENTION, *supra* note 102).

²⁶⁹ The International Monetary Fund is hereinafter referred to as the IMF. For a discussion on the role of the IMF in the context of globalisation, see MICHEL CAMDESSUS, *THE IMF AND THE CHALLENGES OF GLOBALIZATION: THREE ADDRESSES* (1995).

²⁷⁰ The North American Free Trade Agreement body is hereinafter referred to as NAFTA.

²⁷¹ See John Azzi, *Tackling Tax Treaty Tensions: Time to Think about an International Tax Court*, 52 BULL. FOR INT’L FISCAL DOC. 344, 349-50 (1998).

²⁷² See e.g. Tanzi, *supra* note 4. See also Vito Tanzi, *Is there a Need for a World Tax Organization?*, in Assaf Razin and Efraim Saka (eds.), *THE ECONOMICS OF GLOBALIZATION: POLICY PERSPECTIVES FROM PUBLIC ECONOMICS* 173 (1999). With an organisation such as the World Tax Organisation, this body would require a basis to manage transnational litigation, mediation and arbitration; for a discussion of some of the issues, see Tomas Kennedy-Grant, *Transnational Litigation and Arbitration*, N.Z. L. J. 7 (1998). In the context of developing a new world order and its implications for taxation, see Richard M. Bird, *Shaping a New International Tax Order*, 42 BULL. FOR INT’L FISCAL DOC. 292 (1988). For a

Yet another avenue may be to develop a General Agreement on Trade, Tariffs and Taxes (GATTT), an addition to the current GATT.²⁷³ One particularly promising approach for dispute resolution in Europe has been arbitration, although this approach is less conducive to dispute resolution than negotiation facilitated by way of mediation.²⁷⁴ International arbitration models also need to be considered further in the development of such a body. The proposal advanced by this paper is for a World Tax Organisation that would eventually extend upon Tanzi's proposals,²⁷⁵ as well as draw upon aspects of the WTO, and incorporate policy setting and dispute resolution (with both adversarial and arbitration components) mechanisms. However, this paper only develops this concept to the extent of such an organisation having a degree of responsibility and oversight for binding rulings and APAs.

One further contributing factor to securing international consensus or agreement on tax policy is striving for greater cohesion between the financial accounting and tax accounting systems in participating members or signatories to such an agreement. Major differences exist between continental Europe, where financial and tax accounting are closely related, and the Anglo-American situation where differences are much more noticeable.²⁷⁶ The OECD conducted a review of accounting standard harmonisation in the mid 1980s,²⁷⁷ although little has come of this, except for a growing role for the International Federation of Accountants and the International Accounting Standards Committee's efforts.²⁷⁸ The move to adoption of International Financial Accounting Standards from 2007 (with early adoption from 2005) will have a significant impact on this issue.²⁷⁹

The extent of informal collective processes for determining tax policy that currently exist is minimal to say the least.²⁸⁰ Such informal collective processes could form the

response to Bird, *see* Leif Mutén, *A New International Tax Order?*, 42 BULL. FOR INT'L FISCAL DOC. 471 (1988).

²⁷³ *See e.g.* CHARLES M. MCLURE, JR., INTERNATIONAL ASPECTS OF TAX POLICY FOR THE 21ST CENTURY (mimeograph, 1990), cited in RICHARD M. BIRD AND JACK M. MINTZ, TAXATION TO 2000 AND BEYOND 11 (Richard M. Bird and Jack M. Mintz eds., Canadian Tax Paper No. 93, 1992).

²⁷⁴ *See* Luc Hinnekens, *Legal Sources and Interpretation of European Tax Arbitration Convention and its Recognition of the Taxpayer*, 47 CONG. INT'L FISCAL ASS'N 11 (1995), William W. Park, *Control Mechanisms in International Tax Arbitration*, 47 CONG. INT'L FISCAL ASS'N 35 (1995), and International Chamber of Commerce, *The Resolution of International Tax Conflicts*, 47 CONG. INT'L FISCAL ASS'N 97 (1995).

²⁷⁵ *See e.g.* Tanzi, *supra* note 4, and Tanzi, *supra* note 272.

²⁷⁶ *See* Thomas M. Porcano et al., *Alignment of Taxable Income with Accounting Profit*, 10 AUST. TAX FORUM 475 (1993), Thomas M. Porcano and Alfred V. Tran, *Relationship of Tax and Financial Accounting Rules in Anglo-Saxon Countries*, 33 INT'L J. ACCT. 433 (1998), Shahrokh M. Saudagaran and Joselito G. Diga, *Accounting Harmonization in ASEAN: Benefits, Models and Policy Issues*, 7 J. INT'L ACCT. AUD. & TAX'N 21 (1998), and Leo G. van der Tas, *European Accounting Harmonization: Achievements, Prospects and Tax Implications*, EC TAX REV. 178 (1992). For an international comparison of income taxation, including the role of financial accounting, *see* HUGH J. AULT (ed.), COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS (1997).

²⁷⁷ OECD, HARMONIZATION OF ACCOUNTING STANDARDS (1986), and OECD, ACCOUNTING STANDARDS HARMONIZATION: THE RELATIONSHIP BETWEEN TAXATION AND FINANCIAL REPORTING – INCOME TAX ACCOUNTING (1987).

²⁷⁸ *See* Saudagaran and Diga, *supra* note 272, at 22, 25, 33-34.

²⁷⁹ *See* feature in the July 2003 issue of the *Chartered Accountants Journal* (NZ), and in particular, Liz Hickey, John Spencer, Tony van Zijl and Joanna Perry, *Adoption of IFRS – Background and Process*, 82 CHARTERED ACCTS. J. 4 (2003).

²⁸⁰ *See e.g.* CHRISTOPHER C. FINDLAY, CONFLICT AND COOPERATION IN INTERNATIONAL TAX POLICY: AUSTRALIA'S REFORM PROPOSALS, (ASEAN-Australia Economic Papers No. 28, 1987).

basis upon which a more formalised tax policy process may be developed²⁸¹ as nations adapt to the changes “forced” upon them from globalisation. Much of this informal process occurs between diplomats and key political and official personnel, with the processes involved normally not formally documented.²⁸²

Possible ‘test cases’ for a world (international) tax organisation

The breadth and success (or otherwise) of multilateral agreements that have a direct or indirect impact on taxation needs some level of consideration. Notable examples from the OECD include its agreement on information sharing by tax administrations,²⁸³ the now failed attempt for an agreement on investment,²⁸⁴ and transfer pricing guidelines for multinational enterprises and tax administrations.²⁸⁵ However, of particular interest and specifically in relation to tax, are the agreements between the Nordic Countries with respect to income tax,²⁸⁶ the Caribbean Community,²⁸⁷ and the E.U. members with respect to indirect taxation.²⁸⁸ Various trading blocs and regional organizations of nations could become the basis for a multilateral (or regional) agreement with respect to taxation should an international tax organisation not eventuate.²⁸⁹

Underlying the arguments of this paper are the arguments surrounding the development of the best-fit international tax policy response to globalisation and how it can be accommodated within (international) tax policy concepts and principles. This can be divided into two major areas, the first concerns the degrees of harmonisation of taxation policy,²⁹⁰ including the debate over whether limited

²⁸¹ Such as an extension to the activities of the OECD or use of the U.N. model for debating and implementing proposed resolutions.

²⁸² The OECD member nations work on a consensus basis with the Secretariat seeking to produce agreements that are acceptable to all members as a result of extensive discussions. The U.N. utilises a permanent committee of influential nations, along with rotating memberships for other nations, with consensus sought but veto powers available to permanent members. Other regional groupings of nations are gradually formalizing their processes; for example consider APEC (*see generally* Lyuba Zarsky, *The Asia-Pacific Economic Cooperation Environment: Regional Environmental Governance in the Age of Economic Globalization*, 8 COLO. J. INT’L ENVTL. L. & POL’Y 323 (1997)) and ASEAN (*see e.g.* MARIA LOURDES ARANAL-SERENO AND JOSEPH SEDFREY SANTIAGO, *THE ASEAN: THIRTY YEARS AND BEYOND* (Maria Lourdes Aranal-Sereno and Joseph Sedfrey Santiago eds., 1997)). The 18 economies represented in APEC are Australia, Brunei, Canada, Chile, China, Chinese Taipei, Hong Kong, Indonesia, Japan, Malaysia, Mexico, New Zealand, Papua New Guinea, Philippines, Singapore, South Korea, Thailand, and the United States. There is an overlap between the 10 ASEAN members and 18 APEC to the extent that Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand are members of both.

²⁸³ OECD, *supra* n 177.

²⁸⁴ OECD, *supra* n 262.

²⁸⁵ OECD *supra* note 97.

²⁸⁶ CONVENTION BETWEEN THE NORDIC COUNTRIES, *supra* note 263.

²⁸⁷ CARICOM Convention, *supra* note 264.

²⁸⁸ For a discussion on the E.U.’s indirect tax harmonisation, *see e.g.* Michel Aujean and Ken Lennan, *The Community Internal Market: Direct and Indirect Taxation Issues*, in *PROCEEDINGS OF CONFERENCE HELD BY THE CONFEDERATION OF EUROPEAN ASSOCIATIONS IN 1989*, 8-22, (George Winckler ed., 1992) and Stephen Smith, ‘*Subsidiarity*’ and the *Co-ordination of Indirect Taxes in the European Community*, 9 OXFORD REV. ECON. POL’Y 67 (1993).

²⁸⁹ These include the European Union (EU), the North American Free Trade Association (NAFTA), the Asia Pacific Economic Cooperative (APEC), the Association of South East Asian Nations (ASEAN), African Economic Community (AEC), and Closer Economic Relations (CER), as between New Zealand and Australia.

²⁹⁰ *See e.g.* James and Oats, *supra* n 68 (examining the degrees of harmonisation) and James, *supra* n 68. See also the discussion in sections 2.4 and 2.5 of this paper.

cooperation, competition²⁹¹ or (complete) harmonisation is appropriate.²⁹² The second concerns whether an international agreement to maintain or raise taxes, and allocation of the jurisdiction (or the right to tax certain income or consumption), should be developed.²⁹³ The context for establishing such agreements is normally applied by commentators to income tax (for both corporations and to a lesser degree, highly mobile and skilled individuals with significant international income derived beyond their country of residence), and to consumption taxes (in particular, the value-added tax and goods and services tax).²⁹⁴

Part of the motivation for this study is to investigate my *a priori* contention that a mutual tax policy setting, enforcement and dispute resolution process is both desirable and feasible in the current political and bureaucratic environment, and further, to determine the conditions conducive to facilitating such a process. The level of integration of policy,²⁹⁵ including the harmonisation versus competition of tax policy debate, needs to be analysed.²⁹⁶ Specific examples of types of taxation which are candidates for integration of policies are income tax levied on corporations²⁹⁷ and individuals, and consumption taxes. While there are suggestions by some commentators that the United States income tax could be replaced by some form of a consumption tax, for the purposes of this study it is assumed that the income tax will continue in the United States and in all OECD member countries, along with the majority of developing and transition nations.²⁹⁸ For this study the focus is narrowed to consider the related areas of binding rulings and advanced pricing agreements relating to issues of income tax.

²⁹¹ The OECD has been responsive to dealing with what is considered to be “harmful competition”; see OECD, *supra* note 5.

²⁹² For a discussion on the relative merits of harmonisation and competition, see Hans-Werner Sinn, *Tax Harmonization and Tax Competition in Europe*, 34 EUR. ECON. REV. 489 (1990).

²⁹³ Agreements to maintain, raise or lower taxes will necessarily have greater restrictions in scope and contain more nation-state freedoms than the process of determining appropriate jurisdiction allocation and sharing of tax revenue, owing to the larger inroads to national sovereignty and culture that the former type of agreement will need to accommodate. See also the discussion earlier in this section of the paper.

²⁹⁴ Hereinafter the value-added tax is referred to as VAT and goods and services tax as GST.

²⁹⁵ See Tanzi, *supra* n 258. For a comment on Tanzi’s proposals, see Joel Slemrod, *Comments*, in TAXING IN AN INTEGRATING WORLD, ch. 2 (appendix) (1994). Slemrod is sympathetic to the views and approach of Tanzi, but he anticipates the move to such a proposal to be slow and not explicit (this is particularly in the case of a global income tax more than for a world tax organisation); see pp 145-6.

²⁹⁶ See Tracy A. Kaye, *European Tax Harmonization and the Implications for U.S. Tax Policy*, 19 B. C. INT’L & COMP. L. REV. 109 (1996), and Stephen G. Utz, *Tax Harmonization and Coordination in Europe and America*, 9 CONN. J. INT’L L. 767 (1994). However, such harmonisation should not be sweeping in its effect, argues Vogel; see Klaus Vogel, *The Search for Compatible Tax Systems*, in TAX POLICY IN THE TWENTY-FIRST CENTURY (Herbert Stein ed., 1988). See also Alvin C. Warren Jr., *Alternatives for International Tax Reform*, 49 TAX L. REV. 599 (1994). See also the discussion in sections 2.4 and 2.5 of this paper.

²⁹⁷ There have been calls for the United States to integrate its corporate and individual income tax regimes as part of this reform; see e.g., Glenn E. Coven, *Corporate Tax Policy for the Twenty-first Century: Integration and Redeeming Social Value*, 50 WASH. & LEE L. REV. 495 (1993).

²⁹⁸ For a discussion on the proposed replacements for the income tax (National Retail Sales Tax, USA Tax, and the Flat Tax) and their international implications, see Stephen E. Shay and Victoria P. Summers, *Selected International Aspects of Fundamental Tax Reform Proposals*, 51 U. MIAMI L. REV. 1029 (1997) and several commentaries that accompanied this paper; George Mindstock, *Comment: What’s on Second?*, 51 U. MIAMI L. REV. 1079 (1997), Reuven S. Avi-Yonah, *Comment on Shay and Summers: Selected International Aspects of Fundamental Tax Reform Proposals*, 51 U. MIAMI L. REV. 1085 (1997), and Michael J. Graetz, *International Aspects of Fundamental Tax Restructuring: Practice or Principle?*, 51 U. MIAMI L. REV. 1093 (1997).

Developing an international (world) tax organization, The United Nations' proposal

The most recent and probably first non-academic discussion suggesting an International Tax Organisation (ITO) was that mooted by a panel of independent financial experts appointed by U.N. Secretary-General Kofi Annan and chaired by former Mexican President Ernesto Zedillo in 2001.²⁹⁹ The proposal was to create an International Tax Organisation (ITO) that would be administered by the U.N. In essence this organisation would help nations collect and disseminate information on tax policies and, opponents insist, assess its own taxes, help governments' tax emigrant citizens working in other countries and even compel member states to share tax data. The ITO would be perceived as potentially taking a leading role in restraining tax competition which is designed to attract MNEs.³⁰⁰

Specifically, in their June 2001 report, presented as independent input to intergovernmental discussions, the Zedillo panel suggested that serious consideration be given to developing this new organisation.³⁰¹ The ITO might take on functions that would include offering technical assistance, providing a forum for the development of international tax norms, maintaining surveillance of tax developments in a manner similar to IMF review of national macroeconomic policies, restraining unwise tax competition designed to attract multinationals and arbitrating international disputes on tax matters.³⁰² It was also suggested by panel members that such an organisation might look into securing international agreement on a formula for unitary taxation of multinationals,³⁰³ as well as the establishment of principals for equitable collection of taxes from emigrants. However, this proposal was put to the Preparatory Committee, where it did not find favour as being implementable in the near future.³⁰⁴

In a briefing note from the University of Barcelona's Observatory of Globalisation (UBOG),³⁰⁵ it is observed that at the very least, an organisation such as the ITO could compile statistics, identify trends and problems, present reports, offer technical assistance, and provide a forum for the exchange of ideas and the development of norms for tax policy and tax administration. It could engage in surveillance of tax developments in the same way that the IMF maintains surveillance of macroeconomic policies.

Going further, the UBOG³⁰⁶ contends that the ITO might engage in negotiations with tax havens to persuade them to desist from harmful tax competition. Similarly, it could take a lead role in restraining the tax competition designed to attract multinationals -competition that, as noted earlier in this paper, often results in the lion's share of the benefits of FDI accruing to the foreign investor. Slightly more ambitiously, an ITO might develop procedures for arbitration when frictions develop

²⁹⁹ United Nations, *Media Kit: Halting a Global Tax*, available at: <http://www.un.org/esa/ffd/ffdconf/article89.htm> (visited 17 February 2004).

³⁰⁰ See CATO INSTITUTE, *CATO HANDBOOK FOR CONGRESS, POLICY RECOMMENDATIONS FOR THE 108TH CONGRESS*, Washington DC, (2002).

³⁰¹ See United Nations, *supra* n 299.

³⁰² A considerable amount of this activity is already undertaken by the OECD.

³⁰³ Reference to the debate on unitary taxation through some form of formulary apportionment is a very emotive and controversial area quite apart from an ITO.

³⁰⁴ See United Nations, *supra* n 299.

³⁰⁵ Observatory of Globalisation of the University of Barcelona, *Briefing Notes; Chapter 4: An International Tax Organisation* (2003), available at: <http://www.ub.es/obsglob/itogen2.html>, (visited 17 February 2004).

³⁰⁶ *Id.*

between countries on tax questions. Even more ambitiously, the UBOG suggests that it could sponsor a mechanism for multilateral sharing of tax information, like that already in place within the OECD, so as to curb the scope for evasion of taxes on investment income earned abroad. Perhaps most ambitious of all, argues the UBOG, it might in due course seek to develop and secure international agreement on a formula for the unitary taxation of multinationals. Another task that might fall to an ITO would be the development, negotiation, and operation of international arrangements for the taxation of emigrants.³⁰⁷

If an ITO were successful in curbing tax evasion and tax competition, there would be two consequences, in the UBOG's view.³⁰⁸ One would be an increase in the proportion of a given volume of taxes paid by dishonest taxpayers and by mobile factors of production (like capital). Most people would consider this an unambiguous gain. The other would be an increase in tax revenue for a given tax rate. Governments could take advantage of the increased revenue by increasing public expenditure, improving the fiscal balance, or cutting tax rates. The latitude to increase public spending would be welcomed by some but deplored by others, who may for that reason oppose the proposal.³⁰⁹

However, this proposal is unlikely to make any significant progress for some time, since it has been the subject of considerable criticism.³¹⁰ For instance the proposal is seen as creating something of an international tax cartel that would keep world taxes high.³¹¹

Scholarly contributions to the processes for developing an international tax organisation

Avi-Yonah,³¹² in his examination of globalisation and tax competition, observes that relying on the OECD to restrict tax competition ultimately suffers from two significant drawbacks. First, it can be envisaged that in the longer run significant markets for both portfolio investment and retail sales will develop outside the OECD. When this situation arises, solutions that rely on OECD enforcement will lose their effectiveness unless those emerging markets were to join the OECD. While several developing countries have joined the OECD recently (for example, Czech Republic, Hungary, Korea (Republic of), Mexico and the Slovak Republic), Avi-Yonah finds it difficult to imagine China or India doing so in the near future.

Secondly, and more importantly, Avi-Yonah contends that relying on the OECD to implement solutions to the tax competition problem, even if those solutions are tailored to benefit developing countries, may not be acceptable to those countries.³¹³ He supports this view by observing that the effort by the OECD to develop a multilateral agreement on investments (MAI)³¹⁴ foundered precisely because developing countries and "left-leaning" non-governmental organisations coordinated a

³⁰⁷ *Id.*

³⁰⁸ *Id.*

³⁰⁹ *Id.*

³¹⁰ See e.g. Daniel J Mitchell, *Radical UN Tax Target*, WASH. TIMES, 22 December (2003); and Refet Kaplan, *Critics Slam Proposed UN Tax Authority*, FOX NEWS, 18 January (2002).

³¹¹ See Kaplan, *Id.*

³¹² Avi-Yonah, *supra* n 2.

³¹³ *Id.*, at 1670-5.

³¹⁴ See OECD, *supra* n 262.

campaign against it as representing the interests of the rich countries and “their” MNEs.

Avi-Yonah’s proposal for restricting tax competition is via a multilateral body that includes developing countries. While no such body currently exists, he acknowledges that several scholars have already proposed setting one up.³¹⁵ However, in Avi-Yonah’s view, there is a natural candidate for the job which already is in place: the World Trade Organisation (WTO).³¹⁶

The WTO, argues Avi-Yonah, is the natural candidate to be the “World Tax Organisation.” In fact, he argues that it is hard to see how the WTO can fulfil its role of ensuring the free flow of trade and reducing non-tariff barriers without having jurisdiction over tax matters. In addition, the fact that the WTO includes representatives from almost all the developing countries gives it an obvious advantage over the OECD even if the solutions it implements are exactly the same as the OECD-based ones proposed above.³¹⁷

Avi-Yonah observes that there are several serious objections to including tax matters in the jurisdiction of the WTO. First, it has been argued that the WTO lacks sufficient tax expertise.³¹⁸ However, that problem, argues Avi-Yonah, can be remedied by hiring a sufficient number of tax experts to sit on the WTO’s panels. In fact, as the WTO has expanded its jurisdiction to non-tariff matters, its staff already includes tax experts who also understand trade issues.³¹⁹

Green has advanced a more serious objection arguing that the costs of imposing the WTO’s legalistic dispute-resolution mechanism outweigh any benefits.³²⁰ Green argues that the need for the WTO to resolve trade disputes legalistically is based on two features that are typically lacking in the tax context: retaliation and lack of transparency.³²¹ In the context of tax competition, Avi-Yonah acknowledges that both retaliation and lack of information appear to be serious problems.

Avi-Yonah acknowledges that Green³²² also raises another objection to giving the WTO authority over taxes which in practice is likely to be far more potent: the problem of sovereignty. This issue has been discussed earlier in this paper.³²³ Countries are wary of giving up their sovereignty over tax matters which lies at the heart of their ability to exercise national power. Green argues that if the WTO dispute resolution mechanism were given authority over tax issues, this may lead to

³¹⁵ See TANZI, *supra* note 258, at 140; Bird, *supra* note 272, at 297-99; John K. Sweet, Comment, *Formulating International Tax Laws in the Age of Electronic Commerce*, 146 U. PA. L. REV. 1949 (1998); Kenneth J. Vandeveld, *The Political Economy of a Bilateral Investment Treaty*, 92 AM. J. INT’L L. 621, 641 (1998).

³¹⁶ Avi-Yonah, *supra* n 2.

³¹⁷ *Id.* at 1670-5.

³¹⁸ See Robert E. Hudec, *Reforming GATT Adjudication Procedures: The Lessons of the DISC Case*, 72 MINN. L. REV. 1443 (1988); Antilegalistic Approaches, *supra* n 266, at 123; William M. Considine, *The DISC Legislation: An Evaluation*, 7 N. Y. U. J. INT’L L. & POL’Y 217 (1974).

³¹⁹ Avi-Yonah, *supra* n 2.

³²⁰ See *Antilegalistic Approaches*, *supra* note 266.

³²¹ See further Avi-Yonah, *supra* n 2, for a discussion on these issues.

³²² See *Antilegalistic Approaches*, *supra* note 266.

³²³ Refer to section 2.7 of the paper.

widespread non-compliance especially given the perception that the WTO is non-transparent and lacks democratic legitimacy.³²⁴

Avi-Yonah counteracts these problems through presenting a solution to this problem as well.³²⁵ Under the GATT regime, all decisions had to be reached by consensus, i.e., with the agreement of the party whose regime is at stake. Under the WTO rules, on the other hand, all dispute settlement rulings are binding unless there is a consensus not to implement them; that is, even when the complaining party agrees to refrain from action. Avi-Yonah argues that the former rule is more appropriate for tax matters than the latter because it gives the loser a veto if it feels that its sovereignty is truly at stake.³²⁶ Similar rules exist for tax matters in both the E.U. and the OECD. However, in practice a country will typically reserve its veto power only to those cases in which the adverse result is truly perceived as a severe limit on its sovereignty. In other cases, the stigma of disapproval is sufficient to ensure cooperation.

Pinto makes an important observation on the limits of sovereignty³²⁷:

However, absolute sovereignty is largely illusory and this is illustrated well by what has come to be known as 'Hobbes' paradox'. According to Hobbes,³²⁸ if men were to hold on to all their rights and liberties and be able to do as they wish (i.e. exercise absolute sovereignty), this would necessarily imply the right to invade other men's rights leading to a state of anarchy or war. In reality, equilibrium or peace can only be achieved when there is a mutual laying down of rights for mutual benefit. Hobbes paradoxically therefore asserts that in fact giving up sovereignty can lead to empowerment (by harnessing mutual benefits), while retaining it can actually lead to disempowerment.

One can extrapolate Hobbes' paradox to the establishment of a World Tax Organisation; that is, if nation states are to achieve mutual benefits and adapt to the challenges presented by electronic commerce in an increasingly integrated economy, there can be no room for the exercise of absolute sovereignty. Rather, the mutual laying down of rights by nation states, by means of cession or restriction of sovereignty, should be undertaken in a manner which is tailored to the new global forces so that the harnessing of mutual benefits can be maximised. Consistent with this is the assertion that nation states can give up or cede sovereign rights if they are able to secure mutual advantages for their citizens; that is, their decision to give up sovereignty would be guided by the benefits that accrue to the individuals making up the nation state.

Tanzi³²⁹ contends with justification that the route of pursuing international agreements in tax matters is unlikely to be a productive one as the experience, over the past two decades, of the E.U. shows. Countries are not likely to abandon their national objectives and to agree to arrangements that they may see as less beneficial to them

³²⁴ See *Antilegalistic Approaches*, *supra* note 307, at 426. See also Joel P. Trachtman, *The Domain of WTO Dispute Resolution*, 40 HARV. INT'L L. J. 333 (1999) (describing factors to be weighed in choosing between rules and standards in the WTO context). But it should be noted that the WTO already has exercised jurisdiction over matters such as food safety, intellectual property, and similar issues that also involve sensitive sovereignty issues.

³²⁵ Avi-Yonah, *supra* n 2, at 1674-5.

³²⁶ *Id.* at 1674-5.

³²⁷ Dale Pinto, *A Proposal to Create a World Tax Organisation*, 9 N. Z. J. TAX'N L. POL'Y 145 (2003), at 157.

³²⁸ T HOBBS, *LEVIATHAN* 92 (1991).

³²⁹ Tanzi, *supra* n 4, at 341-3.

than the alternative of going it alone. Also, countries with different political agendas will find it difficult to agree on a given tax structure. Even in the restricted area of the E.U. the progress towards tax harmonisation has been limited, although improving with time. Tanzi observes that the experience with negotiating tax treaties indicates that tax agreements, even between two countries, are, at times, difficult to reach and are very demanding in time and effort. In any case there is no institutional set-up that facilitates the discussion of issues and the negotiation of agreements on a world basis, and this situation lies at the heart of the problem.³³⁰

This situation leaves the alternative of creating an international organisation which would systematically deal with tax matters or alternatively, of giving a specific mandate to an existing institution. As has been noted previously, there is a world organisation that deals with trade matters (WTO); one that deals with macroeconomic stability and balance of payment equilibrium (International Monetary Fund - IMF); one that deals with economic development (International Bank for Reconstruction and Development - IBRD); and many others that deal with other objectives. The IMF, in particular, focuses on transnational implications of domestic macroeconomic policies. Yet, there is no organisation at the world level that supervises, or attempts to influence, tax developments with transnational implications.³³¹

Tanzi³³² suggests that this situation can be considered unusual because countries are competing less and less through the use of tariffs and quantitative restrictions on trade and through changes in exchange rates and more and more through the use of tax incentives, adjustments in tax rates, changes in administrative treatment of some incomes and so forth. This, Tanzi suggests, is the process that in the view of many tax experts is leading to “tax degradation”.³³³ As trade is liberalised further and as capital becomes freer to move, the advantages to some countries of engaging in tax competition, and the temptation to do so, will increase. The world tax base will become one of the “commons” to be exploited.

Thus, a case can then be made for the establishment of a World Tax Organisation. Tanzi asks the question: what would be the mandate for such an organisation? There are many possibilities, with Tanzi mentioning some of them.³³⁴ At the outset, its mandate would depend on how much power the member countries would want to give to it. It would also depend on how representative it would be of the whole world community. Because the levying of taxes is one of the most political of all governmental actions, it is unlikely that, at this juncture in time, the countries’ governments would want to assign to the World Tax Organisation the power to tax. There is still no example of a supranational organisation that has been given this power, since even the European Commission does not have such power.³³⁵

³³⁰ *Id.*, at 342.

³³¹ *Id.*, at 342.

³³² *Id.*, at 342.

³³³ *Id.*, at 342.

³³⁴ *Id.*, at 342.

³³⁵ Tanzi wrote in 1988: “It is conceivable that the day may come when the countries [of the world] create an ‘International Revenue Services’ to collect taxes that could not be collected by separate governments and to allocate them either to the provision of international public goods or back to the countries.” See Vito Tanzi, *Forces that Shape Tax Policy*, in *TAX POLICY IN THE TWENTY FIRST CENTURY* (Herbert Stein, ed., 1988), at 277.

Tanzi then refers to James Tobin's idea of an international tax on cross-countries' financial transactions, an idea that has been adopted by other writers who have proposed international taxes on bases such as airline tickets, financial transactions, or other bases, to finance the U.N.³³⁶ The collection of such a tax or some version of it, could be assigned to the World Tax Organisation, in Tanzi's view.³³⁷

However, Tanzi recognises that it is unlikely that the countries of the world are ready for such a step or for similar steps even though such taxes could provide financing for the activities of some of the international organisations and would remove the decision to finance established institutions such as the U.N. from the frequent political debate within countries.³³⁸ Nevertheless, Tanzi suggests that the World Tax Organisation could be given responsibilities other than tax collection, with some of the main activities of such an organisation being³³⁹:

- 1) The identification of main tax trends and problems at the international level.
- 2) The compilation and/or generation of relevant tax statistics and tax information for as many countries as possible.
- 3) On the basis of the above information, preparing a (yearly?) *World Tax Development Report* presenting statistics, describing main trends (both statistical and in terms of policy developments), identifying problems, and, perhaps, pointing toward feasible solutions to these problems. Countries' best practices could be identified and made known to other countries. Emerging problems could be highlighted and solutions to them could be studied.
- 4) Providing some technical assistance to countries in tax policy and tax administration always keeping in mind that changes recommended should make the tax system of the country receiving the assistance better coordinated or harmonised with the systems of other countries. Furthermore, the goal of the technical assistance provided by the new organisation would be to make the tax systems more compatible.
- 5) Developing basic norms for tax policy and tax administration. This is an area where little progress has been made.
- 6) Providing a world forum in which countries' policy makers and experts can exchange ideas on tax matters.
- 7) Providing a world forum for tax arbitration when frictions or conflict between countries or among groups of countries arise. Once again, no such forum exists now.
- 8) Providing surveillance over tax developments in the same way as the IMF provides surveillance on macroeconomic developments. Such a process of surveillance could be conducted: (a) at the country level; (b) at the regional level; and (c) at a world level. The modus operandi of the IMF could provide a useful guide for the new organisation.

³³⁶ The Tobin tax was first proposed by James Tobin, *A Proposal for International Monetary Reform*, 4 EUR. ECON. J. (1978), at 153-59. It has been much studied recently. See *inter alia*. B Spahn, *International Financial Flows and Transactions Taxes: Survey and Options*, IMF Working Paper, WP/95/60 (June 1995); and Peter Shame and Janet Stotsky, *Financial Transaction Taxes*, IMF Working Paper, WP/195/7 (August 1995).

³³⁷ Tanzi, *supra* n 4, at 342.

³³⁸ See comments and reaction to the U.N.'s 2001 announcement of a proposed WTO; see United nations, *supra* n 299.

³³⁹ Tanzi, *supra* n 4, at 343.

Thus, Tanzi concludes that the World Tax Organisation would identify tax developments that create cross-national spillover effects and would bring these to the attention of a board of directors representing all the countries.³⁴⁰ The board would recommend changes in those areas where the tax behaviour of a country has clearly negative implications for other countries. For example, it would recommend changes in countries that are obviously raiding the world tax base. This organisation would not get involved in tax issues that do not have significant cross-border spillovers. Furthermore, the World Tax Organisation would only recommend changes and not force them. While these would be the major activities of such an organisation, Tanzi recognises that more detailed and specific terms of reference might include other activities.³⁴¹

Do we need an International (or World) Tax Organisation? Horner³⁴² argues that a new global institution in taxation policy will make a significant, non-redundant contribution to global governance if - and only if - it gives a full and true voice to the fiscal concerns and needs of developing countries. That objective cannot be realised with a one-dimensional focus on tax cooperation. For the developing countries of the world, taxation policy and the development agenda are inseparable.³⁴³

In Horner's view, the U.N. seems to be the best contender for the job of convening an international tax body, and it is clearly positioning itself to become globally what the OECD has become for its interest group. The U.N.'s International Tax Organisation (ITO) proposal³⁴⁴ is a commitment by heads of state to "[e]xplore, including through a global network of tax authorities, the potential benefits and optimal design of an International Tax Organization or other tax cooperation forum, taking into account previous efforts in this regard as well as the special needs of developing countries and countries with economies in transition."³⁴⁵ It also underscores the need for "strengthening the representation and participation of developing countries in all global economic decision making and norm setting bodies. . . ."³⁴⁶ If these ambitions can be realised, the ITO will have an excellent basis for success and a legitimate claim that the new international tax body is not redundant.

Horner then presents several conditions which are considered vital for an international cooperation agreement, this being a necessary component for an effective ITO³⁴⁷:

- 1) *Condition One: No Gag Rules:* All issues must be eligible for discussion at the forum;
- 2) *Condition Two: Fair Share:* Attention should be given to profit allocation rules;
- 3) *Condition Three: Link to Official Development Assistance:* Development issues should be relevant in formulating tax policy;
- 4) *Condition Four: Tax Administration Efficiency:* Developed countries should assist developing countries in improving tax administration; and

³⁴⁰ *Id.* at 343.

³⁴¹ See the companion paper by Tanzi; Tanzi, *supra* n 64.

³⁴² Frances M. Horner, *Do we need an International Tax Organisation?*, 24 TAX NOTES INT'L 179 (2001).

³⁴³ *Id.* at 179.

³⁴⁴ United Nations, *supra* n 299.

³⁴⁵ Horner, *supra* n 342, at 188.

³⁴⁶ Draft Outcome Prepared by the FfD Facilitator (September 2001) para 54, available at: http://www.un.org/esa/ffd/0901/Facilitator_text.htm. (Visited 17 February 2004).

³⁴⁷ See Horner, *supra* n 342, at 192-4.

- 5) *Condition Five: Governance*: Developing countries should have a meaningful voice in any world tax body or tax cooperation arrangement.

A previously suggested application of a world tax organisation model: The cyber-entity

The literature to date is scant on specific areas that a World Tax Organisation/International Tax Organisation (ITO) could be applied to. One area that has received some attention is that of electronic commerce policy and its ensuing taxation implications. One proposal has been offered by Oats and Fernandez,³⁴⁸ namely a Cyber Entity combined with a World Tax Authority (WTA).

Oats and Fernandez suggest that this new global corporation should be called the Cyber-Entity and should be defined as any entity that sells goods or services through the internet.³⁴⁹ The Cyber-Entity will be an artificially created entity, similar to a corporation, but it will be global. Thus, instead of a corporation being incorporated in a particular jurisdiction, the cyber-entity will be born by registration with a WTA.³⁵⁰

The WTA, suggest the authors, will be created by representatives from each country that has agreed, by way of multilateral agreement, to be members of the WTA. The WTA will be given the jurisdiction to register and tax cyber-entities; that is, entities that deal with the internet trade. The WTA will be responsible for the incorporation of the artificially created Cyber-Entity, with its own legal personality, separate from its participators. The personality will be defined by rules that govern its behaviour from its conception before its birth, to the funeral after its death.³⁵¹

Furthermore, each participating country will need to pass legislation in their jurisdiction implementing the scheme, and will have to forgo any right or jurisdiction over the cyber-entity. Each country may be a watchdog for the WTA and liaise with the WTA as to any breaches of WTA law by the Cyber-Entity.

The authors go on to discuss their proposed structure of the Cyber-Entity and its taxation. They then present several advantages and disadvantages of their proposal.³⁵² The advantages of their proposed structure are suggested to be that there will be no incentive for an organisation to artificially split its electronic commerce into various jurisdictions. Since accounting for the organisation will be done on a unitary basis, the tax will be at a uniform rate and in a uniform currency.³⁵³ This will remove tax barriers, resolve the problems of bilateral or multilateral treaties, and promote global economic growth. However, the major disadvantage of economic integration is that it will limit national sovereignty.³⁵⁴ Countries will have to give up rights over this Cyber-Entity. However, it may well be worth giving up national sovereignty for economic growth and prosperity. The major problem to be addressed is how to deal with countries that do not want to be part of this scheme. The authors conclude³⁵⁵:

What is needed is a new paradigm to trigger a change in the international tax order. The cyber-entity concept may seem "way out", but then who would

³⁴⁸ Lynn Oats and Prafula Fernandez, *Creation of a Cyber Entity*, 5 N. Z. J. TAX'N L POL'Y 96 (1999).

³⁴⁹ *Id.* at 105-6.

³⁵⁰ *Id.* at 105-6.

³⁵¹ *Id.* at 104-7.

³⁵² *Id.* at 107.

³⁵³ For discussion on the implications of unitary taxation, see section 2.9 of this paper.

³⁵⁴ For a discussion on sovereignty issues, see section 2.7 of the paper.

³⁵⁵ Oats and Fernandez, *supra* n 348, at 107.

have guessed what the internet itself would have looked like only 5 or 10 years ago. Anything is possible.

Approaches for progressing towards a World Tax Organisation

Two scholars have made inroads into the possible structure of some form of international tax organisation. Their proposals are discussed in turn.

Thuronyi

Thuronyi argues in favour of international tax cooperation, a multilateral treaty, and most importantly, an international tax organisation.³⁵⁶ Thuronyi reviews the problems with the existing international tax system and the problems with the existing treaty network. He identifies the follow issues³⁵⁷:

- 1) The existing framework limits unilateral action;
- 2) Bilateral networks are inconsistent with multinational business structures;
- 3) Bilateral networks represent a fragmented approach;
- 4) Triangular cases are difficult or impossible to handle bilaterally;
- 5) There is incomplete coverage of countries;
- 6) There are problems with interpretation and amendment;
- 7) There is incomplete coverage of taxes;
- 8) Inflexibility; and
- 9) Treaty shopping.

Thuronyi argues convincingly that many of these problems could be overcome with a multilateral treaty framework, and he then presents a proposed structure for a multilateral treaty.³⁵⁸ The proposed multilateral treaty would replace the existing network of tax treaties with a single multipart treaty. The existing treaties would remain in force during a transition period. Thuronyi then advances his proposal in five main parts³⁵⁹:

- 1) The first part would be a common template for bilateral treaties, initially based on the OECD model.
- 2) The second part would be a multilateral treaty, based on the template in part one, but adjusted to take account of its multilateral nature. This part would not be subscribed to by all countries, at least initially.
- 3) The third part, which could evolve over time, would contain general undertakings for cooperation in international taxation (for example, non-discrimination, refraining from unfair tax competition, or agreements on information sharing).
- 4) *The fourth part of the treaty would be institutional, providing for an international organization to administer the treaty and for procedures.*

³⁵⁶ Victor Thuronyi, *In Defense of International Tax Cooperation and a Multilateral Tax Treaty*, 22 TAX NOTES INT'L 1291 (2001).

³⁵⁷ *Id.* at 1294-7.

³⁵⁸ *Id.* at 1297.

³⁵⁹ *Id.* at 1297-8. Emphasis added.

- 5) Finally, derogations and transitional arrangements would provide a bridge between the existing treaty networks and part one of the agreement. There would also be a common text based on the OECD Model, a unilateral version of the common text, general and undertakings.

Finally Thuronyi presents his proposal for the structure of an international organisation to administer this treaty.³⁶⁰

Membership and structure

The multilateral treaty should designate an organisation charged with enforcing, promoting, and interpreting the treaty, proposing amendments, and, more generally, promoting intergovernmental cooperation in taxation. While the OECD currently plays this role to some extent, it is not ideally suited for it, given its limited membership.

Given the political nature of the question, Thuronyi³⁶¹ does not believe that it is useful to discuss extensively what existing or new agency might be entrusted with this task. If sufficient international consensus develops to negotiate a multilateral tax treaty and countries entrust its administration to an appropriate agency, whichever agency is chosen will be an outcome of the negotiation process.

Whatever body is chosen (an existing body or a new body), Thuronyi suggests³⁶² that membership should eventually be nearly universal, but should be conditioned on the satisfaction of specified criteria, as well of course as adherence to the treaty. Not all countries will wish to cooperate by becoming members.

Because each country has a sovereign right to tax, Thuronyi proposes³⁶³ that each country should have a representative in this world body. The appropriate representative would be the highest official in charge of tax policy or tax administration - typically the finance minister or the minister in charge of the tax administration in countries in which there is a separate ministry. A one-country one-vote arrangement seems to have worked, for example, for the WTO. Such a rule is consistent with each country's sovereignty. An additional supermajority requirement on the basis of weighted voting could be layered on top of this.

Thuronyi recognises³⁶⁴ that the tax staff of the organisation should be international in character. Staff should be drawn from tax experts of all countries, and it would be desirable for a substantial portion to be drawn from the ministries of finance and tax administrations of the member countries. While there should be a permanent staff to provide some continuity, it would be important to provide a rotating element for the staff in order to maintain the cooperative character of the organisation. Thus, Thuronyi contends that the staff would benefit from an immediate knowledge of practices in the tax administrations of their own countries.

Functions

Thuronyi suggests that the organisation should be a general forum for discussion of the operation of the international tax system - the system for taxing international

³⁶⁰ *Id.* at 1299-1300. The following discussion in section 4.6.1.1 draws upon Thuronyi's proposal.

³⁶¹ *Id.* at 1299-1300.

³⁶² *Id.* at 1299-1300.

³⁶³ *Id.* at 1299-1300.

³⁶⁴ *Id.* at 1299-1300.

transactions.³⁶⁵ Its staff should conduct studies, including statistical studies, on how the system is working, and propose solutions.

The organisation should, in Thuronyi's view,³⁶⁶ have the power to issue interpretations of the treaty that would have general legal effect (specific disputes would have to be resolved separately). This would be an important improvement over the existing situation with the OECD commentary, because the interpretation would be legally binding. The organisation would provide a forum for continuous review of experience with the treaty. It would encourage the renegotiation of existing agreements to bring them into line with the treaty, including serving as a forum for multilateral negotiations (a country could renegotiate simultaneously a set of existing treaties with other countries). It would deal with problems of interpretation and application of the treaty and would attempt to find solutions by way of issuing reports, issuing formal interpretations of the treaty, and proposing amendments to the treaty text for ratification by the members.

While the primary focus of the organisation would be, in Thuronyi's view,³⁶⁷ to facilitate the *operation of the international tax system*, it should also deal more broadly with taxation, including some purely domestic issues. On purely domestic taxation, however, the organisation should be more of an observer and technical advisor rather than interfering in countries' decisions on tax policy and thereby impinging on their sovereignty. The organisation should gather information on how the tax systems of its member countries operate, including data of a statistical, economic, and legal nature. It should provide technical assistance to its member countries upon request.

The organisation should, argues Thuronyi,³⁶⁸ become a leader in comparative tax law and policy analysis. It should collect and publish the tax legislation of member countries and lead the effort in improving this legislation at a technical level. As part of its task of interpreting and evaluating the multilateral treaty, it should collect and publish judicial decisions and scholarly writings on tax treaty interpretation.

In addition to providing technical assistance in improving domestic tax administration to those of its member countries with weaker administrative capacities, the organisation should, argues Thuronyi, become a *centre for international cooperation* in tax administration.³⁶⁹ It should actively facilitate the cooperation of administrations in areas such as information exchange, joint audits, resolution of transfer pricing cases, and other cooperative efforts to stem tax avoidance and evasion, particularly where international transactions are involved. In so doing, the organisation should work closely with regional groupings of tax administrators, providing support to them as appropriate.

The organisation could, suggests Thuronyi,³⁷⁰ also become a forum for formal resolution of disputes among countries, as is the WTO for trade disputes. Thuronyi cautiously suggests that a dispute-resolution role should not be included in an original draft of a multilateral treaty, for fear of being too ambitious at the beginning. An alternative would be to provide for limited dispute resolution by agreement.

³⁶⁵ *Id.* at 1299-1300. The following discussion in section 4.6.1.2 draws upon Thuronyi's proposal.

³⁶⁶ *Id.* at 1299-1300.

³⁶⁷ *Id.* at 1299-1300. Emphasis added.

³⁶⁸ *Id.* at 1299-1300.

³⁶⁹ *Id.* at 1299-1300. Emphasis added.

³⁷⁰ *Id.* at 1299-1300.

Thuronyi then contends that the process of negotiating a unified tax treaty template would presumably encourage countries to rationalise their bilateral treaty relationships and therefore to minimise the amount of derogation.³⁷¹ While there would not be complete uniformity, the extent of differences could be substantially reduced. Replacement of the network of bilateral treaties with a multilateral treaty, therefore, does not require all countries to effectively scrap all provisions of their bilateral treaties. While it would be desirable to achieve as great a harmonisation of bilateral agreements as possible, the multilateral treaty can be designed in such a manner that each signatory can enter reservations.³⁷²

Thuronyi proposes that during a transition period, existing treaties should remain in effect.³⁷³ This would give negotiators time to review existing treaties and determine to what extent the texts can be brought into conformity with the uniform text. Countries would commit to negotiate any new treaties on the basis of the uniform text. This does not mean that there cannot be differences, but that the treaties must take the form of agreement to the uniform text subject to specified deviations. Eventually, all tax treaties would be brought into this format.

Thuronyi concludes³⁷⁴ his proposal by suggesting that multilateral action is needed to establish an international organisation for cooperation in taxation and a multilateral treaty to replace the current bilateral tax treaty network. While Thuronyi is confident that the arguments in support of these steps are robust, he recognises that the road will not be an easy one, given that people tend to be ‘wedded to old ways.’³⁷⁵

Thuronyi offers a potentially more palatable route, namely that it would not be necessary for all of the elements described in this article to be implemented precisely as envisaged here. For example, an international agency for cooperation in taxation could be established separately, even without an international treaty. This agency could grow into a formal international organisation, and it could provide a forum for negotiation of a multilateral treaty. This notion is essential to the argument in this paper for developing binding rulings and APAs as a potential area for this organisation to be involved with.³⁷⁶

Pinto

Pinto³⁷⁷ contends that consideration should be given to broaden the extent of international tax cooperation so that it truly becomes multilateral through the establishment of a World Tax Organisation. The role of such an organisation, in Pinto’s view, would not be to impose tax or to collect tax, but be a forum where emerging problems that are caused by developments, such as electronic commerce and harmful tax competition, can be discussed in a coordinated and inclusive multilateral way that would extend beyond just OECD countries.

Pinto examines the mandate, scope and role of a World Tax Organisation for tax (including a review of previous proposed models for such an organisation), the

³⁷¹ *Id.* at 1299-1300.

³⁷² *Id.* at 1299-1300.

³⁷³ *Id.* at 1299-1300.

³⁷⁴ *Id.* at 1301.

³⁷⁵ *Id.* at 1301.

³⁷⁶ *Id.* at 1301.

³⁷⁷ Pinto, *supra* n 327.

feasibility of establishing such an organisation (including issues of governance, sovereignty, and multilateral cooperation).³⁷⁸

Pinto concludes³⁷⁹ that based on his analysis, a World Tax Organisation is a desirable initiative that could achieve a more coordinated development of international tax policy than existing mechanisms. Pinto also argues that such an organisation could feasibly be established if created initially with modest powers that could be extended and expanded as it gains acceptance. A graduated process is certainly likely to be more palatable, and again it raises the question of what powers such an organisation should have to commence with. In this regard, Mintz has suggested that “a smaller group of countries could provide leadership to encourage the development of multilateral discussions that [could] ultimately lead to new arrangements for tax coordination.”³⁸⁰

Pinto’s incremental approach,³⁸¹ an approach with which I concur with, could see the organisation’s powers initially restricted to facilitating multilateral cooperation in the development of international tax policy through the distribution of information and the creation of a global forum for discussion in areas of current and emerging international significance, such as electronic commerce, harmful tax competition, and also in my view, transfer pricing. Furthermore, such an organisation could also assume a monitoring role, to keep abreast of new developments in areas such as electronic commerce. Binding rulings and APAs would be suitable areas for initial inclusion with respect to information exchange and development of coordinated application of tax policy, particularly with respect to transfer pricing and the arm’s-length approach that is currently applied.

However, Pinto suggests³⁸² that when the organisation is originally established, it should not aim to assume responsibilities in the areas of either tax collection or imposition, as it is considered unlikely in the short- to medium-term that such responsibilities would be internationally accepted by many countries. Nevertheless, over time, such an organisation may ultimately assume these roles. In my view, to make the organisation effective in the area of binding rulings and APAs, a degree of negotiation, imposition and enforcement of binding rulings and APAs across borders is necessary to achieve the advantages from such international cooperation. Pinto’s immediate desire is that the organisation’s main short-term objective should be the establishment and acceptance of such a fundamental change in the way international tax policy is formulated.³⁸³

Created in this incremental way, Pinto argues convincingly³⁸⁴ that a World Tax Organisation will not only bridge gaps in international tax policy created by the limited scope of unilateral measures such as the Controlled Foreign Company (CFC) rules (and also I would argue transfer pricing), but could also serve as an important

³⁷⁸ *Id.* at 151-159.

³⁷⁹ *Id.* at 159-160.

³⁸⁰ See JM Mintz, *The Role of Allocation in a Globalised Corporate Income Tax*, IMF Working Paper 98/134 (1998), p 36 (further suggesting that this process could be “facilitated by G-7 countries, which account for a significant share of multilateral trade, to initiate discussions and develop a broad set of criteria for multilateral negotiations among developed and developing countries”). Vann has suggested a similar approach could be undertaken in the context of a regional model: see RICHARD VANN ed, *TAXING INTERNATIONAL BUSINESS; EMERGING TRENDS IN APEC AND OECD ECONOMIES* 100 (1997).

³⁸¹ *Pinto, supra* n 327, at 159-160.

³⁸² *Id.* at 160.

³⁸³ *Id.* at 160.

³⁸⁴ *Id.*, at 160.

and effective coordinating mechanism to determine future tax policy in an increasingly globalised world. With the rapid integration of world economies, combined with the transnational activities of global businesses, in Pinto's view a World Tax Organisation may in the not too distant future be a necessary, rather than a desirable, foundation of international tax policy. Thus it is a question of when rather than if, such an organisation becomes a reality.

BINDING RULINGS AND APAS IN A WORLD TAX ORGANISATION: PART OF A GRADUATED APPROACH?

The approaches to a transition from the current predominantly nationally-focussed tax policy approach to my proposed new internationally-focussed best-fit response need to be considered. In arriving at a best-fit response (ultimately, in my view, a multilateral agreement on developing tax policy, including allocation of taxes, jurisdiction determination and a general commitment with regard to maintaining existing taxes is needed, but for the purposes of this study this is restricted to binding rulings and APAs as a first step), the transition process from the current environment to one that fully recognises globalisation's impact on tax policy is vital. Frequently, this process is neglected or left to lawyers and other officials to develop after the new policy is finalised.³⁸⁵ Various options to arriving at a best-fit response include gradualism (which implies some form of dual system) and going "cold-turkey". Concurrent with ascertaining the most prudent approach for implementing a new policy process, the cost/benefit considerations must be considered.

A further option is to implement changes on a regional (as opposed to global) scale in coordinating international tax policy, such as in the E.U.³⁸⁶ One scholar has suggested that a suitable test case, in the context of a multilateral tax treaty, could be the APEC nations.³⁸⁷ In this paper I pursue the international application of a mutual tax policy setting and development process for a particular issue (binding rulings and APAs) rather than tax policy in wider terms on a regional basis.

While a greater level of harmonisation from a regional perspective is a desirable (and achievable) goal,³⁸⁸ widespread application via extensive ratification³⁸⁹ is crucial in an environment of globalisation. Nevertheless, international tax policy may not be fully recognisable until after draft legislation (or a draft policy process) is prepared and subsequently ratified. The drafting process necessarily follows the initial heads of agreement concerning the underlying policies, and normally involves several previous iterations prior to the final draft agreement.³⁹⁰ This also applies in the context of

³⁸⁵ In the context of moving to a consumption tax in the United States, see Ronald A. Pearlman, *Transition Issues in Moving to a Consumption Tax*, A.B.A. SEC. ON TAX'N (1996).

³⁸⁶ In the context of corporate taxation in the E.U., see generally Sijbren Cnossen, *Company Taxes in the European Union: Criteria and Options for Reform*, 17 FISCAL STUD. 67 (1996).

³⁸⁷ Vann, *supra* note 15. See OECD, ELECTRONIC COMMERCE: THE CHALLENGES TO TAX AUTHORITIES AND TAXPAYERS (1997) and Owens, *supra* note 3. One example of a model multilateral income tax treaty in operation is that which applies to the Nordic Countries; see CONVENTION BETWEEN THE NORDIC COUNTRIES, *supra* note 263. A further example is the treaty that applies for eleven of the fourteen members of the Caribbean Community; see CARICOM CONVENTION, *supra* note 264.

³⁸⁸ An example of practical implementation of harmonisation has occurred in the European Union with respect to indirect taxes.

³⁸⁹ Such as ratification by the original 134 member nations to GATT and the WTO (now over 180 members, including China).

³⁹⁰ For a useful discussion on the general tax legislative process, see Richard K. Gordon and Victor Thuronyi, *Tax Legislative Process*, in TAX LAW DESIGN AND DRAFTING Vol. 1, 10-14 (Victor Thuronyi ed., 1996). However, the approach for taxing electronic commerce may not necessarily utilise the same

developing an international tax organisation, following the approach suggested in the earlier discussion.

CONCLUDING OBSERVATIONS

This paper, like that of Pinto³⁹¹ and Thuronyi,³⁹² focuses on the policy rather than the detailed operational issues of a World Tax Organisation. However, this paper extends upon Pinto³⁹³ through suggesting an area that a WTO would be a positive development, namely binding rulings and APAs with cross-border effects. Furthermore, the approach proposed in this paper largely endorses that proffered by Thuronyi.³⁹⁴

With respect to binding rulings and APAs, multilateral agreements are far superior to unilateral or even a series of bilateral agreements. Administering such an agreement would be greatly facilitated by an international organisation, such as the World Tax Organisation that has been proposed in this paper. Furthermore, binding rulings and APAs would, in my view, be a less contentious subject area for sufficient nations to relent a degree of their tax policy sovereignty to a suitably developed and organised international body. However, a greater degree of harmonisation of APA processes, and more particularly binding rulings regimes, is needed to facilitate any form of international cooperation in this area.³⁹⁵ This in itself would represent a significant achievement as a first step. Thus to answer the question posed in the title to this paper, an International or World Tax Organisation would be an appropriate forum for administering binding rulings and APAs.

However, should such an organisation be considered desirable by a large number of nations, then further work and research will need to be conducted in many areas, including the need to take a closer look at the detailed structure of the World Tax Organisation model, the need to undertake further investigation in relation to the possible obstacles of establishing a World Tax Organisation, and finally, consideration will need to be given to the development of a potential framework towards developing a workable World Tax Organisation. These issues form part of my on-going research.

policies as may apply to other areas of tax allocation. For example, is a proposal to allocate income tax revenues by some formulaic apportionment method (such as sales, Avi-Yonah, *supra* note 2), applicable for electronic commerce?

³⁹¹ Pinto, *supra* n 327.

³⁹² Thuronyi, *supra* n 356.

³⁹³ Pinto, *supra* n 327.

³⁹⁴ *Id.*

³⁹⁵ See the earlier discussion comparing binding rulings internationally by Sawyer, see IRD study, *supra* n 214.