Brooklyn Journal of International Law

Volume 34
Issue 3
SYMPOSIUM:
Ruling the World: Generating International Legal Norms

Article 6

2009

Reflections on the Role of the OECD in Developing International Tax Norms

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INTRODUCTION

On September 8–9, 2008, the Organisation for Economic Co-operation and Development ("OECD") held a Special Conference commemorating the 50th Anniversary of the OECD Model Tax Convention ("Model Convention" or "Model").[1] The Conference was attended by over 650 participants from the private sector and the government, representing over 100 countries. Both the level of participation[2] and the geographical diversity represented at the conference would seem concrete evidence of the perceived importance of the role of the OECD in developing international tax norms. In his remarks opening the conference, the OECD Secretary General noted that the success of the OECD Model was based on three elements: "the capacity to adapt international tax rules to the changing business environment, the enhanced participation of the business community and the progressive involvement of non-member countries."[3] His observations about the Model Convention are more generally applicable to all of the OECD's work in the tax area.

In this paper, I would like to focus on the process through which the OECD works, as reflected in several of the projects in which the OECD could be said to be developing international tax norms. Hopefully, a better understanding of how the OECD functions at a practical level will help to inform the fascinating theoretical academic scholarship that has focused on the OECD tax work.[4]

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1. *See* Joann M. Weiner, *OECD Celebrates 50th Anniversary of Model Tax Convention*, 51 TAX NOTES INT'L 997 (2008).

2. The conference was sold out within a few weeks of its announcement.

3. Angel Gurría, OECD Secretary-General, Remarks at Conference on the 50th Anniversary of the OECD Model Tax Convention (Sept. 8, 2008).

4. *See, e.g.*, Allison Christians, *Sovereignty, Taxation and Social Contract*, 18 MINN. J. INT'L L. 99 (2009); Arthur J. Cockfield, *The Rise of the OECD as Informal 'World Tax Organization' Through National Responses to E-commerce Tax Challenges*, 8 YALE J.L. & TECH.136 (2006); Diane M. Ring, *What's at Stake in the Sovereignty Debate?: International Tax and the Nation-State*, 49 VA. J. INT'L L. 155 (2008).

I. LEGAL STRUCTURE AND ORGANIZATION OF THE OECD

The OECD was formed in 1961 as the successor to the Organization for European Economic Co-operation, which was set up in 1948 to coordinate Marshall Plan relief.[5] It is based on the Convention of December 14, 1960.[6] The OECD Council is the principal decision-making body of the organization and is composed of representatives from the thirty Member countries, which send Ambassadors to the OECD as well as staff national delegations. Decisions must be made on a consensus basis, and any country has the right to veto any proposed action at the Council level. The substantive work of the OECD is carried out in specialized Committees working in various areas: economics, trade, financial markets, labor, public governance, and the like. There are about 200 Committees, working groups, and expert groups in all. Some 40,000 senior officials from national administrations come to OECD Committee meetings each year to request, review, and contribute to work undertaken by the OECD Secretariat. The Committees meet regularly to come to decisions on issues and submit proposals to the Council for approval.

While the founding Convention provides for "decisions" that are binding on Member States,[7] this form of an OECD Act is not often used. The most frequently used form of an OECD Act is the Council Recommendation. Under the OECD's procedures, a Recommendation represents the strong political commitment of a country to follow the Recommendation in its domestic policy. Recommendations are often composed of a general statement of principle with an Annex setting out more detailed rules and entitled "Guidelines." The OECD also issues Reports, which are not legal instruments but written analyses of particular issues. They can be adopted at the Committee level as well as at the Council level.[8] Before final action is taken by the OECD in the area of taxation, the work is of-

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5. OECD, History, http://www.oecd.org/pages/0,3417,en_36734052_36761863_1_1_1_1_1,00.html (last visited Apr. 20, 2009).

6. Convention on the Organisation for Economic Co-operation and Development, Dec. 14, 1969, 12 U.S.T. 1728, 888 U.N.T.S. 179 [hereinafter OECD Convention]. Interestingly, it was viewed as the economic counterpart to the North Atlantic Treaty Organization.

7. *Id.* The Code on the Liberalization of Capital Movements is an example.

8. For example, the report "The Application of the OECD Model Tax Convention to Partnerships" was first presented as a report with suggested changes to Commentary and then changes in the Commentary were implemented in a Recommendation as part of the 2000 Model update. *See* OECD, 2 *Model Tax Convention on Income and on Capital* R(15-1) (Apr. 2000) (*current version available at* www.oecd.org/dataoecd/43/57/42219418.pdf).

ten published for public comment as a Discussion Draft.[9] The OECD also publishes statistical analyses and other descriptive information in the various fields in which it operates. The Economics Directorate publishes Economic Surveys of both Member and non-Member countries, often with quite prescriptive policy analyses in many areas, including tax.

Funding for the OECD is provided by the Member States. A portion of the budget is funded by contributions based on relative GDP and another portion based on individual country contributions. In 2008, the United States provided nearly 25% of the budget of EUR 303 million, and Japan contributed 14%. Iceland contributed 0.1%.[10]

The original membership of the OECD has expanded over the years, most recently with the admission of Mexico (1994), the Czech Republic (1995), Hungary (1996), Korea (1996), Poland (1996), and the Slovak Republic (2000).[11] Thus, while the OECD is often characterized as the "rich man's club," in fact the Member country economies vary substantially.[12] Currently, an accessions process leading to membership is under way with Chile, Estonia, Israel, Russia, and Slovenia. Discussions are also underway with Brazil, China, India, Indonesia, and South Africa on enhanced engagement programs with a view to possible membership.[13] In addition, a number of countries have Observer status on various Committees. For example, Argentina, Chile, China, Russia, India, and South Africa are Observers on the Committee on Fiscal Affairs.[14]

The activities of the Committees are supported by the Secretariat and led by the Secretary General, who also chairs Council meetings, thus providing a link between the staff input and the Member countries. The

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9. *See* OECD, *OECD Aims to Improve International Tax Disputes Mechanisms* (Mar. 13, 2006), http://www.oecd.org/document/28/0,3343,en_2649_37989739_36271004_1_1_1_1,00.html.

10. OECD, Scale of Members' Contributions to the OECD's Core Budget-2009, http://www.oecd.org/document/14/0,3343,en_2649_201185_31420750_1_1_1_1,00.html (last visited Apr. 24, 2009).

11. OECD, Ratification of the Convention on the OECD, http://www.oecd.org/document/58/0,3343,en_2649_201185_1889402_1_1_1_1,00.html (last visited Apr. 20, 2009).

12. For example, both Mexico and Korea have basic tax policies that reflect strong interests as source countries.

13. OECD, OECD Member Countries, http://www.oecd.org/countrieslist/0,3351,en_33873108_33844430_1_1_1_1_1,00.html (last visited Apr. 20, 2009).

14. OECD, *China, South Africa to Participate in Work of OECD's Committee on Fiscal Affairs* (June 6, 2004), http://www.oecd.org/document/21/0,3343,en_2649_34897_32074069_1_1_1_1,00.html; OECD, *OECD Countries Welcome Chile's Participation in the OECD's Taxation Work*, http://www.oecd.org/document/33/0,3343,en_2649_34897_36339297_1_1_1_1,00.html (last visited Apr. 20, 2009); OECD, *OECD Invites India to Participate in Its Committee on Fiscal Affairs*, http://www.oecd.org/document/9/0,3343,en_2649_34897_37131209_1_1_1_1,00.html (last visited Apr. 20, 2009).

Secretariat is organized around Directorates, which provide support for the various Committees. The current professional staff is about 700. Some of the staff are international civil servants associated with the OECD on a long-term basis, and others are secondees from national administrations, typically spending several years at the OECD.

II. ORGANIZATION OF TAX ANALYSIS AT THE OECD

Most work in the tax area is done by the Committee on Fiscal Affairs ("CFA"). The Committee meets twice a year in Paris. Country representatives are generally high-level officials in national treasuries and tax administrations. The United States typically sends the International Tax Counsel and the Deputy Assistant Secretary for International Tax. Other Treasury and Internal Revenue Service officials may attend depending on the items on the agenda. The Chair of the CFA is currently from Italy;[15] recent past chairs have been from Sweden, the United States, the United Kingdom, and Canada. Currently, in addition to representatives of the thirty Member countries, Observers are sent from Argentina, Chile, China, India, Russia, and South Africa.

According to the CFA's Mission Statement, its goals are

> to provide a forum for tax policymakers and administrators to discuss current policy and administration issues; to assist OECD countries and non-OECD [countries][16] to improve the design and operation of their tax systems; to promote co-operation and co-ordination among them in the area of taxation; and to encourage non-OECD economies to adopt taxation practices which promote economic growth through the development of international trade and investment.[17]

Much of the preparatory work for the CFA meetings is done by the CFA Bureau, an executive Committee that meets periodically between the CFA plenary meetings. The Bureau develops the agenda for the CFA meeting and often prepares Recommendations for particular issues, which have a great deal of presumptive weight in the discussions. Often, at impasses in the CFA meeting discussions, the Bureau will meet separately and prepare compromise solutions. The CFA approves the Pro-

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15. OECD, *New Chair of the OECD's Committee on Fiscal Affairs*, http://www.oecd.org/document/20/0,2340,en_2649_34897_36396500_1_1_1_1,00.html (last visited Apr. 20, 2009).

16. OECD documents typically refer to "Non-Member Economies" rather than Non-Member Countries because of the participation of some dependent territories that have fiscal autonomy (e.g., Hong Kong) or to avoid political issues (e.g., Taiwan). Here, I will use the less awkward Non-OECD Member.

17. ORG. FOR ECON. COOPERATION & DEV., OECD'S CURRENT TAX AGENDA (2008), *available at* http://www.oecd.org/dataoecd/38/17/1909369.pdf.

gram of Work and gives mandates to various subsidiary bodies to carry out the work. Topics for the work usually come from the subsidiary bodies themselves, based on proposals by Member countries, businesses, or the Secretariat, and the proposals are subsequently approved by the CFA.

The most important subsidiary bodies are structured as follows: Working Party 1 deals with tax treaty and related issues; Working Party 2 covers tax policy analysis and statistical work; Working Party 6 deals with the taxation of multinational enterprises, including transfer pricing; Working Party 8 investigates how Member governments can cooperate to minimize the extent of tax evasion and avoidance; Working Party 9 examines consumption taxes.[18] In addition to the Working Parties, the Forum on Harmful Tax Practices advances the OECD's work on harmful tax practices, and the Forum on Tax Administration provides a forum to improve taxpayer service and compliance.

The CFA also sponsors a number of events aimed at pursuing a dialogue and sharing expertise with non-Member countries at its Multilateral Tax Centres in Austria, Hungary, Korea, Mexico, and Turkey and at its in-country Centres in Moscow and Yangzhou, China.[19] Individual events are also provided. For example, four events are held each year in India at the Indian National Academy of Direct Taxes in Nagpur. These meetings cover a broad range of topics including tax treaty policy and negotiation, transfer pricing, tax policy including modeling and the use of incentives, auditing, and value added tax compliance. Over sixty events, each typically lasting one week, are staged each year.

Another important mechanism through which the OECD carries on its dialogue with Non-OECD Members in the tax area is the Global Forum on Taxation, which are large international meetings held to cover a variety of subjects. The composition of the Global Forum generally varies depending on the topics covered. The annual Global Forum Meeting on Tax Treaties, which has the broadest country participation, typically attracts several hundred participants from over ninety countries.

The CFA's work is supported by the Centre for Tax Policy and Administration, a Directorate within the Secretariat. The Centre is divided into Divisions that serve the various working parties and other subsidiary bodies. Some of the staff of the Centre are on long-term or indefinite contracts, and others are seconded to the Centre for more limited periods

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18. The odd numbering arrangement comes from the fact that when Working Parties achieve their mandate, they go out of existence but the continuing Working Parties are not renumbered.

19. ORG. FOR ECON. CO-OPERATION & DEV., CTR. FOR CO-OPERATION WITH NON-MEMBERS, THE OECD'S GLOBAL RELATIONS PROGRAMME (2007–08), *available at* http://www.oecd.org/dataoecd/57/5/39109041.pdf.

of time by the Member countries. The Centre staff play a key role in the CFA's work and represent the organization, not any particular country. While procedures vary from topic to topic, typically the responsible Division prepares the initial drafts of the documents on the matter in question. The drafts are first discussed in smaller working groups or directly at the Working Party or Forum level and then discussed on a line-by-line basis by the delegates. Proposed changes and redrafted text are put forward by the delegates. The Chair of the meeting usually summarizes the results of the discussion. The text is then redrafted by the staff and reviewed by the delegates for final approval. In some cases, additional changes are made in the final drafting by the Secretariat and are approved by written communication. Thus, the skill of the staff in dealing with delegates in reaching (and in some cases possibly creating) a consensus on the substantive issues is extremely important. Depending on the complexity and political sensitivity of the issues involved, the drafting process can take a few weeks or more than a decade (e.g., as has been the case for the recently approved Report on Attribution of Profits to Permanent Establishments).

Private sector input into the CFA's work comes from several sources. The Business and Industry Advisory Committee ("BIAC") and, to a lesser extent, the Trade Union Advisory Committee ("TUAC") comment on documents both while they are being prepared and after they have been issued. In addition, it is common to issue a Discussion Draft for public comment and, in some cases, to hold a Consultative meeting attended by both government and private sector representatives to review the Discussion Draft.[20] Dialogue with the private sector at the inception of a project may take the form of a Centre for Tax Policy and Administration Roundtable, such as those held in recent years on business restructuring and the tax treaty treatment of collective investment vehicles. There are also a variety of ways in which dialogue can be conducted throughout the course of a project, either by having private sector representatives participate in the drafting groups, which was done with the e-commerce work in the 1990s and the current projects on collective investment vehicles and real estate investment trusts, or by having them act as advisory groups to the governmental delegates, which was done with the revisions to the OECD Model Commentary on international transportation income.

Some general observations can be made about the process through which the CFA deals with tax matters. In the first place, the consensus principle is extremely important and taken very seriously by the participants. The lengthy discussions, skillfully led by the Chair and the Secre-

20. *OECD Aims to Improve International Tax Disputes Mechanisms*, *supra* note 9.

tariat, can often lead to agreements and compromises that were not at all evident when the discussions began. In addition, the process is an iterative one, with the same parties, both in terms of countries and in terms of persons, often having a wide range of issues to consider over a number of years. Countries are reluctant to be too intransigent on a particular issue, as they may need the support of other Members on a subsequent question where they have more at stake. Peer pressure and the perceived status of various individuals, especially those with a long history at the institution, also play a role.

Sometimes the pressure for consensus can lead to difficulties if the pressure to agree on language generates too much ambiguity and leads to differences in subsequent interpretation and implementation. There is a danger that striving for consensus can result in agreement on "principles" at such a high level of generality that they do not in fact advance matters. While creative ambiguity can at times be useful, masking important differences with bland platitudes is not helpful. As a delegate once observed, if country A says the world is flat and country B says the world is round, and after a long discussion, the OECD issues a report that says the world is an attractive shape and declares a consensus has been reached, it is difficult to call that real progress in establishing international norms. On the other hand, "parking" a contentious question in ambiguous language while reaching agreement on other related issues can leave open the possibility of revisiting that issue for "clarification" at another time.

These aspects of the OECD process are discussed below in the context of more concrete developments in the tax area.

III. THE PROCESS AT WORK: SOME SELECTED TAX "NORMS" AND THE OECD INVOLVEMENT

A. Harmful Tax Competition[21]

It is commonplace that increased globalization of trade and investment has made countries' economies and policies more interconnected. In the tax area, that has meant that policies that have been historically developed in a closed economy now have increasingly important impacts on other countries, as economies have become more open. This has led to concerns about "harmful tax competition," where one country's tax system can have a potentially negative impact on those of other countries. In

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21. Reuven Avi-Yonah's Article looks at the harmful tax competition project after ten years; my focus here is to look back at the process through which the project developed. *See* Reuven S. Avi-Yonah, *The OECD Harmful Tax Competition Report: A Retrospective After a Decade*, 34 BROOK. J. INT'L L. 783 (2009).

particular, this increased openness has resulted in the appearance of special tax regimes and practices aimed at attracting mobile activities and capital from other jurisdictions through legislative and administrative tax breaks tailored to attract foreign investment. These problems attracted a great deal of concern among Member States and in 1996, after much internal discussion, the OECD Ministers charged the organization to "develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases, and report back in 1998."[22] The OECD proposal was supported by the G7 at their Summit in Lyon in 1996, where they urged the OECD to "vigorously pursue its work in [tax competition] aimed at establishing a multilateral approach under which countries could operate individually and collectively to limit the extent of these practices."[23]

The work was initially carried out in a so-called "Special Session," an ad hoc organizational form that cuts across divisional lines to deal with a particular problem. The Special Session fulfilled its mandate by the 1998 deadline provided by the Ministers and issued the report "Harmful Tax Competition: An Emerging Global Issue" ("Report" or "1998 Report").

The first issue to be considered in the Special Session was the development of a framework for determining when and in what circumstances tax competition can be appropriately characterized as "harmful."[24] This issue has been the subject of a long and ongoing debate in the economic literature about the benefits and detriments of tax competition. Some see tax competition as a good and healthy thing—it keeps the Hobbesian Leviathan in check, limits the State's tendency to expand, promotes more efficient government and governmental services, and limits political pandering to domestic interest groups, purposes that are all very much public choice and Buchannan oriented.

On the other side, there are those who see tax competition as resulting in a destructive "race to the bottom." Tax competition has a number of potential negative effects: it causes "bidding wars" in the competition for mobile activities, ultimately resulting in no tax at all on mobile capital; it makes redistributive, benefits-based income taxation impossible; it may require States to shift to other revenue sources, taxing less mobile activities and taxing labor, in particular, more heavily; it may force a reduction

22. ORG. FOR ECON. CO-OPERATION & DEV., HARMFUL TAX COMPETITION, AN EMERGING GLOBAL ISSUE 3 (1998), *available at* http://www.oecd.org/dataoecd/33/0/1904176.pdf [hereinafter HTC REPORT].

23. *Id.* at 7.

24. The HTC Report made a distinction between harmful tax competition in the form of harmful preferential regimes, which are discussed here, and the issue of tax havens, which are discussed *infra* at note 35. *See* HTC REPORT, *supra* note 22, at 19–21.

in public expenditures to a suboptimal level; it may prevent the implementation of democratically arrived at tax policy decisions as to tax mix and tax level, and generally leave everyone worse off.[25]

There was substantial attention paid to theoretical work in the Special Session discussions. There was wide agreement that the general international movement in the direction of a broader tax base with fewer preferences and lower rates, which was in part a result of the "competitive" reaction to changes in the U.S. and U.K. systems in the mid-1980s, was a good thing.[26] It forced the elimination of wasteful and inefficient tax preferences and excessively high marginal rates, and it generally increased efficiency. This approach is consistent with the basic market orientation of the OECD.

It is also clear, though, that some kinds of tax practices can have more negative effects than positive ones, and the issues facing the Special Session were how to identify those situations and how to develop some kind of consensus on a distinction between "fair" and "harmful" tax competition.[27]

As one could imagine, reaching international agreement on a definition of harmful tax competition was a difficult and contentious process. Some countries—as would be expected of typically high-tax countries—started out from the tentative position that any country that had a low rate of tax and could potentially attract investment through that rate was engaging in harmful tax competition. And in some senses that was true, viewed solely from the national perspective of the high-tax country, since the other

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25. Reuven S. Avi-Yonah, *Globalization*, *Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1576 (2000).

26. *See generally* HTC REPORT, *supra* note 22.

27. Much of the economic literature on tax competition is in the subnational area and is generally positive about tax competition. The argument goes something like this: local taxes tend to be benefits-based taxes, and there is substantial mobility of both individuals and business activities. Thus, competition will result in different tax/benefit mixes, which actors will respond to by moving, and the results will force local governments to be more efficient in the provision of public services, and people will sort themselves out according to preference. *See generally* Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956). This is the so-called efficient Tiebout equilibrium. Obviously, things in the international setting are different. In the first place, mobility is different, though it might be similar with respect to mobile service activities. More important, from a theoretical point of view, national-level taxes have a redistributional function beyond being simply benefits based. This is the classic Musgrave model in which local units provide services and the National government provides nonspatially limited public goods and transfer payments. It is not clear how much the subnational analysis, to the extent the OECD comes to the conclusion that tax competition is uniformly good, is relevant in the international context.

jurisdictions with low rates were capable of attracting investment away from the high-tax country.

On the other hand, the issues of what general rate of income tax to impose, or whether or not a State should even have an income tax at all, are basic questions of national policy and sovereignty, which every country, at least historically, has been able to decide for itself. So, while a low rate of tax may be potentially harmful, this cannot be enough—at least at this stage of international cooperation—to constitute harmful tax competition.

The Report issued by the Special Session distinguishes between a general low rate, which applies to all taxpayers and activities in a jurisdiction, and a special regime or practice, which is limited to mobile activities.[28] The special regime is combined with some other features that make it likely that the effect and, in all probability, the purpose of the regime were simply to attract investment from elsewhere with no other impact on the domestic economy. The first situation is not covered by the Report, and the second constitutes harmful tax competition.[29] So to take two extreme examples, if a country introduces a general, nondiscriminatory, across-the-board 12.5% corporate tax rate, this would be viewed as an appropriate policy choice under the approach adopted by the OECD. In contrast, it would constitute harmful tax competition if the country has a special zero-tax regime for corporations engaged in offshore banking where (1) only foreign investors can invest; (2) those corporations cannot do business in the domestic economy; and (3) the country will not exchange information about the income of such corporations with the investors' home country (so that the latter country could try to continue to tax its residents on the income arising in the regime). For cases in between these extremes, the Report emphasizes that the decision is to be made on the basis of all the factors taken together in context.[30]

The articulation of these principles was an important first step in creating a framework that can preserve the benefits of "fair" competition while restraining the negative effects of other forms. However, the actual implementation of these ideas requires some sort of international institutional framework through which the principles can be developed and monitored. Countries dealing with issues of tax competition are, to use a game theory concept, in a prisoner's dilemma situation. If all cooperated, all would be better off than if no one cooperated, but if some cooperated

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28. HTC REPORT, *supra* note 22, at 20–21.

29. One could see this as recognition of some sort of "sovereign duty" not to utilize a tax practice that has the sole purpose of negatively impacting another jurisdiction. *Cf.* Christians, *supra* note 4.

30. HTC REPORT, *supra* note 22, at 21.

and others did not, the defectors who did not play by the rules could actually be the winners. What was needed was an institutional framework both to develop the principles and to establish a monitoring mechanism that, if necessary, would sanction those countries that were tempted to stray. The beginning of such a structure was developed in the OECD work through the establishment of the Forum on Harmful Tax Practices and the Global Forum on Taxation.

The Report established a new subsidiary body within the OECD, the Forum on Harmful Tax Practices, which, since 1998, has administered a set of guidelines on tax practices setting out certain obligations on countries that adopted the Report. Under these guidelines, which the Report implemented, the countries agreed to carry out a self-review process of their domestic measures in light of the criteria set out in the Report and to eliminate within a stipulated period of time those measures found to constitute harmful tax competition, as defined by the Report. In addition, they agreed not to introduce any new measures that would constitute harmful tax competition. The self-review process presented the countries with a classic prisoner's dilemma. Each country was looking over its shoulder to try to decide whether to cooperate or not. All of them recognized that they would be better off if they cooperated, but they would be worse off if they listed their regimes as harmful while other countries did not. Conversely, they could be better off if they did not list themselves as harmful while others did.

However, there is another mechanism that strengthens discipline: a peer review process that begins after the initial self-review period. Under this procedure, a country can ask the Forum to review a measure of another country not listed in the self-review, and the Forum can give an opinion as to whether or not the regime constitutes harmful tax competition. If a measure is found to be harmful under the criteria of the Report, the offending Member State is obligated under the Report to remove it.

What does this mean in practice? This question involves the legal nature of the measures contained in the Report. As a formal matter, the Report deals with "Recommendations," a defined term of art in the OECD treaty; as indicated above, these are not binding international law commitments. Under the Treaty, countries undertake to make a strong political commitment to follow the Recommendations, but the Treaty expressly recognizes that there may be circumstances in which a country is unable to fulfill its commitment or needs to delay compliance. This "soft" international undertaking is not legally binding but creates substantial peer pressure to act in accordance with the Recommendation. This process has been extremely effective in bringing countries to eliminate regimes found to be harmful under the criteria of the Report. Of the forty-seven preferential tax regimes that had been identified as potentially harmful in 2000, none of the regimes are deemed harmful at the present time.[31] A number of regimes have been abolished, others have been amended to remove their potentially harmful features, and still others were found not to be harmful on further analysis of their actual impact. Here, the actual details of the results are less important than the process by which they were reached. Countries were able to establish a cooperative process through which they could escape the logic of the prisoner's dilemma. In addition to the consultative process foreseen in the Report, the Report also provided for so-called "co-ordinated defensive measures" against harmful tax practices. These are, in general terms, measures that can counteract the effects of the harmful tax competition in various ways. For example, if the residence country can directly tax the income that arises in the offshore regime, this can have the effect of discouraging its taxpayers from taking advantage of that regime in the first place. Any country can unilaterally introduce such measures, but they are more effective if done on a coordinated basis, the course recommended by the Report. Similarly, in some cases, harmful tax competition is the result of the utilization of favorable provisions in a tax treaty. A Recommendation urges countries to modify treaties to exclude from treaty benefits the income and entities benefiting from measures found to constitute harmful tax competition. Given the requirement of action by consensus, the likelihood that the OECD would ever actually approve of a defensive measure against a Member country is doubtful, but in any event the issue has not been tested because all regimes previously identified as harmful have been eliminated.

The Recommendation on harmful tax competition was approved by the Council with the abstentions of Switzerland and Luxembourg. In annexes to the Recommendation, these countries objected to two basic aspects of the Report: (1) its focus was only on geographically mobile activities and did not include "bricks and mortar" investments, and (2) its stress on the importance of the elimination of bank secrecy.[32] From a process point of view, however, the interesting thing is that neither country elected to veto the project as it could have done under the OECD operating rules. This

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31. ORG. FOR ECON. CO-OPERATION & DEV., REPORT TO THE 2000 MINISTERIAL COUNCIL MEETING AND RECOMMENDATIONS BY THE COMMITTEE ON FISCAL AFFAIRS, TOWARDS GLOBAL TAX CO-OPERATION (2000), *available at* http://www.oecd.org/data oecd/9/61/2090192.pdf; ORG. FOR ECON. CO-OPERATION & DEV., CTR. FOR TAX POL'Y & ADMIN., THE OECD'S PROJECT ON HARMFUL TAX PRACTICES: 2006 UPDATE ON PROGRESS IN MEMBER COUNTRIES, www.oecd.org/dataoecd/1/17/37446434.pdf (last visited Apr. 20, 2009).

32. HTC REPORT, *supra* note 22, at 73.

would seem to indicate a judgment that the impact of a veto on this important and high-visibility project would have had a significant negative impact on these countries' abilities to work in the future with the organization. In addition, both countries in fact participated in the Forum on Harmful Tax Practices, submitted their potentially harmful regimes for review and, in the case of Switzerland, ultimately made the changes necessary to have their regime taken off the list of harmful tax regimes.[33]

A second aspect of the harmful tax competition project involved the treatment of tax havens. This work has been described elsewhere (with varying degrees of accuracy),[34] and I would like to focus primarily on some aspects of how the work evolved. The 1998 Report made a distinction between countries that collected "significant revenues" from income tax and those that did not. With respect to the first category, a "harmful preferential regime" was present if the regime involved no or low tax and either "ring-fencing," (that is, limiting the tax to foreign investors), lack of transparency, or lack of exchange of information. Tax havens, on the other hand, which by definition did not have significant revenues, also involved no or nominal tax rates, and lack of transparency and exchange of information, in addition to the lack of any requirement of "substantial activity" (that is, it was possible to set up a "letter box" or "booking centre" in the jurisdiction). This requirement was parallel to the "ring-fencing" requirement for other jurisdictions, as it stipulated that there be some real connection between the low-taxed activity and the jurisdiction.

Applying these criteria, the OECD, in 2002, listed thirty-five jurisdictions that met the technical tax haven criteria and began discussions with those jurisdictions focused on getting from them "commitments" to eliminate the "harmful features" from their tax systems.[35] At the same time, the Council instructed the Forum to prepare a list of "uncooperative tax havens," those havens that did not agree to make the necessary commitments. While the OECD process was taking place, there was a change of Administration in the United States, and after six months, during which time he apparently thought about what reaction to take, Paul O'Neill, incoming U.S. Secretary of the Treasury, made the following announcement:

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33. The situation involving the Luxembourg 1929 Holding Company regime is more complicated and involves the application of the EU state aid disciplines.

34. *See generally* J.C. SHARMAN, HAVENS IN A STORM: THE STRUGGLE FOR GLOBAL TAX REGULATION (2006); Lorraine Eden & Robert T. Kudrle, *Tax Havens: Renegade States in the International Tax Regime?*, 27 LAW & POL'Y 100 (2005).

35. OECD, *The OECD List of Unco-operative Tax Havens—A Statement by the Chair of the OECD's Committee on Fiscal Affairs, Gabriel Makhlouf* (Apr. 18, 2002), http://www.oecd.org/document/28/0,3343,en_2649_33745_2082460_1_1_1_1,00.html.

> Although the OECD has accomplished many great things over the years, I share many of the serious concerns that have been expressed recently about the direction of the OECD initiative. I am troubled by the underlying premise that low tax rates are somehow suspect and by the notion that any country, or group of countries, should interfere in any other country's decision about how to structure its own tax system. I also am concerned about the potentially unfair treatment of some non-OECD countries. The United States does not support efforts to dictate to any country what its own tax rates or tax system should be, and will not participate in any initiative to harmonize world tax systems. The United States simply has no interest in stifling the competition that forces governments—like businesses—to create efficiencies. . . . In its current form, the project is too broad and it is not in line with this Administration's tax and economic priorities.[36]

The O'Neill announcement, despite its substantial mischaracterization of the thrust behind the OECD project, appeared on its face to be a dramatic withdrawal of support by the United States, previously a key player in the tax competition work.[37] In fact, it had much less impact on the progress of the project than was initially anticipated. In 2001, the OECD revised its criteria for tax haven status by eliminating the "no substantial activities" requirement, which had been of very little significance in practice.[38] In addition, it agreed not to apply defensive measures to tax havens any sooner than it applied them to Member country regimes. This was largely meaningless because, by this time, it was clear that the Member countries themselves would have eliminated the harmful features of the regimes. In 2002, the OECD published its list of seven "uncooperative tax havens," which has subsequently been reduced to three.[39]

The harmful tax competition exercise raises some interesting process points. While the OECD did have an extensive dialogue with the havens in connection with the commitment process, the process still had a confrontational tone. In its later forms, the tone is more conciliatory. The former havens that have made commitments to transparency and exchange of information are now called "Participating Partners"; they are working together with Member countries in the context of an OECD

36. Press Release, Paul O'Neill, Sec'y of the U.S. Dep't of the Treasury, PO-366 (May 10, 2001) [hereinafter O'Neill Press Release].

37. The U.S. International Tax Counsel was the first Co-Chairman of the Forum on Harmful Tax Practices.

38. OECD, *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report* 9, http://www.oecd.org/dataoecd/60/28/2664438.pdf (last visited Apr. 20, 2009).

39. These are Andorra, Liechtenstein, and Monaco. *See* OECD, Centre for Tax Policy and Administration, List of Unco-operative Tax Havens, http://www.oecd.org/document/57/0,3343,en_2649_33745_30578809_1_1_1_1,00.html (last visited Apr. 20, 2009).

Global Forum on Taxation to develop uniformity in rules on transparency and exchange of information.[40] Cooperative efforts have also generated a Model Exchange of Information Agreement,[41] which has been successfully used in bilateral and multilateral negotiations. However, one can wonder how much of the later cooperation would have developed if the initial phases of the project had not been as prescriptive as they were. In addition, while a number of exchange agreements have been concluded,[42] there is an increasing concern about "foot dragging" on the part of some jurisdictions that have made commitments and avoided the initial listing process, but have taken no real steps toward implementation since then. Consideration may then turn again to defensive measures, for example, perhaps a list of "Committed but Uncooperative Jurisdictions" suggesting that "establishing international norms" in some cases must involve the combination of cooperation and enforcement mechanisms.

It is also interesting to note that the focus of much of the later work in this area is on exchange of information generally, not just exchange in connection with the narrowly defined activities of geographically mobile financial services covered by the 1998 Report. For example, the Exchange of Information Agreements that have been entered into with the havens are not limited to information concerning geographically mobile services but cover exchange generally. In addition, they are not limited to exchange in criminal conduct, but cover civil exchange as well.[43] Thus, somewhat ironically, from one perspective, the U.S. "withdrawal" from the project had no impact at all on the elimination of ring-fenced regimes in Member countries. Actions by countries that eliminated ring-fenced regimes in response to the OECD Recommendations involved the recognition by those countries of a substantive international obligation not to construct regimes aimed entirely at the tax base of other countries, a clear example of the OECD's "interfering with [an]other country's decision about how to structure its own tax system," which O'Neill found so objectionable.[44] At the same time, the increased attention that the U.S.

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40. OECD GLOBAL FORUM ON TAXATION: A PROCESS FOR ACHIEVING A GLOBAL LEVEL PLAYING FIELD 1 (June 3–4, 2004), http://www.oecd.org/dataoecd/13/0/31967501.pdf.

41. OECD, *Agreement on Exchange of Information on Tax Matters*, http://www.oecd.org/dataoecd/15/43/2082215.pdf (last visited Apr. 20, 2009).

42. For a list of the exchange agreements, see OECD, *Model Agreement on Exchange of Information on Tax Matters, Developed by the OECD Global Forum Working Group on Effective Exchange of Information*, http://www.oecd.org/document/7/0,3343,en_2649_33767_38312839_1_1_1_1,00.html (last visited Apr. 20, 2009).

43. *See, e.g.*, Agreement on Assistance in Civil and Criminal Tax Matters Through Exchange of Information, F.R.G.-Isle of Man, Mar. 2, 2009, *available at* http:www.oecd.org/dataoecd/57/5/42262036.pdf.

44. *See* O'Neill Press Release, *supra* note 36.

position brought to the importance of exchange of information seemingly aided in establishing an international norm or benchmark for exchange, which includes civil tax matters and goes far beyond O'Neill's references to "tax evaders" and "prosecution of illegal activity."

While non-Member countries were not directly involved in developing the analytical framework of the 1998 Report before it was adopted, substantial effort was made to bring non-Member countries into the dialogue. In many cases, their concerns with harmful tax competition were greater than those of Member countries because they were less able to protect their tax bases unilaterally. Three regional seminars were held in Mexico, Singapore, and Turkey while the Report was being drafted.[45] At this time, the issues raised by harmful tax competition were discussed and the views of non-Member countries were expressed. After the Report was published and the Forum on Harmful Tax Practices set up, a number of multilateral meetings were held in conjunction with the Southern African Development Community, the Asian Development Bank, and the Inter-American Center of Tax Administrations. After the issuance of "Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices" ("2000 Report"), which listed preferential regimes in Member countries and provided the initial list of tax havens, an international symposium to discuss the global implications of harmful tax practices was held in Paris and attended by twenty-seven non-Member countries.[46] The purpose of these meetings was to encourage non-Member countries to associate themselves with the 1998 Report. The Global Forum on Taxation has also held events dealing with harmful tax practices and the need for a "level playing field" with regard to transparency and exchange of information. These efforts can be seen as part of the wider move by the OECD to be more inclusive.

B. Dispute Resolution and Arbitration

As international trade and investment increase, so too do the possibilities of disagreements among countries as to the appropriate application of international tax rules. These disputes may involve transfer pricing issues, differing characterization rules for income, disagreement about whether a permanent establishment exists, or more generally, the appropriate exercise of potential taxing rights by the source-country jurisdiction.

45. *The OECD's Global Relations Programme*, *supra* note 19.

46. *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report*, *supra* note 38, at 7.

The OECD Model Convention and bilateral treaties based on the Model provide a procedural mechanism, the Mutual Agreement Procedure ("MAP"), for resolving these types of disputes where the interpretation and application of a treaty is involved. Article 25 of the Model Convention, implemented in existing bilateral treaties, provides that if the taxpayer believes that the actions of one or both of the countries result in taxation "not in accordance with the convention," he can present the case to the "competent authority" of the country of which he is a resident.[47] If that country cannot resolve the problem unilaterally, it has the obligation under the treaty to undertake discussions with the other country to "endeavor" through the MAP to resolve the issue. This procedure usually results in a "mutual agreement" that provides a resolution to the issue regarding the treaty. If, after "endeavoring" to agree, the two countries are in fact unable to agree, however, the taxpayer is potentially left with unrelieved double taxation, thus thwarting the principal purpose of the treaty, to avoid double taxation.[48]

The lack of a mechanism to achieve a solution to these issues under tax treaties has become more and more striking as nontax barriers to trade and investment are eliminated and tax issues assume greater and greater importance. Competing trade[49] and investment disciplines[50] already provide institutional structures to resolve disputes in their fields of competence, and the lack of such a mechanism in the tax area is highlighted.

For many years, there have been proposals to have unresolved treaty issues dealt with by some form of arbitration procedure.[51] A number of existing treaties contain a provision for *optional* arbitration, but as a practical matter, the provisions have not been used; as both competent authorities must agree to go forward, it is possible for one of the authorities to block the arbitration when the taxpayer requests the proceeding. In order to ensure some kind of consistent and binding arbitration decision, it would be necessary to provide for the *mandatory* arbitration of unresolved cases after a certain period of time has passed. There have been

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47. OECD, Model Convention with Respect to Taxes on Income and on Capital art. 25, para. 5, July 17, 2008, *available at* http://www.oecd.org/dataoecd/14/32/41147804.pdf [hereinafter Model Tax Convention].

48. *Id.*

49. *See, e.g.*, Reuven Avi-Yonah, *The WTO, Export Subsidies, and Tax Competition*, *in* WTO AND DIRECT TAXATION 115 (Michael Lang, Judith Herdin & Ines Hofbauer eds., 2005).

50. *See, e,g.*, Thomas Walde & Abba Kolo, *Investor-State Disputes: The Interface Between Treaty-Based International Investment Protection and Fiscal Sovereignty*, 35 INTERTAX 424 (2007).

51. *See, e.g.*, GUSTAF LINDENCRONA & NILS MATTSSON, ARBITRATION IN TAXATION (1981).

several proposals modeled on commercial arbitration from private sector groups providing for mandatory arbitration in tax matters.[52] These proposals essentially deal with the arbitration of tax disputes as an *alternative* to the existing MAP procedures.

Not unexpectedly, countries' reactions to proposals for mandatory arbitration in taxation have historically been muted. From a theoretical perspective, giving up the power to determine the tax liability of a taxpayer to a nongovernmental body could be viewed as an unacceptable intrusion on the State's sovereignty. From a practical point of view, the competent authorities charged with deciding the case could object to having the case taken out of their hands. Nonetheless, the practical need for some kind of mechanism to resolve disputes grew increasingly clear. At the same time, there were complaints from the private sector about the functioning of the existing MAP procedure. The procedure took too long and was not transparent; it was costly and expenses were incurred with no assurance of an acceptable outcome.

The recognition early on that effective dispute resolution mechanisms were essential to the functioning of the OECD led to an OECD project to develop them. As the Committee of Fiscal Affairs observed in describing the background of the work of the Joint Working Group charged with developing the dispute resolution proposals:

> [P]roviding an effective dispute resolution mechanism for tax disputes is closely connected to the basic OECD approach to its work. The OECD is a consensus organization and does not typically generate "hard law" but principles and guidelines. Working in this way, it is unavoidable that differences in interpretation and application will arise. It is thus an important responsibility of the Organization to make every effort to ensure that there is a well-functioning procedural mechanism to deal with these disputes when they do arise. This is true both with regard to relations between Member countries, but also, and in some ways more importantly, in relations between the OECD Member countries and Non-OECD Economies . . . .
>
> The starting point for the [Joint Working Group's] work was a detailed examination of the existing MAP process. It is clear that the MAP process will continue to be the basic mechanism for the resolution of international tax disputes. The existing MAP process has provided and will continue to provide a generally effective and efficient method for dealing with these issues. . . . [However] it remains the case that the existing procedures do not ensure that in all cases a final resolution of in-

52. ORG. FOR ECON. CO-OPERATION & DEV., CTR. FOR TAX POL'Y & ADMIN., IMPROVING THE PROCESS FOR RESOLVING INTERNATIONAL TAX DISPUTES, app. at 40–54 (July 27, 2004), *available at* http://www.oecd.org/dataoecd/44/6/33629447.pdf.

> ternational tax disputes can be achieved. Thus the JWG has considered in some detail a range of Supplementary Dispute Resolution . . . techniques which can help to ensure that international tax disputes come to a satisfactory conclusion.[53]

The focus of the OECD dispute resolution work was thus on improving the MAP process generally and providing *supplementary* mechanisms to make the MAP work more effectively. In this way, the proposal for mandatory arbitration could be considered together with other changes and improvements in MAP generally and not a (threatening) free-standing proposal. This approach was carried forward in the structure of the arbitration proposal developed by a Joint Working Group and ultimately adopted as part of the 2008 amendments to the Model Convention.[54] Arbitration was not presented, as in previous proposals, as an alternative to MAP, but as a means of supplementing MAP. Rather than taking the entire unresolved case away from the competent authorities, the proposed arbitration procedure referred unresolved *issues* to the arbitrators. When the arbitrators' decisions on those issues were reached, the case was returned to the competent authorities to establish an agreed solution to the entire case. This solution went far to assuage countries' sovereignty concerns and, at the same time, left the competent authorities with an important role in the final resolution of the case.

A remaining issue was the relation of the arbitration procedure to the taxpayer's domestic law remedies. Under the original proposal, the taxpayer was required to give up his rights to domestic legal remedies as a condition to entering into the arbitration process. When this structure was presented in the initial Discussion Draft,[55] it was met by skepticism from the private sector. There was objection to waiving domestic rights in a situation where the process remained a government-to-government one, the taxpayer had no right to be directly represented, and there was no assurance that double taxation would in fact be relieved. There were also concerns that such waivers might not be legally enforceable in some countries.

In response to these concerns, the procedure was subsequently modified to provide that submission to arbitration did not require waiver of domestic rights. The unresolved issue would be submitted to arbitration; the arbitral decision would then be incorporated into a mutual agreement,

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53. *Id.* at 3.

54. Model Tax Convention, *supra* note 47.

55. ORG. FOR ECON. CO-OPERATION & DEV., CTR. FOR TAX POL'Y & ADMIN., PROPOSALS FOR IMPROVING MECHANISMS FOR THE RESOLUTION OF TAX TREATY DISPUTES 9 (Feb. 2006), *available at* http://www.oecd.org/dataoecd/5/20/36054823.pdf.

which would be presented to the taxpayer as an agreed solution giving a uniform interpretation or application of the treaty. If the taxpayers affected by the case agreed, the case could be resolved; if not, as is the normal procedure in mutual agreement cases, any taxpayer affected by the case could reject the MAP and be left with domestic remedies.[56] In this way, the arbitration functioned to supplement MAP and allowed the case to be resolved. This approach was in general satisfactory to governments since it minimized the intrusion of nongovernmental actors in the dispute resolution process and was also responsive to private sector concerns by providing for the mandatory resolution of the dispute issues without unduly compromising the ultimate recourse to domestic remedies. Thus, by moving from an approach that viewed arbitration as an alternative to traditional procedures, to dealing with arbitration as part of a general process of improving dispute resolution, a satisfactory resolution of the various concerns was achieved.

Article 25.5 of the Model Convention now contains a procedure for mandatory arbitration following the structure outlined above, and a sample mutual agreement contained in the Commentary includes a substantial discussion as to the details of the procedure.[57] It provides for a number of "default" provisions to deal with situations where one of the parties to the arbitration is stalling or refusing to cooperate. For example, if one of the competent authorities does not appoint an arbitrator within the stipulated time frame, the Director of the Centre for Tax Policy and Administration is authorized to make the appointment, thus allowing the process to go forward. It is not expected that many cases will in fact require arbitration. Even under prior procedures, the vast majority of MAP cases were satisfactorily resolved, and the possibility of arbitration at the end of the two-year period provided should likely increase the competent authorities' efforts to reach a successful conclusion to the case.[58]

The new paragraph is accompanied by a footnote, which provides:

> In some States, national law, policy or administrative considerations may not allow or justify the type of dispute resolution envisaged under this paragraph. In addition, some States may only wish to include this paragraph in treaties with certain States. For these reasons, the para-

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56. In practice, it is very rare for an agreed MAP solution to be rejected because it can cause the taxpayer to face the possibility of conflicting national decisions and the resulting double taxation.

57. Model Tax Convention, *supra* note 47.

58. The prophylactic effect of the existence of an arbitration procedure should encourage the competent authorities to reach a decision to avoid having to refer the case to arbitration. As was observed in the process of the dispute resolution work, "The best arbitration is no arbitration."

> graph should only be included in the Convention where each State concludes that it would be appropriate to do so . . . .[59]

The inclusion of the footnote was important for some countries that were still hesitant about the arbitration procedure, and it allowed them to approve the procedure in principle while still retaining some flexibility in its application.[60] It was clear in the nearly ten-year process leading to the adoption of the new article that it took countries some time to understand and become comfortable with arbitration. In that process, it was important to move from a generalized discussion of whether countries were "for" or "against" arbitration to looking at the details of a concrete proposal, which could then be modified in a nuanced way to take specific concerns into account. The use of the footnote technique was part of that evolution.

It remains to be seen how the dispute resolution process will work in the future. Article 25.5 in the Model, even accompanied by the footnote, establishes the principle that an arbitration procedure is important in the proper functioning of the treaty, and the extensive Commentary offers solutions to many of the structural problems involved in making arbitration function. The United States has recently ratified three new treaties containing mandatory arbitration procedures: Protocol to the Germany-United States treaty (signed June 1, 2006), the new Belgium-United States treaty (signed November 27, 2006), and the 5th Protocol to the Canada-United States treaty (signed September 21, 2007). In addition, other important recent treaties contain mandatory arbitration provisions along the lines of the OECD Model.[61] Thus, it may take some time before arbitration is a standard provision in bilateral treaties. However, as an "international norm," the provision in the Model will certainly speed up the process.

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59. Model Tax Convention, *supra* note 47.

60. *See id.* at 7 n.1. The footnote technique was also used in connection with the adoption of Article 27 dealing with assistance in the collection of taxes, an issue that also raises some sensitive issues.

61. The recently signed Netherlands-U.K. treaty contains an arbitration provision that tracks very closely the provision in the OECD Model. *Compare* Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, Neth.-U.K., art. 25(5), Sept. 26, 2008, *available at* http://www.minfin.nl/dsresource?objectid=59016&type=pdf, *with* ORG. FOR ECON. CO-OPERATION & DEV., CTR. FOR TAX POL'Y & ADMIN., THE 2008 UPDATE TO THE MODEL TAX CONVENTION, para. 1 (July 17, 2008), *available at* http://www.oecd.org/dataoecd/20/34/41032078.pdf.

C. Services Permanent Establishment

One of the principal functions of tax treaties is to relieve double taxation by allocating taxing jurisdiction between the source and resident States. This is technically accomplished by reducing the source country's taxing claims in some situations and requiring the residence country to give double tax relief for the source country tax in cases where the source country has retained the right under the treaty to tax the income.

Under this set of rules, in order for the source country to have the right to tax business profits, the OECD Model requires a certain level of economic penetration in the source country, a so-called "permanent establishment." While the treaty definition of permanent establishment is complex, it generally requires some sort of "fixed place of business" through which the business of the enterprise is carried on.[62] As a result of this definition, the provision in the source country of personal services not attributable to a permanent establishment generally does not give the source country the right to tax.[63] The 2008 update of the OECD Model confirms the OECD's basic policy conclusion that its provision of personal services should not constitute a permanent establishment. However, the Commentary to Article 5 now provides for an "alternative provision" whereby countries that do not share the policy conclusion could allow the taxation of profits from the provision of personal services if the period in which the personal services are performed in the source country exceeds 183 days over a twelve-month period, even in the absence of a fixed place of business.[64] The public Discussion Draft that presented the Report of the Working Group that developed the proposal set forth the background of the proposal:

> The report of the Working Group concluded that no changes should be made to the provisions of the OECD Model Tax Convention and that services should continue to be treated the same way as other types of business activities. Under the applicable rules of the OECD Model, the profits from services performed in the territory of a Contracting State by an enterprise of the other Contracting State are not taxable in the first-mentioned State if they are not attributable to a permanent establishment situated therein (as long as they are not covered by other Articles of the Convention that would allow such taxation). This result,

62. The OECD work on establishing an international consensus on how this principle would apply in the case of electronic commerce has been extensively discussed in the literature. *See, e.g.*, Cockfield, *supra* note 4, at 144.

63. The U.N. Model contains a services permanent establishment provision. U.N. Model Double Taxation Convention Between Developed and Developing Countries art. 5(3)(b), U.N. Doc. ST/ESA/102 (Jan. 1, 1980).

64. Model Tax Convention, *supra* note 47, at 102–03.

> under which these profits are only taxable in the State of residence of the enterprise, is supported by various policy and administrative considerations. . . . The report acknowledged, however, that some States are reluctant to adopt the above principle of exclusive residence taxation of services that are not attributable to a permanent establishment situated on their territory but that are performed on that territory and noted that these States propose alternative provisions to preserve source taxation rights, in certain circumstances, with respect to the profits from such services.
>
> The Working Group considered that it was important to circumscribe the circumstances in which States that did not agree with its conclusion could, in a bilateral treaty, provide that profits from services performed by a foreign enterprise could be taxed by them even if not attributable to a permanent establishment situated on their territory. In particular, the Group considered that it was important to stress that a State should not have source taxation rights on income derived from the provision of services performed by a non-resident outside that State, that only the profits from services, as opposed to the gross payments for these services, should be subjected to tax and that it was appropriate, for compliance and other reasons, not to allow a State to tax the profits from services performed on their territory in certain circumstances (e.g. when such services are provided during a very short period of time).[65]

IV. WHAT IS THE "MODEL"? WHAT IS THE "NORM"?

This brief exposition of a few recent activities of the OECD in the tax area is by no means exhaustive and is intended only to review several representative projects.[66] It does allow, however, some modest conclusions about the OECD's role in the "formation of international norms."

It is clear that the OECD has become much more open and inclusive in its work. The accession project for new Members, the increased role of Observers in Committee activities, the proposal for enhanced engagement, the extensive activities in the Multilateral Centres, and the activities of the Global Forum on Taxation have all brought different voices to the discussions of international tax issues. In addition, business representatives are consulted more frequently, as it is important that the tax policy makers understand the commercial settings in which the tax rules will

65. ORG. FOR ECON. CO-OPERATION & DEV., CTR. FOR TAX POL'Y & ADMIN., THE TAX TREATY TREATMENT OF SERVICES: PROPOSED COMMENTARY CHANGES 2–3 (Dec. 8, 2006), *available at* http://www.oecd.org/dataoecd/2/20/37811491.pdf [hereinafter TAX TREATY TREATMENT OF SERVICES].

66. For a description of the ongoing work at the Centre for Tax Policy and Analysis, see ORG. FOR ECON. CO-OPERATION & DEV. CTR. FOR TAX POL'Y & ADMIN., CURRENT TAX AGENDA (2008), *available at* http://www.oecd.org/dataoecd/38/17/1909369.pdf.

apply. All States have an interest in designing workable rules, and including private sector representatives in the process (e.g., through the use of Discussion Drafts prior to final decisions) helps to focus on these issues.

This expansion of scope, however, has increased the difficulty of reaching consensus on some questions. The OECD has been most successful where it works to establish principles of sufficient specificity to be helpful in channelling policy formulation, but not principles so detailed as to be too restrictive of the ways in which the countries can implement them. Thus, with respect to dispute resolution, the basic principle of the need for arbitration as a means to resolve treaty disputes has been established, but the details have been left open.[67] In addition, the footnote concerning the possibility that some countries may not wish to use arbitration in all cases also makes the Model less prescriptive, but at the same time, it keeps the basic principle as part of the Model.

A similar situation exists in the case of reservations and observations to the Model.[68] By allowing countries to indicate reservations with respect to particular narrow issues, agreement can be reached on the basic structure and approach of the provision in question. The discussions and peer pressure to come to a consensus conclusion on as much of the treaty and commentary text as possible work to narrow the areas of disagreement. Thus, the OECD work can provide the basic structure for technical rules on which all agree, leaving other issues for further, usually bilateral, negotiation. In other cases, the use of alternative provisions in the Commentary to the Model can preserve the basic principle in the Model while allowing countries "reluctant" to accept the majority view to have their position expressed. At the same time, this allows a process in which variation from the Model can be "circumscribed" and made to work technically.[69]

Not all view these developments as favorable. The BIAC comments from the business community indicated that it was very "concerned"

67. Note, for example, that details of the arbitration procedure are set forth in an Annex.

68. *See* Model Tax Convention, *supra* note 47, at 14–15.

69. For example, the changes in the commentary make it clear that if personal services are to be taxed in connection with a personal services permanent establishment, they must be taxed on a net basis, allowing a deduction for associated costs, and not on a gross basis, thus disapproving of the approach taken by some countries and establishing net-basis taxation as the norm. *Tax Treaty Treatment of Services*, *supra* note 65, at 6.

about the use of alternative provisions.[70] A former Chair of the Committee on Fiscal Affairs recently observed:

> In terms of the model tax convention, in my view, in many ways it no longer reflects consensus because of all of the reservations and observations the convention and the commentary now contain. More importantly, some of the diverging views are now presented in areas that go beyond reservations and observations. For example, the commentary to the latest update to the model includes an alternative position on the taxation of services in the article on permanent establishments (article 5). How can consensus be maintained if the commentary provides alternative positions? A similar situation arises in the article on assistance in the collection of taxes (article 27). The article contains a footnote saying that in some countries, national law, policy, or administrative considerations may not allow or justify the type of assistance envisaged under this article and therefore indicates that this article only applies where countries agree. In my view, if the country's law does not allow for collection assistance as provided in this article, then the country should change its law. Because the model convention increasingly allows countries to cherry-pick among their favorite provisions, the model really no longer is a model.[71]

Thus, in taking its work forward, the challenge for the OECD will be to develop techniques that can not only establish agreement on policy principles and technical rules to the extent possible, but at the same time provide for adequate "escape valves" on certain issues to facilitate agreement on others. While the OECD is certainly not a "Ruler of the World," by taking advantage of its expanded institutional structure and its high technical standards, going forward it seems to be well-placed to contribute to the development of international tax norms.

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70. Letter from Patrick J. Ellingsworth, Chair, Bus. & Indus. Advisory Comm. on Taxation & Fiscal Affairs, to Jeffrey Owens, Dir., Ctr. For Tax Pol'y & Admin. (Feb. 20, 2007), *available at* http://www.biac.org/statements/tax/Final-07-01-22-services-tax-treaty-treatment.pdf.

71. Joann M. Weiner, *Inteview with Joseph Guttentag*, 51 TAX NOTES INT'L 1024 (2008). Guttentag was Deputy Assistant Secretary of the Treasury (International) in the Clinton Administration.