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More Cooperation, Less Uniformity: Tax Deharmonization and the Future of the International Tax Regime

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More Cooperation, Less Uniformity: Tax Deharmonization and the Future of the International Tax Regime

Steven A. Dean*

Efforts to foster improved international tax cooperation have become preoccupied with tax harmonization. Deharmonization offers the possibility of harmony without uniformity. By exploring two examples of tax deharmonization in practice and considering the origins and limitations of tax harmonization, this Article brings the traditional emphasis on harmonization into question. It then makes the case that deharmonization—cooperation without uniformity—could provide a viable alternative. Achieving tax deharmonization’s potential would require revisiting some of the most basic elements of our current international tax regime, particularly the benefits principle.

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I. INTRODUCTION

In recent years, prominent experts have engaged in a charged debate over the nature of international taxation. On one side, Reuven Avi-Yonah has made the case that a coherent international tax regime not only exists, but is so deeply entrenched that it verges on customary international law status.¹ On the other, H. David Rosenbloom has observed that the persistently anarchic state of cross-border taxation serves as proof that no such system exists.² One explanation for this apparent contradiction is that the thousands of double-tax treaties that make up our international tax regime, like silos left over from the Cold War, have lost none of their power but are nonetheless useless in today's asymmetric conflicts.³

1. See Reuven S. Avi-Yonah, *International Tax as International Law*, 57 TAX L. REV. 483, 498 (2004) ("I briefly survey some examples that in my opinion strengthen the view that an international tax regime does exist and that it rises to the level of customary international law.").

2. See H. David Rosenbloom, *International Tax Arbitrage and the "International Tax System"*, 53 TAX L. REV. 137, 166 (2000) (dismissing the idea of an "international tax system" as "imaginary"). The debate appears to have reached a new pitch but is not entirely new. Nancy Kaufman identifies a similar conflict between those who see customary international tax law and those who do not. See Nancy H. Kaufman, *Fairness and the Taxation of International Income*, 29 LAW & POL'Y INT'L BUS. 145, 148 n.23 (1998).

3. The double-tax treaties that largely make up that regime may have played a key role in taming the threat of double taxation, but they tend to seem about as relevant to today's pressing problems, such as offshore tax evasion, as an enormous stockpile of Cold War nuclear weapons is to preventing terrorists' attacks. See Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1575-76 (2000) [hereinafter Avi-Yonah, *Globalization*] (highlighting inability of developed states to enforce taxes on income derived from capital because of pressures of globalization); Reuven S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301, 1304 (1996) ("The current regime suffers from significant weaknesses, especially in two areas in which the development of the world economy has made the principles that were agreed upon in the 1920s and 1930s obsolete: the growth of internationally mobile capital markets for portfolio investment and the rise of integrated

This Article concludes that to win today's battles—including bringing offshore tax evaders to heel and resolving conflicts with relatively weak states—policymakers must embrace new tools and strategies. The confounding combination of weakness and strength that Avi-Yonah and Rosenbloom describe can in part be traced to a misguided focus on uniformity. By emphasizing uniformity at the expense of cooperation, the international tax regime squanders opportunities to build interstate alliances and reduce cross-border tax conflict. Allowing for the possibility of alternatives to the conventional harmonization-based model of international tax cooperation could help states to promote greater harmony, even when harmonization is impossible.⁴

To evaluate the potential of international tax policies that simultaneously embrace heterogeneity and cooperation, the Article introduces the concept of tax deharmonization. Tax deharmonization, international tax cooperation that calls for cooperating states to fill complementary roles, may seem fanciful but has already come to play an important role in efforts to resolve international tax conflicts.⁵

multinational enterprises (MNEs).”); Steven A. Dean, *The Incomplete Global Market for Tax Information*, 49 B.C. L. REV. 605 (2008) (detailing inadequacy of existing extraterritorial tax information acquisition infrastructure); Mitchell A. Kane, *Strategy and Cooperation in National Responses to International Tax Arbitrage*, 53 EMORY L.J. 89 (2004) (noting persistence of international tax arbitrage); Diane M. Ring, *One Nation Among Many: Policy Implications of Cross-Border Tax Arbitrage*, 44 B.C. L. REV. 79 (2002) (examining implications of international tax arbitrage for the international tax regime); Julie Roin, *Tax Treaties and Tax Competition* (Sept. 25, 2008) (unpublished manuscript, on file with Columbia Law School), available at http://www.law.columbia.edu/null/download?&exclusive=filemgr.download&file_id=162361 (suggesting that tax treaties may actually contribute to the tax competition problem).

4. To those most familiar with it, it may seem a stretch to compare the international tax regime to a cathedral, but it is instructive to consider the parallel between that regime and software development. Eric Raymond used the cathedral metaphor to describe the pre-open source method of developing complex software. See ERIC S. RAYMOND, *THE CATHEDRAL AND THE BAZAAR: MUSINGS ON LINUX AND OPEN SOURCE BY AN ACCIDENTAL REVOLUTIONARY* (1999). Raymond explains how inexpensive, Internet-based communication facilitated the emergence of a collaborative alternative to the conventional “cathedral” approach to software development pursuant to which a small group of experts, known as “wizards,” create a complex piece of software. *Id.* at 21-22. In the tax context, the most important wizards are the “four economists,” and their cathedral is the network of bilateral double-tax treaties that acts as the backbone of the modern international tax regime. See *infra* note 76 and accompanying text. Just as open-source software has provided a counterpoint to the influence of the “geographically compact communities,” such as Bell Labs, that once dominated the field, a fall in transaction costs could pave the way for the development of innovative alternatives to our aging international tax cathedral. See RAYMOND, *supra* note 4, at 51.

5. Unfortunately, even when deharmonization becomes reality, it goes unrecognized, obscured by a veneer of harmonization. See *infra* notes 35-49 and accompanying text.

When those conflicts involve profoundly different states, deharmonization often represents the only means of forging a relationship between them. Tax deharmonization is no panacea for all of the international tax regime's ills, but only a clear-eyed assessment will reveal the role it plays—and perhaps more importantly, could play—in that regime.

One reason it may be helpful to shift our focus away from uniformity and towards harmony is that the international tax landscape is itself less homogenous than it was nearly a century ago when the foundation of our current international tax regime was laid.⁶ Creating a framework that acknowledges and accounts for the differences that exist among states would make tax harmonization less important than it traditionally has been.⁷ That would be consistent with the conclusions of scholarly examinations of tax harmonization. Until recently, it was more or less taken for granted that harmonization, a convergence among national tax systems towards a universal ideal, represented the surest route to greater efficiency.⁸ That assumption has

6. “[A]dvocates of tax harmonization overstate their case by implicitly assuming the fungibility of governments and jurisdictions. Countries are not like bushels of corn, indistinguishable from one another. Instead, they vary along many different dimensions. . . .” Julie Roin, *Competition and Evasion: Another Perspective on International Tax Competition*, 89 GEO. L.J. 543, 561 (2001). Even at the most basic level, the characteristics of states are not uniform. See, e.g., Diane M. Ring, *What’s at Stake in the Sovereignty Debate?: International Tax and the Nation-State*, 49 VA. J. INT’L L. 155, 161 (2008) (“[S]tates vary widely in the degree to which they possess and demonstrate the elements of sovereignty . . .”).

7. Adam H. Rosenzweig, *Why Are there Tax Havens?* (unpublished manuscript, on file with author) (criticizing the failure of the international tax regime to recognize the significance of differences among nations such as their relative marginal returns on capital). There are exceptions, of course. The most significant is the traditional distinction between capital importers and capital exporters. See Michael J. Graetz & Michael M. O’Hear, *The “Original Intent” of U.S. International Taxation*, 46 DUKE L.J. 1021, 1033-34 (1997) (noting conflict between capital importers and exporters). Of course, yesterday’s capital exporters can become today’s capital importers (the United States being a particularly striking example of this). Structural differences among nations—such as size and population—are likely to prove more problematic. By contrast, the fiscal federalism literature focuses on the differences between jurisdictions that exist at the subnational level and “explores, both in normative and positive terms, the roles of the different levels of government and the ways in which they relate to one another.” Wallace E. Oates, *An Essay on Fiscal Federalism*, 37 J. ECON. LITERATURE 1120, 1120 (1999). Although many of the considerations of fiscal federalism are irrelevant to the international context, to the extent that national governments differ in the same way as levels of government, fiscal federalism may suggest that they should not try to fill identical roles.

8. Even Avi-Yonah’s alternative withholding tax scheme to facilitate capital income taxation called on each cooperating jurisdiction to play parallel roles. Avi-Yonah, *Globalization*, *supra* note 3, at 1672-74. Harmonization is often either implicitly or explicitly assumed to be a necessary condition for an optimally efficient international tax regime. See, e.g., Mihir A. Desai & James R. Hines Jr., *Evaluating International Tax Reform* 17 (Harvard

created a longstanding bias towards harmonization in cross-border tax matters⁹ that has increasingly been brought into question.¹⁰ Economists have demonstrated that “the efficiency of tax harmonization is far from clear-cut.”¹¹ Current tax scholarship likewise illustrates the risks posed by assuming that there are no meaningful differences among nations.¹²

If the international tax regime is to outgrow its excessive reliance on uniformity, it is essential that we understand the obstacles to deharmonization. Will deharmonization be able to capitalize on the

NOM, Working Paper No. 03-48, 2003), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=425943 (“[G]lobal welfare is maximized by harmonizing the taxation of foreign income among capital-exporting countries . . .”). Sometimes the desire for harmonization is expressed through criticism of nonconforming states. The OECD initiative against harmful tax competition offers a notable recent example. See Steven A. Dean, *Philosopher Kings and International Tax: A New Approach to Tax Havens, Tax Flight, and International Tax Cooperation*, 58 HASTINGS L.J. 911, 919 & n.65 (2007) (observing that the initiative identified “uncooperative tax havens” based on the absence of characteristics typical of OECD members). Of course there are exceptions to the harmonization consensus. See generally Michael J. Graetz, *Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 26 BROOK. J. INT’L L. 1357, 1412-13 (2001) (“Caution, however, is warranted in assuming that conforming our nation’s tax system with that of other nations, even developed nations with effective income taxes, will inevitably improve our national welfare.”); Roin, *supra* note 6 (critiquing arguments in favor of harmonization).

9. Even before our current international tax regime took shape, symmetry in cross-border tax matters was extremely common. See *infra* notes 66-72 and accompanying text. The same pro-symmetry bias is evident in the double-tax treaties that give form to the international tax regime and in more recent efforts to create its successor. See *infra* Part II. One notable exception is the U.N. model treaty designed to be used between developed and developing states. Allison D. Christians, *Tax Treaties for Investment and Aid to Sub-Saharan Africa: A Case Study*, 71 BROOK. L. REV. 639, 661-64 (2005) (describing origins and purpose of the U.N. model treaty). Another exception is tax sparing. *Id.* at 692-95 (discussing the operation and ramifications of tax sparing provisions).

10. Scholars have noted specific examples of the limitations of harmonization-based strategies. See, e.g., Julie Roin, *Rethinking Tax Treaties in a Strategic World with Disparate Tax Systems*, 81 VA. L. REV. 1753, 1755-56 (1995) (“I argue that many of the fundamental revenue assumptions underlying the policy of seeking reductions in source taxation are incorrect when the treaty partner is a country with an integration system, and are particularly inappropriate when the treaty partner has an imputation system.”).

11. Carl Gagné & Stéphane Riou, *Globalization, Asymmetric Tax Competition, and Fiscal Equalization*, 9 J. PUB. ECON. THEORY 901, 902 (2007) (arguing that while tax competition may “distort the spatial allocation of capital[, tax] harmonization may not be desirable”). When economic differences between nations are taken into account, harmonization can be affirmatively harmful. See Richard E. Baldwin & Paul Krugman, *Agglomeration, Integration and Tax Harmonisation*, 48 EUR. ECON. REV. 1, 21 (2004) (“In our model, simple tax harmonisation—defined as adoption of a common tax rate—always harms at least one nation and the seemingly sensible policy of adopting a rate that is between the two initial rates turns out to harm both nations.”).

12. See Rosenzweig, *supra* note 7 (explaining that by failing to distinguish among jurisdictions across relevant criteria the international tax regime could inhibit cooperation).

decline in interjurisdictional transaction costs that, as Anne-Marie Slaughter¹³ and others¹⁴ have noted, has transformed so many other international legal regimes? Will parochialism—here, in the form of the “benefits principle”—be as much of an impediment to deharmonization as it has been for harmonization? Ultimately, this Article answers those questions with a yes and a maybe, concluding that the answer to the second depends on the willingness of states to conceptualize their rights and obligations in new ways.

II. DEHARMONIZATION

As long as national tax systems develop in response to unique social and administrative pressures,¹⁵ jurisdictions will continue to rely on tax systems that exhibit at least as many differences as similarities.¹⁶ Tax harmonization represents the traditional answer to that entropic pressure, reflecting a confidence that nations can avoid international tax conflicts by becoming more like one another. Unfortunately, in part because many of the jurisdictions that populate today’s international tax landscape have little in common, it seems that harmonization is no longer equal to the task. This Part introduces the concept of deharmonization, an alternative to harmonization that may be more robust.¹⁷

A. *Tax Deharmonization*

If the drive for harmonization is motivated by the potential benefits of conformity, deharmonization draws inspiration from the advantages of specialization.¹⁸ In a sense, pining for global

13. See generally ANNE-MARIE SLAUGHTER, *A NEW WORLD ORDER* (2004).

14. See generally REGULATORY CO-OPERATION FOR AN INTERDEPENDENT WORLD (Org. for Econ. Co-Operation & Dev. ed., 1994).

15. See *infra* note 113 and accompanying text.

16. That diversity may actually make harmonization counterproductive. “[V]arying social traditions, values, and economic conditions . . . may not be well-served by harmonization Harmonization . . . might increase economic or social costs.” Scott H. Jacobs, *Regulatory Co-Operation for an Interdependent World: Issues for Government*, in REGULATORY CO-OPERATION FOR AN INTERDEPENDENT WORLD 33 (Org. for Econ. Co-Operation and Dev. ed., 1994). Although the same diversity exists in all types of regulation to some extent, this dynamic may be especially significant when it comes to taxation for two reasons. First, tax policy implicates a wider array of issues and interests than, for example, the rules governing the issuance of securities and the protection of shareholders. Second, the near absence of frictions preventing taxpayers from capitalizing on any asymmetries that do exist magnifies the significance of even relatively minor variations in tax rules.

17. See *supra* note 6 and accompanying text.

18. See *infra* notes 58-62 and accompanying text.

homogeneity in taxation and the welfare benefits it could produce is not so different than farmers in the nineteenth-century American West wishing ranchers and their crop-trampling cattle would just disappear into the sunset.¹⁹ Those farmers, like newly arrived homeowners unhappy about a smoke-bellowing factory in their midst, only wanted their neighbors to be like them.²⁰ Unfortunately, they lacked the power to compel conformity and could not rely on consensual private ordering tools to achieve it.²¹

Of course, as those two scenarios suggest, under the right circumstances conformity might not be necessary or even desirable. The groups might collectively be better off if the ranchers could pay the farmers to install fencing around their fields or if the homeowners paid the factory owner to use a better grade of coal to eliminate noxious emissions.²² In a perfect world, all such deals would be struck and there would be less need for potentially inefficient²³ rules ensuring conformity. One reason many such arrangements are not created is the presence of transaction costs.²⁴

19. Coase famously uses the problem of cattle straying onto neighboring land and causing damage to illustrate the challenges of limiting the harmful effects a business has on neighboring landowners. See R.H. COASE, *THE FIRM THE MARKET AND THE LAW* 13 (1988).

20. See Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1121-23 (1972) (considering efficiency and distributional implications of a factory using cheap, polluting coal in a wealthy residential neighborhood).

21. One potential tool would be restrictive covenants. Even if we assume away procedural obstacles to creating such covenants, there remains the substantive question of why one party would agree to live by a standard that happens to suit his or her neighbors.

22. See *supra* notes 19-20 and accompanying text.

23. Ellickson provides a useful illustration of the potential inefficiency of homogeneity by describing the inefficiencies produced by the absence of a “mom-and-pop or convenience-type grocery store” in the Santa Monica Mountains as a result of zoning restrictions. See Robert C. Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Use Controls*, 40 U. CHI. L. REV. 681, 684-85 (1973). Ellickson suggests that a government could produce a more efficient result by making it easy for grocers and their neighbors to reach a private contractual agreement to compensate neighbors for the harms imposed on them by the existence of the grocery store instead of simply banning grocery stores through zoning. *Id.* at 686.

24. COASE, *supra* note 19, at 115 (“Once the costs of carrying out market transactions are taken into account, it is clear that such a rearrangement of rights will only be undertaken when the increase in the value of production . . . is greater than the costs which would be involved in bringing it about.”). A different problem is posed by uncertainty about initial entitlements. In the domestic context, initial entitlements are determined by the state. See Calabresi & Melamed, *supra* note 20, at 1090. In the international tax context, entitlements to tax revenues are a function of norms such as the benefits principle. See *infra* note 79 and accompanying text. Those norm-based entitlements are much more likely to be the subject of dispute than those established by the state.

In rare cases, those bargains would allow states to divide large gains—what Mancur Olson might refer to as “Big Bills Left on the Sidewalk.”²⁵ Tax flight treaties, for example, a variation on Calabresi and Melamed’s pay-the-polluter approach,²⁶ could allow the United States alone to split a portion of \$50 billion per year in revenues with tax havens.²⁷ The amount of U.S. income tax revenues such an arrangement with even a single leading tax haven could yield suggests that either extraordinarily high transaction costs or a degree of irrationality poses an obstacle to their creation.²⁸

In general, the payoffs are likely to be smaller. For instance, a country that hosts a substantial amount of U.S. investment might agree to collect and provide the United States with information about Qualified Electing Funds²⁹ with U.S. shareholders.³⁰ The United States could pay for that assistance just as neighboring homeowners might pay a factory owner to upgrade the coal it uses.³¹ Whether such a bargain would be worthwhile depends largely on the balance between

25. Mancur Olson, Jr., *Big Bills Left on the Sidewalk: Why Some Nations Are Rich, and Others Poor*, 10 J. ECON. PERSP. 3, 22 (1996) (arguing that improving government institutions and economic policies can help realize many gains from specialization and trade).

26. See Calabresi & Melamed, *supra* note 20, at 1121-23.

27. See Dean, *supra* note 8, at 917 n.27.

28. If tax evaders and their agents share benefits of \$100 in the form of unpaid taxes, a cooperative intergovernmental arrangement that allows participating governments to collect and share that \$100 would almost certainly leave those governments collectively better off than they would be without an agreement. Because the actual benefits are so large—for example, the estimated U.S. revenue losses attributed to tax flight are an order of magnitude larger than the GDP of the Cayman Islands—it seems likely that a mutually beneficial intergovernmental deal could be struck at the expense of tax cheats. See Joseph Guttentag & Reuven Avi-Yonah, *Closing the International Tax Gap*, in BRIDGING THE TAX GAP: ADDRESSING THE CRISIS IN FEDERAL TAX ADMINISTRATION 101 (Max B. Sawicky ed., 2005) (estimating U.S. losses to tax flight at \$50 billion per year); U.S. Cent. Intelligence Agency, *The World Factbook: Field Listing—GDP*, <https://www.cia.gov/library/publications/the-world-factbook/fields/2001.html?countryName=&countryCode=®ionCode=?> (last visited Oct. 23, 2009) (estimating the Cayman GDP for 2004 at just under \$2 billion).

29. A QEF is a specific type of non-U.S. corporation whose shareholders are subject to current U.S. taxation on the income of the corporation. See 26 U.S.C. § 1295 (2006). Because the corporation is foreign, U.S. tax authorities have limited means to verify the tax information self-reported by taxpayers.

30. If the United States were to strike this deal with France, it would be a little like the United States paying France to “fence out” aggressive U.S. taxpayers, sparing the United States the need to fence them in.

31. This is a solution to one of the difficulties the United States faces in monitoring the extraterritorial activities of its taxpayers that is not premised on increased harmonization. A harmonization-based approach would encourage France to adopt QEF rules equivalent to those employed by the United States so that they could collect and would want to exchange QEF information with the United States.

the costs of implementing the arrangement and the benefits it would produce.

These two illustrations suggest the potential specialization holds to create alliances that expand the reach of the international tax regime beyond the limits of harmonization. Unlike harmonization-based approaches, neither arrangement would require all parties to perform precisely the same functions for precisely the same reasons. Instead, states could play complementary roles and even be motivated by different incentives. Because deharmonization does not require a “double coincidence of wants,” it could succeed in creating efficient cooperative arrangements between jurisdictions with little in common.³²

Those examples also reveal an important reason that deharmonization might be normatively desirable as well as practical.³³ As considered below, sometimes specialization produces a more efficient outcome than homogeneity. As intergovernmental transaction costs continue to fall, the benefits of at least some forms of international tax specialization may soon be within reach.

B. Deharmonization in Disguise

Deharmonization strategies promise mutual benefits for cooperating states. The mystery then is what prevents the emergence of these types of relationships. One possibility is that asymmetric cooperative arrangements simply do not work in the real world. This Subpart shows that this is only partly true. Asymmetric cooperative tax arrangements do exist, but only when they can be made to look like

32. Thinking of the limits of barter transactions offers one way to understand the harmonization conundrum. The success of barter transactions is limited by the fact that they require a “double coincidence of wants” to take place. *DICTIONARY OF THE SOCIAL SCIENCES* 33 (Craig Calhoun ed., 2002). For reciprocal harmonization to occur, jurisdictions must have the same coincidence of wants. As a result, the less similar those jurisdictions are, the less likely they are to harmonize.

33. Ellickson’s grocery store example illustrates the potential benefits of specialization. See Ellickson, *supra* note 23, at 648-85. On the one hand, a flat ban on grocery stores provides a benefit by ensuring that no individual property owner is able to impose uncompensated costs on its neighbors by opening a grocery store. However, such a ban would also prevent a group of neighbors from affirmatively bargaining to allocate the costs and benefits of opening a grocery store. As a result, even if opening a grocery store would not impose any uncompensated harm on any property owner while producing a net benefit for the community as a whole, the ban would still apply, leaving the entire community less well off.

the product of harmonization.³⁴ Two examples of that pattern—deharmonization made to look like harmonization—follow.

The Southern African Customs Union (SACU) is an agreement among South Africa, Botswana, Lesotho, Namibia, and Swaziland that, among other functions, facilitates the collection and sharing of tax revenues.³⁵ The 1969 SACU agreement provided that “[a]ny customs, excise, sales and additional duties collected in the common customs area shall be paid quarterly into the Consolidated Revenue Fund of South Africa.”³⁶ A portion of those revenues was then paid by South Africa to Botswana, Lesotho, Namibia, and Swaziland according to a formula, with South Africa retaining the balance.³⁷ The special role the 1969 agreement assigned to South Africa—in effect acting as a tax administrator for its SACU partners—was consistent with its dominant economic position within SACU.³⁸

In 2002, a revised SACU agreement went into effect.³⁹ Nominally, the 2002 agreement transformed SACU from a hierarchical arrangement with South Africa in control to one in which

34. The most common example of what can be thought of as deharmonization in disguise is tax sparing. *See generally* Kim Brooks, *Tax Sparing: A Needed Incentive for Foreign Investment in Low-Income Countries or an Unnecessary Revenue Sacrifice?*, 34 *QUEEN'S L.J.* 505 (2009). Tax sparing is an arcane arrangement between pairs of countries that typically attempts to preserve the benefits of tax incentives offered by a developing country with the cooperation of a developed country. “When a tax sparing provision is properly constructed, it provides what is in effect a grant from a capital-exporting [developed] country to a taxpayer operating in a capital-importing [developing] country, to assist in the latter’s development.” *Id.* at 558. Tax sparing’s appeal is partly its capacity to provide an asymmetric benefit to a developing country while “avoid[ing] the paternalism often inherent in direct grant programs for foreign aid administered by high-income countries.” *Id.* at 549.

35. *See* S. African Customs Union, History of SACU, <http://www.sacu.int/about.php?include=about/history.html> (last visited Oct. 23, 2009). SACU claims to be the “world’s oldest customs union.” *Id.*

36. 1969 Southern African Customs Union Agreement art. 13, Dec. 11, 1969, U.N.T.S. 70 [hereinafter 1969 SACU Agreement].

37. *Id.* art. 14. That revenue-sharing formula contained a

compensation mechanism to account for the effects a customs union can have on its less developed members. In the case of SACU, South Africa compensated for the fact that it gathered more economic gains due to the SACU arrangement than its partners by distributing a disproportionate amount of SACU tax revenues to Botswana, Lesotho, and Swaziland (and later Namibia).

JAMES J. HENTZ, *SOUTH AFRICA AND THE LOGIC OF REGIONAL COOPERATION* 12 (2005).

38. South Africa’s 2008 GDP was an order of magnitude larger than the combined GDPs of its four partners. *See* World Bank, World Development Indicators Database: Gross Domestic Product 2008 (Oct. 7, 2009), <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf>.

39. 2002 Southern African Customs Union Agreement (Oct. 21, 2002) [hereinafter 2002 SACU Agreement], *available at* <http://www.sacu.int/main.php?include=docs/legislation/2002-agreement/main/html>.

member states operate on equal footing.⁴⁰ In reality, the 2002 revisions did little to alter the basic economics of SACU.⁴¹ Nothing in the revised SACU agreement prevents South Africa from continuing to play the lead role in administering the revenue fund.⁴² Although SACU remains a fundamentally asymmetric arrangement, since the 2002 revisions it appears to be one in which no SACU member plays a role different from any other. It is, in other words, deharmonization disguised as harmonization.

The same pattern, formal equality masking important substantive differences, can be seen in Tax Information Exchange Agreements (TIEAs).⁴³ The modern TIEA first emerged in the 1980s in response to concern about offshore tax evasion.⁴⁴ Recognizing that secrecy played

40. The 2002 SACU Agreement means that the SACU operates according to a “one-country, one-vote formula and major decisions of the various intergovernmental and regional institutions require consensus.” Martina Metzger, *Regional Cooperation and Integration in Sub-Saharan Africa* 10 (United Nations Conference on Trade and Dev., Discussion Paper No. 189, 2008), available at http://www.unctad.org/en/docs/osgdp20084_en.pdf. It created a Council of Ministers that was to “consist of at least one Minister from each Member State and . . . be the supreme decision making authority of SACU matters.” 2002 SACU Agreement, *supra* note 39, art. 8, ¶ 1. Rather than being paid into the Consolidated Revenue Fund of South Africa, SACU revenues are now paid into a Common Revenue Pool managed by either a member state or a SACU body, appointed at the discretion of the Council of Ministers. *Id.* arts. 32-33.

41. The 2002 SACU Agreement appears to have preserved the basic elements of the 1969 agreement in substance if not in form. For instance, South Africa was designated as the administrator of the Common Revenue Pool “for a transitional period.” 2002 SACU Agreement, *supra* note 39, art. 33. As an economic matter, the 2002 revisions “provided the BLNS with basically the same implicit revenue transfers as they had been receiving under the old agreement. Its main benefit for South Africa is that it put a cap on the amount of transfers required under the agreement.” Frank Flatters & Matthew Stern, SACU Revenue Sharing: Issues and Options ¶ 2.2 (Aug. 2006) (unpublished comment), available at <http://www.dnafrika.com/publications.php>.

42. It appears that South Africa does indeed continue to play the lead role in administering SACU. See Tsidiso Disenyana, *Development Through Trade* (Nov. 3, 2008), <http://bilaterals.org/spip.php?article13701>.

43. TIEAs aspire to be a way to bridge the divide between very different types of states. In that sense, they are yet another effort to break free of the harmonization conundrum. They attempt to accomplish that by narrowing their focus to a single aspect of the traditional international tax ties between states: information exchange. At some level, the agreements could encourage tax harmonization between a pair of jurisdictions just as double-tax treaties do. See *infra* notes 81-85 and accompanying text. Access to tax information of the type needed to enforce a comprehensive, modern income tax provides an incentive for the TIEA partner to develop one. Unfortunately, that modest incentive is almost certainly insufficient to produce any meaningful harmonization.

44. Information exchange agreements have a much longer history, dating back to the early part of the twentieth century. Today’s information exchange agreements are quite different from the older versions. See Dean, *supra* note 3, at 637-57 (describing development of information exchange agreements).

a crucial role in taxpayers' efforts to avoid U.S. income taxes,⁴⁵ the United States pursued TIEAs to acquire the extraterritorial tax information necessary to identify the investments and income of U.S. taxpayers.⁴⁶

TIEAs are essentially a single article stripped from a typical double-tax treaty. Like those treaties, TIEAs employ a structure that assigns reciprocal rights and obligations between pairs of states. The 1984 U.S. model agreement offers a useful illustration. It provides that the "competent authorities of the Contracting States shall exchange information to administer and enforce the domestic laws of the Contracting States concerning taxes."⁴⁷ Such language ensures the agreement imposes identical obligations on, and grants equivalent rights to, both signatories.

Although TIEAs are formally reciprocal, because they typically exist between states that are profoundly different, their nominal symmetry tends to be illusory. In practice, one state is likely to need extraterritorial tax information covered by the TIEA while the other does not. When that is true, tax information in fact only flows in one direction.⁴⁸ If the U.S. model TIEA described above were to enter into force between the United States and a hypothetical tax haven, the

45. Lynnley Browning, *An Offshore Spotlight for Madoff*, N.Y. TIMES, Dec. 31, 2008, at B1 (describing inquiry into whether offshore Madoff investment vehicles were used to help investors evade U.S. taxes by hiding income from U.S. authorities).

46. See Bruce Zagaris, *The Procedural Aspects of U.S. Tax Policy Towards Developing Countries: Too Many Sticks and No Carrots?*, 35 GEO. WASH. INT'L L. REV. 331, 332-34 (2003).

47. 1984 U.S. Model Exchange of Information Agreement art. 4, para. 1. The U.S. model treaty of that period similarly states that the "competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes." 1981 U.S. Model Income and Capital Tax Convention art. 26, ¶ 1. The OECD model TIEA uses the same neutral formulation. For example, it provides that "[e]ach Contracting Party shall ensure that its competent authorities for the purposes specified in Article 1 of the Agreement, have the authority to obtain and provide upon request: information held by banks." Org. for Econ. Co-Operation & Dev., Agreement on Exchange of Information on Tax Matters art. 5, ¶ 4, <http://www.oecd.org/dataoecd/15/43/2082215.pdf> (last visited Aug. 31, 2009).

48. The report of a U.N. group concluded that because of structural differences in the tax regimes of TIEA partners, the relatively advanced TIEA partner would receive, but would not be required to provide, tax information. United Nations Ad Hoc Group of Experts on Int'l Cooperation in Tax Matters, *Tax Treatment of Cross-Border Interest Income and Capital Flights: Recent Developments* ¶ 52, U.N. Doc. ST/SG/AC.8/2003/L.10 (July 9, 2003) [hereinafter U.N. Tax Experts Report], available at <http://daccess-dds-ny.un.org/doc/UNDOC/LTD/N03/427/20/PDF/N0342720.pdf?OpenElement>.

United States would receive information about its taxpayers and the tax haven would not.⁴⁹

C. *Two Types of Deharmonization*

SACU and TIEAs share important characteristics. Both create frameworks in which states engage in cross-border cooperation by filling roles consistent with their respective strengths and needs. They also illustrate an important point of divergence among deharmonization strategies. Pursuant to the SACU agreement, participating states pool and share tax revenues. TIEAs by contrast only envision administrative assistance, in the form of extraterritorial tax information, flowing across borders. This Article refers to SACU-style deharmonization as base deharmonization⁵⁰ and to TIEA deharmonization as administrative deharmonization.⁵¹

In a sense, base deharmonization differs from administrative deharmonization in the extent—rather than the kind—of the interjurisdictional cooperation it represents. Both call for states to expend tax resources in a way that might not increase the amount of revenue extracted from their own tax bases. Base deharmonization, unlike administrative deharmonization, calls for states to share the benefits of cooperation in the same way that they share the burdens. Both forms could be employed in connection with virtually any form of taxation, from an income tax to a carbon tax. Despite their

49. The basic premise of TIEAs is that a tax haven can acquire sought-after tax information more cheaply than its TIEA partner. If that is true, this specialization would be efficient, creating the possibility of gains for both parties.

50. Even when considered only in the context of a single tax, base deharmonization could take a variety of forms. One jurisdiction might play a lead role in administering the tax in exchange for a disproportionate share of the collective revenues generated by the tax. See *infra* note 107 and accompanying text. Allocating tasks to governments based on their relative strengths instead of requiring each government to fill every role would be advantageous. For a new tax, such as the carbon tax, the benefits of that aggregation would be particularly pronounced. The compensation element may be complicated by the indirect economic implications of the interstate relationship. For example, in the case of the SACU, South Africa (the lead administrator) actually receives a disproportionately small percentage of tax revenues because the existence of the SACU free trade zone is an enormous boon to South Africa. Limiting carbon emissions could likewise create disproportionate nontax benefits for developed states, making it possible that they would both bear a relatively heavy administrative burden and receive a relatively small share of aggregate carbon tax revenues.

51. The discussion is limited to these two categories of deharmonization, but that focus is not intended to suggest that this is the only possible way to distinguish among deharmonization strategies.

similarities, the differences between them are significant enough that it is appropriate to distinguish between the two forms.⁵²

Regardless of the particular form it takes, deharmonization would mark a dramatic departure from orthodox international tax policymaking. The bulk of the extant regime is designed to both capitalize on and to deepen similarities among nations' tax systems. The next Part explores how tax harmonization became synonymous with international tax cooperation and then considers the practical limitations of a symmetry-based approach.

III. THE LIMITS OF TAX HARMONIZATION

Domestically, tax simplification has long been the holy grail of tax policy, constantly pursued but never attained.⁵³ Tax harmonization may be its equivalent in the international tax policy context. For the same reasons that commentators bemoan the insidious harms of complexity,⁵⁴ the big⁵⁵ and small⁵⁶ differences among national tax systems are seen as a drag on efficiency and a detriment to global welfare. As Part III explains, within a single jurisdiction, complexity distorts taxpayer behavior and imposes significant costs on individuals and businesses. Cross-border tax differences do the same when taxpayers' activities extend across national boundaries.

It is important to recognize, however, that the analogy between harmonization and simplification is imperfect. Unlike simplification, harmonization lacks a persuasive, independent normative foundation.

52. Administrative deharmonization requires a relatively modest degree of interaction between jurisdictions. Collaboration that calls for one jurisdiction to contribute a portion of its tax base to a joint effort is likely to involve a significantly higher level of engagement. More importantly, as discussed *infra* Part V, they raise different types of implementation concerns.

53. Edward J. McCaffery, *The Holy Grail of Tax Simplification*, 1990 WIS. L. REV. 1267, 1267 (1990) ("People have long sought, or said they have sought, simpler tax laws. Yet, by most measures, tax laws remain extremely complex." (citation omitted)).

54. See Steven A. Dean, *Attractive Complexity: Tax Deregulation, the Check-the-Box Election, and the Future of Tax Simplification*, 34 HOFSTRA L. REV. 405, 416 & nn.45-46 (2005) (noting preservation of resources as a common reason for objecting to tax complexity).

55. Tax flight offers an example of the problems that arise when tax regimes are fundamentally different. Tax flight often results when a regime with a sophisticated income tax collides with one that lacks key features of that tax. The resulting mismatch allows tax cheats to camouflage their income in order to hide it from tax authorities. See Dean, *supra* note 8, at 924-25.

56. International tax arbitrage occurs when taxpayers are able to exploit relatively subtle differences between national tax regimes in the same way that financial arbitrageurs are able to exploit market inefficiencies to capitalize on relatively small price differences. See Kane, *supra* note 3, at 109.

As the preceding and subsequent Parts show, cooperation—not harmonization—is the desired outcome in international taxation. Harmonization can lay claim to a lineage even older than the international tax regime itself, but tradition alone does not make harmonization indispensable.

A. *Tax Harmonization*

Understanding what is meant by the term “tax harmonization” is surprisingly challenging.⁵⁷ One might think that in its purest form, tax harmonization would mean simply translating one set of tax laws into each relevant language and having them enacted by each nation’s legislature. In reality, such an effort would in some respects go too far, while in others it would not go far enough to achieve an idealized form of harmonization.

Because the objective of tax harmonization is eliminating differences between tax systems from the taxpayer’s perspective, formal differences may be insignificant. As a result, insisting that literal translations of any given statutory provision be employed in each jurisdiction would often be pointless.⁵⁸ At the same time, merely using identical statutory language offers no guarantee those laws will be interpreted and applied in an identical fashion.

Substantive, rather than merely formal, tax harmonization would require each nation to create tax regimes that are identical in three principal respects. First, each nation would need to tax the same assets and activities. In other words, each nation’s tax base would need to be precisely the same as every other nation’s tax base.⁵⁹ Second, the rate

57. The same is true of simplification. See Boris I. Bittker, *Tax Reform and Tax Simplification*, 29 U. MIAMI L. REV. 1, 1 (1974) (“Neither ‘tax simplification’ nor its mirror image, complexity, is a concept that can be easily defined or measured.”).

58. Mutual recognition of regulatory regimes sometimes serves as a substitute for traditional harmonization. It reflects the insight that rules need not be identical to achieve equivalent regulatory results. Mutual recognition has recently been the focus of cross-border securities regulation cooperation. See Press Release, Delegation of the European Comm’n to the USA, Statement of the European Commission and US Securities and Exchange Commission on Mutual Recognition in Securities Markets (Feb. 1, 2008), http://www.eurunion.org/eu/index.php?option=com_content&task=view&id=1576&Itemid=58 (expressing U.S./EU intention to facilitate investor access to foreign securities by recognizing the adequacy of investor protections offered by foreign jurisdictions).

59. The base on which a tax is imposed refers to the economic event that triggers the tax or the asset on which the tax is levied. The range of tax bases employed by different jurisdictions is wide. Some jurisdictions rely heavily on consumption taxes such as value-added taxes. Others, such as the United States, rely heavily on income taxes. Even among tax bases that are broadly similar, the differences can be significant. For example, a tax on income could be limited to specific categories of income (such as wages) or it could be a

of tax imposed on those tax bases would need to be the same in every jurisdiction.⁶⁰ Finally, each nation's tax laws would need to be administered in a comparable fashion.⁶¹ Only by achieving a high degree of conformity with respect to each of those three criteria can two or more nations be said to have achieved true tax harmonization. Unfortunately, that is much easier said than done.

Altering national legal and regulatory structures represents one path towards harmonization. International agreements provide both an alternative to, and a means of, advancing the harmonization of purely domestic rules. To the extent that states can rewrite their domestic laws through international law, statutory and regulatory differences may be made irrelevant. Treaties and other instruments can also promote uniformity in a more subtle way.

Double-tax treaties, for example, encourage states to adopt and retain income taxes.⁶² Those double-tax treaties form the core of the international tax regime. As the following discussion explains, they also serve as a direct link to an era that ordinarily seems far removed from the issues that confront today's policymakers. Conceived well

comprehensive tax on all forms of economic income. In addition, subtractions from or additions to a given tax base are often introduced to subsidize or discourage particular activities. Those deviations represent policy decisions that depend entirely on the needs and priorities of particular jurisdictions. Tax base harmonization need not be accompanied by tax rate harmonization. *See infra* note 60 and accompanying text. Base harmonization alone, however, is no substitute for base and rate harmonization combined. *See, e.g.*, Michael J. Graetz & Alvin C. Warren, *Income Tax Discrimination and the Political and Economic Integration of Europe*, 115 YALE L.J. 1186, 1227-32 (2006) (examining current European proposal to harmonize only the base of the corporate tax within the European Union).

60. The second important dimension along which tax regimes differ is the nominal rate that applies to a given base. In the simplest case, the amount of tax due is determined by multiplying a single rate by the chosen base. That suggests that two tax regimes employing an identical base need only add an identical rate to be perfectly matched. In practice, achieving true parity is difficult even when questions of tax base are put to one side. One reason is that instead of being applied at a single rate, rates often differ according to a taxpayer's status. For example, the United States imposes income tax at rates ranging from 0% up to a nominal maximum of 35%, varying according to the nature and amount of income earned by a taxpayer and the taxpayer's status. *See* 26 U.S.C. § 1(i) (2006).

61. The last key difference among tax regimes is a function of the different tools and methods tax authorities use to encourage taxpayers to pay the taxes that they owe. In recent years, a renewed focus on issues such as the "tax gap" has underscored the importance of choices about the administration of a tax regime. *See generally* Guttentag & Avi-Yonah, *supra* note 28. As a practical matter, even if two tax regimes were identical both in terms of base and rates, employing different enforcement mechanisms could produce very different results for taxpayers. For example, if an income tax were imposed on a base that included both wage income and investment income, but wages are subject to information reporting and withholding while investment income is subject to neither reporting nor withholding, the effective tax rate on the latter would be significantly lower.

62. *See infra* notes 78-84 and accompanying text.

before the end of the colonial era, these treaties remain extraordinarily influential.

B. The Age of Easy Symmetry

Of the many ways that harmonization assumed a central role in the international tax regime, perhaps the least obvious to even those most familiar with that regime, is a byproduct of the influence of the small group of economists generally credited with its creation.⁶³ Their nearly century-old blueprint provides the framework around which that regime has evolved.⁶⁴ As this Subpart suggests, it may have been inevitable that they would incorporate symmetry deeply into their design.

This Subpart starts by taking a step back from the modern international tax regime to consider how governments addressed questions of asymmetry and harmonization before the threat of double taxation and the treaties meant to tame it took center stage. It begins by describing the world in which the principal architects of today's international tax regime learned to tackle important cross-border tax policy challenges. Put bluntly, it presents a picture of a time when symmetry could be, and emphatically was, taken for granted.

By importing that presumption of uniformity into the institutional structures that form the foundation of today's international tax regime, that small group of experts implicitly chose harmonization (homogeneity) over deharmonization (specialization). From the start, that choice proved to be problematic.⁶⁵ Over the course of the twentieth century, as the international community came to be populated by an increasingly diverse group of independent actors and as technological change forced them to live in close virtual proximity to one another, the limitations of tax harmonization became increasingly troublesome.

Although tax harmonization has come to be perceived as the primary counterbalance to a host of ills, that need not have been the

63. See, e.g., Reuven S. Avi-Yonah, *All of a Piece Throughout: The Four Ages of U.S. International Taxation*, 25 VA. TAX REV. 313, 317-18 (2005) (listing Thomas Adams, Edwin Seligman, and Mitchell Carroll as the "three principal American" international tax law figures from the early years of the international tax regime).

64. See *infra* notes 76-78 and accompanying text.

65. See Graetz & O'Hear, *supra* note 7, at 1033-34 (describing conflict between capital importers and exporters in the early days of the modern international tax regime). It is interesting to think of what an asymmetrical, deharmonized resolution to that conflict might have looked like. Would collection have been concentrated in one or more importing nations?

case. The historical context in which the international tax regime's foundation was laid raises the possibility that uniformity may have been made important simply because it was familiar, rather than because of any normative commitment to it.

During the nineteenth century, Europe and its sub-Saharan African colonies could not have been more different. Nevertheless, from a tax standpoint, the two became a well-matched pair.⁶⁶ Certainly, it is remarkable that the tax systems of the metropolises and colonies were so similar.⁶⁷ One could also ask a more fundamental question. Why would those colonies even attempt to collect taxes? The relative revenue potential of the metropolitan and colonial tax bases was obviously quite different.⁶⁸ Presumably, the metropolises could have eliminated the need for any taxes at the colonial level with relatively subtle rate increases at home.

Popular resistance to the idea of subsidizing the colonies,⁶⁹ along with a skepticism regarding the benefits of colonial investments⁷⁰ and

66. Not only did colonies by and large collect the taxes necessary to defray their administrative expenses in essentially the same way as the metropolises, they did so relying on the same sorts of taxes. Compare Edwin R.A. Seligman, *The French Colonial System*, in *ESSAYS IN COLONIAL FINANCE BY MEMBERS OF THE AMERICAN ECONOMIC ASSOCIATION* 20, 38 (1900) (showing the majority of Senegal's 1898 revenues came from customs duties and liquor taxes), with *THE INTERNATIONAL YEAR BOOK* 321 (Frank Colby & Harry Peck eds., 1899) ("Of the indirect taxes, which yielded according to the estimates for 1898, 59 per cent. of the revenue, the most productive were the customs duties, the tax on spirits, the tax on sugar and the registration tax."). As a practical matter, a less symmetrical arrangement, perhaps one in which tax collection was centralized at the metropolitan level, may have been superior. For whatever reason, the metropolises preferred to mirror their own tax structure at the colonial level.

67. In the abstract, there is little reason to think that the administratively sophisticated European governments and their far smaller sub-Saharan African counterparts would both be a good match for the same tax regime. It seems obvious that taxes that would make sense in one context would be poorly suited to the other. A tax straightforward enough to be administered effectively in absence of a well-developed bureaucracy would almost necessarily fail to balance the competing interests a metropolitan tax would need to address.

68. Returning to the comparison between Senegal—a midsized French colony—and France, Senegal's revenues in 1898 amounted to 0.12% of France's revenue. See Seligman, *supra* note 66, at 38 (estimating Senegal's 1898 revenues at just under 4,000,000 francs); Colby & Peck, *supra* note 66, at 321 (estimating France's 1898 revenues at just over 3,400,000,000 francs).

69. Isidore Loeb, *The German Colonial Fiscal System*, in *ESSAYS IN COLONIAL FINANCE BY MEMBERS OF THE AMERICAN ECONOMIC ASSOCIATION* 40, 42 (1900) ("Particular emphasis was placed [by opponents of colonial expansion] upon the cost of colonial undertakings, and the resulting burden upon the home taxpayer. . . . The government, accordingly, adopted a conservative policy.").

70. CRAWFORD YOUNG, *THE AFRICAN COLONIAL STATE IN COMPARATIVE PERSPECTIVE* 97 (1994) ("Metropolitan treasuries, citadels of skepticism concerning the material benefits likely to accrue from colonial expansion in Africa, insisted on an iron law of fiscal self-sufficiency of the newly acquired colonial territories."). The depth of the resistance to

simple indifference,⁷¹ made it essential for the colonies to collect taxes. Faced with a need to generate tax revenue in the colonies to satisfy the demands of administering and expanding those colonies, the metropolises by and large did the obvious. Administrators relied on the same taxes that served them well at home.⁷²

Because the complex relationship between taxation and sovereignty has no bearing, the explanation may be more straightforward.⁷³ The metropolises appear to have simply been reluctant to use metropolitan revenues to finance colonial expenditures. That parochial reticence and the resulting need for sub-Saharan colonies to finance all or part of their own administration have been called the principle of “colonial self-sufficiency.”⁷⁴ Although not independent states, it seemed self-evident that the colonies should possess a complete taxing apparatus and that it should mirror that of the metropole.

C. *Symmetry and the Modern International Tax Regime*

To today’s international tax experts, references to nineteenth century relationships between colonies and metropolises are certain to seem both alien and irrelevant. Nevertheless, the link between today’s international tax regime and the colonial era is far from attenuated. During the years in which the modern regime took shape, the post-World War II independence movement that ended the colonial

expanding metropolitan funds on the colonies was exemplified in the granting of concessionary charters to private companies for large capital projects. The metropolises sacrificed valuable future rights to revenues and profits rather than contribute capital up front. See JUAN LL. GRIFFITHS, *THE AFRICAN INHERITANCE* 54 (1995).

71. Metropolitan electorates “were decidedly uninterested in their colonial estates, and their parliamentary representatives could not be persuaded to allocate sums for the exploitation of these holdings. Thus the colonies had to be self-financing.” Peter Kilby, *Manufacturing in Colonial Africa*, in 4 *COLONIALISM IN AFRICA 1870-1960*, at 470, 492 (Peter Duignan & L.H. Gann eds., 1975) (describing the mood of English and French electorates).

72. See *supra* note 66 and accompanying text.

73. Had the colonies been sovereign, the traditional arguments linking sovereignty and taxation would apply. See *generally* Ring, *supra* note 6. Alternatively, had sovereignty been the long-term goal of the colonial project, it may have been farsighted to lay the fiscal foundation of each future state at the start. Obviously, the colonies were neither independent nor, in this relatively early stage of the colonial project, being groomed for independence. See YOUNG, *supra* note 70, at 182-83 (noting that even by the mid-twentieth century most colonial powers saw independence for their African colonies as something likely to occur in the distant future, if at all).

74. YOUNG, *supra* note 70, at 97 (“The principle of colonial self-sufficiency dates from 1815 Only Italy was a systematic exception to this rule; Eritrea, Somalia, and Libya were costly ventures, requiring metropolitan financial commitments throughout the colonial period.”). The reluctance to finance the administration of the colonies varied somewhat over time, with greater emphasis being placed on the need for fiscal autonomy by the early twentieth century. *Id.*

relationship between Europe and sub-Saharan Africa was still decades into the future.⁷⁵

For tax experts of the day, the role of taxation in the colonial enterprise would not have been foreign at all. One of the so-called “four economists”⁷⁶ that are often credited as architects of the international tax regime, Edwin Seligman, even contributed to a volume titled “Essays in Colonial Finance” published by the American Economics Association in 1900.⁷⁷ The colonies and the notion that each jurisdiction, no matter how different, should have essentially interchangeable tax regimes were simply part of the world those tax experts knew. Given that context, it may be difficult to imagine experts such as Seligman doing anything other than creating an international tax regime that would take both the existence and importance of uniformity for granted.

The bilateral tax treaties they helped to design—borrowing heavily from existing European tax treaties⁷⁸—form the backbone of today’s international tax regime. Those treaties are an important conduit through which harmonization secured its dominant position in international taxation. They allow pairs of nations to coordinate aspects of their tax regimes according to what has been referred to as the “benefits principle.”⁷⁹ Over time, double-tax treaties have become so ubiquitous as to be virtually synonymous with international tax cooperation.⁸⁰

75. YOUNG, *supra* note 70, at 182-217 (describing shift towards independence that occurred after World War II).

76. See Avi-Yonah, *supra* note 63, at 318 (“Edwin Seligman . . . was the guiding spirit behind the 1923 ‘four economists’ report to the League of Nations (1923 Report), which laid the foundations for the international tax regime . . .”).

77. See *supra* note 66 and accompanying text.

78. See Mitchell B. Carroll, *International Tax Law: Benefits for American Investors and Enterprises Abroad*, 2 INT’L LAW. 692, 693 (1968).

79. See Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 TAX L. REV. 507, 509 (1997) (“The Benefits Principle assigns the right to tax active (business) income primarily to the source jurisdiction, while the right to tax passive (investment) income is assigned primarily to the residence jurisdiction.”). The logic of the benefits principle rests in part on the Lockean notion that governments earn the right to collect tax revenues by providing the services that make the creation of the underlying income possible. *Id.* at 521 (“[T]he provision of infrastructure or education, as well as more specific government policies such as keeping the exchange rate stable or interest rates low . . . justifi[es] source-based corporate taxation in the sense that the host country’s government bears some of the costs of providing the benefits that are necessary for earning the income.”).

80. “The public international law of taxation is dominated by over 1,500 bilateral treaties (the number goes up steadily) for the prevention of double taxation of income and capital.” Victor Thuronyi, *International Tax Cooperation and a Multilateral Treaty*, 26 BROOK. J. INT’L L. 1641, 1641 (2001) (citation omitted).

Double-tax treaties take two tax regimes that are similar and refine those similarities. Their coordination function and the viral process through which those treaties propagate⁸¹ mean that they encourage harmonization⁸² in two ways. First, double-tax treaties create a limited, international law sphere of substantive harmonization that prevents double taxation by ensuring that each state limits the application of its tax system in accordance with the same conception of the benefits principle.⁸³

The other process by which tax treaties promote harmonization is incidental to the elimination of double taxation. Because those treaties are reciprocal, essentially making each treaty a barter arrangement, they work best when each state's tax regime is similar.⁸⁴ Because the costs of not having access to treaty benefits can be significant, treaties provide an incentive for nations to standardize their tax systems.⁸⁵ This two-part process creates a pattern in which double-tax treaties both invite and produce symmetry. Over time and at the margins, the role of treaty benefits in promoting harmonization has been significant.

Unfortunately, the link between double-tax treaties and symmetry has a downside. When a pair of states has tax systems that are

81. John F. Avery Jones, *Are Tax Treaties Necessary?*, 53 TAX L. REV. 1, 3 (1999) (calling tax treaties "self-perpetuating").

82. See Daniel Shaviro, *Some Observations Concerning Multijurisdictional Tax Competition*, in REGULATORY COMPETITION AND ECONOMIC INTEGRATION: COMPARATIVE PERSPECTIVES 58 (Daniel C. Esty & Damien Geradin eds., 2001) (describing the importance of double-tax treaties for harmonization).

83. See Avi-Yonah, *supra* note 79. Even though each jurisdiction's internal laws remain unchanged, the treaty reduces the practical significance of those differences.

84. Both today's treaties and the early models from which they evolved operate by orchestrating a quid pro quo of reciprocal tax concessions. See Carroll, *supra* note 78, at 693. For such an arrangement to take root, both treaty partners' tax systems must be similar in important respects. Obviously, each nation must impose an income tax. That income tax must also have a broadly similar reach. As a result, the rise of those treaties gave an advantage to nations that fit the dominant mold and provided an incentive to others to conform. This standardization process reaches its height—or perhaps its nadir—in the lengths to which states go to maintain internal laws for the specific purpose of being replaced by treaty provisions. See, e.g., Jones, *supra* note 81, at 3 (describing pattern of enacting "outrageous . . . provisions of internal law" so that others "will come running to its door asking for a treaty in familiar form").

85. It may be difficult to imagine a nation introducing a comprehensive income tax simply to secure the reduced U.S. tax burdens such a treaty might ultimately produce. It is not quite so farfetched to think that an unwillingness to give up those benefits would inhibit a move away from an income tax. See STAFF OF JOINT COMM. ON TAXATION, 104TH CONG., IMPACT OF INTERNATIONAL COMPETITIVENESS OF REPLACING THE FEDERAL INCOME TAX (Comm. Print 1996), available at <http://www.house.gov/jct/s-5-96.pdf> ("If the United States adopts a new tax system that is vastly different . . . [a] treaty country could choose to terminate its present income tax treaty with the United States, if the treaty is no longer relevant because of the incompatibility of the two taxing systems.").

fundamentally mismatched, double-tax treaties can do nothing to spur harmonization.⁸⁶ The two most striking examples of those limits are the disappearance of treaties with tax havens at the moment that a strong relationship between the relevant governments was needed most⁸⁷ and the absence of treaties with sub-Saharan Africa.⁸⁸ Because double-tax treaties can only build on preexisting symmetry, those treaties can only reach so far. The absence of a critical mass of symmetry creates a chicken-and-egg dilemma referred to below as the harmonization conundrum. Without symmetry to build on, harmonization becomes impossible.

D. Cross-Border Symmetry in a Heterogeneous World

As the preceding discussion suggests, homogeneity has long been both a product of and a precondition for the success of the international tax regime. On the whole, this dynamic has been fruitful, but it also creates a problem.⁸⁹ Because harmonization presupposes a meaningful degree of uniformity among cooperating states, when that underlying homogeneity is lacking, our harmonization-based international tax regime is rendered powerless, effectively making cooperation itself very difficult.

As taxpayers find it increasingly easy to disregard both borders and distance, finding solutions to today's international tax dilemmas will require meaningful engagement, not only between nations that are more or less the same, but also between those that are profoundly different. That raises the prospect that the harmonization conundrum—the absence of symmetry is itself an obstacle to creating symmetry—will stifle the evolution of the international tax regime and prevent the emergence of cooperative relationships between mismatched states.

86. Even when two states' tax regimes are broadly similar, underlying differences in their economic conditions pose an obstacle for double-tax treaties. The fight between some developed and developing countries over tax sparing offers an example of that dynamic. *See* Christians, *supra* note 9, at 694-95 (noting that the United States refuses to adopt tax sparing provisions while some developing countries refuse to sign tax treaties that omit such provisions).

87. *See* Press Release, U.S. Treasury Dep't, Treasury Department Announces Termination of Extensions of Income Tax Conventions Between the U.S. and the U.K. and the U.S. and Belgium to 18 Countries and Territories (July 1, 1983) (announcing termination of treaty extensions with former colonies that had come to be perceived as tax havens).

88. Christians, *supra* note 9, at 641.

89. *See* Jones, *supra* note 81, at 1 ("Tax treaties are a very considerable success story for the OECD and its predecessors, the League of Nations, and the OEEC.").

The frustrations of the current state of the international tax regime are best illustrated by the problem of offshore tax evasion, or tax flight. Tax flight occurs when taxpayers camouflage their income or assets by using offshore accounts or entities.⁹⁰ Substantive harmonization would obviously go a long way towards eliminating tax flight.⁹¹ Unfortunately, there is no clear path towards that harmonization. Today, neither the brute force of the colonial era nor double-tax treaties can manage the alchemical trick of producing symmetry from asymmetry.⁹² One possible solution to that harmonization conundrum is finding a means of generating the requisite critical mass of symmetry. To do that, jurisdictions troubled by tax flight turned to the power of informal norms.

To persuade tax havens to enter into cooperative—nominally reciprocal but substantively asymmetrical⁹³—information exchange relationships, Organisation for Economic Co-Operation and Development (OECD) members sought to employ both carrots and sticks, combining veiled threats of sanctions⁹⁴ with the compliance pull of an international regime.⁹⁵ In part through the OECD,⁹⁶ they worked to articulate a set of norms ultimately embodied in formal cooperation commitments from target states and buoyed by the promise of “defensive measures”⁹⁷ from OECD members to encourage the

90. See Dean, *supra* note 8, at 924-25.

91. As a theoretical matter, if the tax haven jurisdictions in which those accounts and entities are often formed were to import the tax systems of those jurisdictions suffering from tax flight lock, stock, and barrel, it would become much easier to prevent businesses and individuals from hiding their income. That is because persuading tax havens to mirror other nations' substantive and procedural tax rules would give tax havens both more reason and more opportunity to cooperate in the fight against tax flight. See Dean, *supra* note 8, at 925-26 & nn.61-62.

92. The brute force approach of the colonial era, although perhaps appealing to some, is no longer a realistic option. At the same time, significant and persistent gaps in the global tax treaty network suggest that, despite the potency of those treaties, the existing international tax regime is unlikely to bridge the gap with tax havens. Even though the treaties that form the backbone of that regime have considerable power to shape nations' behaviors, their connection to tax havens is minimal and growing weaker rather than stronger.

93. See *supra* notes 43-49 and accompanying text.

94. See ORG. FOR ECON. CO-OPERATION & DEV., HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE 37 (1998) (suggesting the possibility of “co-ordinated” “defensive measures”).

95. See Thomas M. Franck, *Legitimacy in the International System*, 82 AM. J. INT'L L. 705, 705 (1988) (“[M]ost states observe systemic rules much of the time in their relations with other states.”).

96. In conjunction with that initiative, the OECD published a landmark report on harmful tax competition. See ORG. FOR ECON. CO-OPERATION & DEV., *supra* note 94.

97. *Id.*

reluctant.⁹⁸ In essence, the OECD initiative represented an effort to harness the potential of informal norms to short-circuit the harmonization conundrum in order to expand the reach of the international tax regime beyond the limits of the aging double-tax treaty infrastructure.

There is little doubt that norms can serve as highly effective tools for regulating behavior.⁹⁹ Individuals and states alike can “internalize norms and act in accordance with them because they understand them to be correct or appropriate.”¹⁰⁰ Nevertheless, understanding precisely how and why those norms emerge and take root is more difficult than observing that they sometimes do.¹⁰¹ One requirement appears to be that those governed by a set of norms share a collective identity¹⁰² or

98. The initiative’s eventual focus on information sharing was consistent with the growing consensus that greater information access was the key to combating tax flight. See Roin, *supra* note 6, at 545 (“Although there has already been some movement [towards] obtaining better tax information . . . it should become a primary rather than secondary goal of tax reform efforts.”).

99. See generally ROBERT C. ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* (1991) (explaining power of informal norms to govern social interactions). The success of the Basel Committee and the International Organization of Securities Commissions in creating cooperative financial regulatory standards shows that norms can work well in the international economic law context. See David Zaring, *Informal Procedure, Hard and Soft, in International Administration*, 5 CHI. J. INT’L L. 547 (2005).

100. Oona A. Hathaway, *Between Power and Principle: An Integrated Theory of International Law*, 72 U. CHI. L. REV. 469, 481 (2005) (“[I]nterest-based scholars are wrong to assume that states engage only in consequentialist pursuit of objective self-interest.”).

101. Norms, neither weeds nor hothouse flowers, flourish in many—but not all—environments. The classic hypothesis holds that norms thrive in relatively homogenous, close-knit contexts. See ELLICKSON, *supra* note 99, at 177 n.35 (“[T]he more close-knit a group is, the better it will be able to use its informal-control system to minimize the sum of transaction costs and deadweight losses.”). That homogeneity promotes the trust necessary for mutually beneficial cooperation to succeed. Unlike a tenth-century French villager who consumes virtually nothing not produced by one of his village’s eighty residents, states—at least in terms of taxation—do not have the luxury of belonging to a community able to “spontaneously enforce[] its morality as a set of compulsory norms.” RUSSELL HARDIN, *TRUST* 7 (2006). Neither tax homogeneity nor tax cooperation is easy to come by in today’s international tax regime. The profound differences that exist among nations and national tax systems that limit the reach of the double-tax treaty network also inhibit the processes by which norms encourage compliance and discourage defection.

102. That shared identity need not be the product of the cloistered existence of the tenth century resident of a “grim and oppressive” village referred to above. See HARDIN, *supra* note 101, at 7. It could instead be a function of the more limited relationships that predominate in modern life. See HARDIN, *supra* note 101, at 8. Dueling offers an example of the ties that support the functioning of norms. See Lawrence Lessig, *The Regulation of Social Meaning*, 62 U. CHI. L. REV. 943, 968-72 (1995) (noting that the social norms governing the illegal, but widely observed, practice of dueling limited it to a very specific group). “Odd as it may seem, this practice of dueling—the ritual of retiring to a field and firing pistols at one another to satisfy a social insult—was the domain of southern gentlemen

are rendered trustworthy¹⁰³ through the existence of a relationship they value.¹⁰⁴ Those ties provide an avenue through which breaches may be sanctioned.¹⁰⁵

Unfortunately, after decades branded as outlaws, tax havens appeared to believe they had little reason to abide by those norms.¹⁰⁶ As a result, employing informal norms offered no escape from the harmonization conundrum. Instead, the limitations and failures of the extant international tax regime were simply replicated in the alternative, norm-driven regime.

IV. THE TAX DEHARMONIZATION ALTERNATIVE

Tax harmonization offers a mechanism for reducing cross-border tax conflict, but it is not the only mode of cooperation that allows states to simultaneously generate efficiency and legitimacy. Collaborative specialization offers one alternative. Arrangements in which a jurisdiction devotes tax resources not simply to raising revenues through its own tax system—but instead deploys them in concert with other jurisdictions contributing different resources—could do as much or more to achieve those aims. If each jurisdiction's unique contribution reflects a relative advantage it enjoys compared to other participating jurisdictions, that pooling would create a tax that is normatively superior to one that harmonization could produce.¹⁰⁷ It

only. Not just anyone could successfully challenge another for a duel; only someone with a sufficiently high social standing." *Id.* at 968 (citations omitted).

103. See HARDIN, *supra* note 101, at 1-2 (highlighting importance of "trustworthiness" as a prerequisite to trust).

104. See *id.* at 31 (explaining "encapsulated interest theory of trust" as typically relying on an ongoing relationship "that the trusted would like . . . to continue").

105. See Andrew T. Guzman, *A Compliance-Based Theory of International Law*, 90 CAL. L. REV. 1823, 1827 (2002) ("[C]ompliance occurs due to state concern about both reputational and direct sanctions triggered by violations of the law.').

106. Tax havens already played the role of outsiders to the international tax regime. That meant that the threat of reputational and other sanctions that might otherwise have been employed to encourage them to conform to prevailing norms had little incremental effect. It certainly suggests that tax havens and their critics do not "have highly homogeneous beliefs about" international tax policy. See SLAUGHTER, *supra* note 13, at 200 (describing conditions that contributed to the success of the Basel Committee). If a jurisdiction has been seen, and has grown to see itself, as an outlaw, norms seem an unlikely means of returning it to the fold. As Franck might put it, "[o]bligation is perceived to be owed to a community of states as a necessary reciprocal incident of membership in the community." Franck, *supra* note 95, at 753 (emphasis omitted). Because tax havens have been explicitly cast as outsiders to the international tax regime, they were unlikely to feel obligated to adhere to that regime.

107. A simple example can illustrate the benefit of such an exchange. Assume that two jurisdictions, Big and Small, will use two tax resources to impose a new carbon tax: administrative resources and enforcement resources. Also assume that Big can provide both resources at less cost per \$100 of carbon tax revenue collected. Big can administer a carbon

would, of course, also obviate the need for each jurisdiction to maintain identical regimes.¹⁰⁸

This Part expands on the parallel between simplification and harmonization to provide a means of isolating the benefits harmonization provides.¹⁰⁹ Thinking about cross-border differences as just another form of complexity makes it easy to understand the two key benefits of tax harmonization: efficiency and legitimacy. It also suggests why those benefits always seem to be just out of reach.¹¹⁰ Fortunately, the analogy between harmonization and simplification is flawed. While simplification is the only means of combating complexity, harmonization is just a subset of a broader array of international tax cooperation strategies.

At the risk of understatement, actually achieving the high level of homogeneity that represents tax harmonization's ideal endgame would be challenging.¹¹¹ Of course, asking sovereign governments to agree to

tax for \$5 per \$100 of revenue collected, while it would cost Small \$6. Big can also enforce a carbon tax for \$2 per \$100 of revenue collected, while it would cost Small \$4. Even though Big has an absolute advantage in both enforcement and administration (it can do both more cheaply than Small can), it would still make sense to concentrate enforcement in Big and administration in Small because Big has a relatively strong advantage in enforcement. That would produce a combined cost of \$8 per \$100 of revenue (Small's \$6 administration cost plus Big's \$2 in enforcement cost). If administered and enforced independently, the cost would be \$8.50 per \$100 of revenue ($\$5 + \$6 + \$2 + \$4 = \$17$ per \$200 or \$8.50 per \$100). Survivors of an introductory economics class will recognize this as an illustration of the principle of comparative advantage.

108. One could reasonably ask whether that specialization would simply represent a particularly baroque form of tax harmonization pursuant to which a group of states collectively administer an identical tax. If states were to adopt a deharmonized carbon tax, for example, in a sense they would have achieved partial base harmonization, even though each might play a unique role in administering the tax. If that were the case, virtually any international tax cooperation in which a pair of states cooperates on tax matters could be lumped into the same category, and the term tax harmonization would be rendered virtually meaningless. Even if only half of the pair actually collected the relevant tax, that could be dismissed as a mere rate differential.

109. See *supra* notes 53-56 and accompanying text.

110. See *supra* note 53 and accompanying text.

111. Even if each nation were writing on a blank slate, creating an identical base, rate structure and administrative regime in every one would be a Herculean task. In reality, nations would be starting from very different points. Obviously, the formal rules that make up their tax regimes differ. See generally Ring, *supra* note 3. Perhaps more significantly, the broader tax cultures in which those rules operate are not only distinct but are also deeply entrenched. Michael A. Livingston, *From Milan to Mumbai, Changing in Tel Aviv: Reflections on Progressive Taxation and "Progressive" Politics in a Globalized but Still Local World*, 54 AM. J. COMP. L. 555, 560 (2006) ("Tax culture . . . may be defined to refer to the body of beliefs and practices that are shared by tax practitioners and policy-makers in a given society and thus provide the background or context in which substantive tax decisions are made."). From a more practical perspective, enormous disparities exist in the administration of different national tax systems. Richard M. Bird & Eric M. Zolt, *Technology and Taxation*

a single, uniform standard for almost any purpose is difficult. Because taxation lies so close to the core of national sovereignty, it is not surprising that attempts to foster international tax cooperation have yielded more frustration than harmonization.¹¹² The question this Part poses is whether a misplaced devotion to harmonization is itself part of the problem.

A. *The Benefits of Tax Harmonization*

The great diversity that exists among national tax regimes suggests how monumental the task of achieving true harmonization would be.¹¹³ Having imagined that remarkable degree of symmetry, the inevitable question for a national government is precisely how marching in lockstep with others would benefit it. The most straightforward answer is that it creates benefits much like those that tax simplification provides.

1. Efficiency

The primary appeal of both simplification and harmonization is rooted in a concern for economic efficiency.¹¹⁴ Tax simplification focuses on the expenditures taxpayers make to meet and minimize their tax obligations and the steps a government can take to reduce them.¹¹⁵ In essence, tax harmonization does the same.

in Developing Countries: From Hand to Mouse (UCLA Sch. of Law, Law-Econ. Research Paper No. 08-07, 2008), available at <http://ssrn.com/abstract=1086853>. In combination, those differences create an environment in which global tax uniformity seems highly unlikely.

112. “No significant issue in international tax can be discussed without raising the question of sovereignty.” See Ring, *supra* note 6, at 156.

113. See Ring, *supra* note 3, at 81 (“Despite many common features in our trading partners’ tax systems, the multitude of factors that produce tax law, including social policy, administrative constraints, and political compromise render conflicting rules a likely possibility.”).

114. Efficiency is commonly cited as the justification for tax simplification efforts. See Dean, *supra* note 54, at 416 & nn.45-46. Efficiency is also generally used to justify the existence of double-tax treaties, which have been called “the main mechanism for . . . harmonization.” Shaviro, *supra* note 82, at 58.

115. The related expenditures of government actors and third parties can also be thought of as costs of tax complexity. See *Tax Reform: Hearing Before the H. Comm. on Ways & Means*, 109th Cong. (2005) (statement of Joel B. Slemrod, Paul W. McCracken Collegiate Professor of Business, Economics, and Public Policy, Professor of Economics, and Director of the Office of Tax Policy Research, University of Michigan) (“In my view the most informative measure of tax complexity is the resource cost of collecting taxes. This is equal to the IRS budget plus the value of the time and money spent by the taxpayers and third parties to the collection process (such as employers who withhold tax for their employees.)”).

Tax complexity is said to impose three distinct costs on taxpayers.¹¹⁶ Rule complexity refers to the costs taxpayers incur to understand the obligations tax rules impose on them.¹¹⁷ Compliance complexity represents taxpayers' exertions to ensure that they meet those obligations.¹¹⁸ The third type of complexity is transactional complexity. It is transactional because it reflects the expenses taxpayers incur by engaging in transactions conducted in pursuit of tax benefits.¹¹⁹

In combination, those costs represent a significant drain on societal welfare. Each dollar spent by taxpayers to understand and comply with their tax obligations or to plan and execute tax-saving strategies is a dollar that will not be spent or invested in a more productive manner.¹²⁰ Even if a given expenditure yields a positive return for the taxpayer in question, it represents a net loss for society.

Tax harmonization targets the distinct yet equally wasteful expenditures triggered by the interactions of disparate tax systems. Unlike taxpayers that operate exclusively within a single jurisdiction, multijurisdictional taxpayers must consider not only the complexities associated with each jurisdiction but also must take into account what amounts to an additional layer of complexity that results from the clash of mismatched concepts and rules.¹²¹ Those expenditures represent more than the sum of rule, compliance, and transactional complexity encountered within the two or more jurisdictions in which the taxpayer conducts activities.

Such taxpayers must, for example, pay not only to understand the tax rules of the two jurisdictions, but also to understand how the two distinct sets of rules interact.¹²² Likewise, they must not only comply

116. See DAVID F. BRADFORD, *UNTANGLING THE INCOME TAX* 266-67 (1986).

117. *Id.*

118. *Id.*

119. *Id.* At the extreme, taxpayers invest in aggressive tax shelters, investing in complex strategies and perhaps spending \$2 on rule, compliance, and transactional complexity for every \$3 they save in tax. On a more modest scale, tax laws afford taxpayers many opportunities to modify their behavior in more subtle ways, incurring similar costs to reduce their tax liability.

120. See Dean, *supra* note 54, at 416-18.

121. See Philip R. West, *Foreign Law in U.S. International Taxation: The Search for Standards*, 3 FLA. TAX. REV. 147, 148 (1996).

122. Perhaps the most intriguing example of the complex relationship between U.S. tax law and foreign law is a regulation dealing with hybrid entities—entities that are classified differently in different jurisdictions. The regulation explicitly makes the U.S. tax treatment of an entity dependent on its treatment in another jurisdiction, making it impossible to determine the U.S. tax treatment of some entities without first understanding their treatment under foreign law. 26 C.F.R. § 1.894-1(d)(2)(ii)(B)(1) (2008) (governing the

with two sets of tax rules but must also ensure that the two compliance efforts do not conflict. Finally, by virtue of being subject to two different tax regimes, taxpayers more than double their opportunities for achieving tax savings by engaging in socially wasteful behavior.¹²³ The result is that such taxpayers encounter added complexity whenever they venture into a new jurisdiction. Part of that complexity is intrinsic to the new jurisdiction's tax regime (static complexity) and part exists only because the taxpayers have a simultaneous presence in two distinct jurisdictions (dynamic complexity).

2. Legitimacy

By reducing static complexity and eradicating dynamic complexity, harmonization can provide welfare benefits that parallel those that make tax simplification so appealing. On their own, those efficiency gains make tax harmonization appealing. Like simplification, tax harmonization also offers the promise of something more: legitimacy.¹²⁴ To understand why, it is helpful to recognize that the efficiency gains described above could largely be achieved via a very different route. Each state could easily be forced to adopt similar regimes if cutthroat interjurisdictional tax competition were allowed to flourish.

For example, it is sometimes assumed that unfettered competition would drive tax rates on geographically mobile capital to zero.¹²⁵ In their zeal to attract or retain such investments, and the nontax benefits associated with them, nations would have no choice but to forgo any tax claim with respect to that capital. Because they would no longer be subject to taxes on cross-border investments, individuals and businesses would face neither static nor dynamic rule, compliance, or transactional complexity when they invest overseas. At least in terms of those sources of efficiency loss, tax competition can produce precisely the same result that could be achieved through tax harmonization.

availability of treaty benefits to certain entities). *See generally* West, *supra* note 121, at 147 (discussing role of foreign law in U.S. tax law).

123. In addition to engaging in tax planning within each jurisdiction, taxpayers can exploit differences between them. In some cases, that exploitation is said to constitute "tax arbitrage." *See* Kane, *supra* note 3, at 96 (offering a definition of tax arbitrage).

124. In the case of simplification, the added legitimacy is a function of the transparency created by simplicity. BRADFORD, *supra* note 116, at 4 (noting that complexity can undermine confidence in the fairness of a tax).

125. Shaviro, *supra* note 82, at 61 (describing the concern that capital mobility could make taxing capital income impossible).

How, then, are tax harmonization and tax competition different?¹²⁶ The true difference between harmonization and competition is not simply a matter of outcomes, but of process. While tax harmonization would produce symmetry through cooperation, competition would do it with rivalry. Affirmatively seeking to harmonize disparate tax regimes would require concerted engagement among cooperating nations. Both choosing a single standard and working to conform to that standard would demand a high level of commitment and interaction. That process would provide an avenue for governments and, by extension, their constituents to participate in the design of the resulting system.

Tax competition's uniformity, by contrast, is more likely to unfold in the absence of sustained dialogue among affected nations. Because the harmonized regime would be the product of intergovernmental negotiation and consent rather than simply a capitulation to overwhelming market forces, voters would have had, indirectly, a hand in its creation. An identical result achieved through the collaborative process of harmonization would enjoy the benefit of the increased legitimacy that accompanies engagement and participation.¹²⁷

In the tax context that legitimacy may be especially important.¹²⁸ The legitimacy advantage harmonization would enjoy could prove

126. One possibility is that tax harmonization would be more likely than competition to produce a global tax regime that appropriately balances the many competing interests of relevant states. The best illustration of this may be the presumption that tax harmonization, unlike competition, would produce a relatively broad tax base. Such a broad tax base would be both efficient and distributionally appealing. Obviously, it would be comforting to conclude that attention from national governments would be more likely to produce an optimal cross-border tax regime than neglect. Unfortunately, it is also possible that nations could choose to converge towards a uniform regime with a relatively narrow base that, for instance, wholly excludes geographically mobile capital from the tax base.

127.

[P]erception of legitimacy will vary in degree from rule to rule and time to time. It becomes a crucial factor, however, in the capacity of any rule to secure compliance when, as in the international system, there are no other compliance-inducing mechanisms.

Legitimacy is used here to mean that quality of a rule which derives from a perception on the part of those to whom it is addressed that it has come into being in accordance with right process.

Franck, *supra* note 95, at 706 (emphasis omitted).

128. Often, there is tension between the two goals of creating a legitimate cross-border framework and building one that is robust. The tension is apparent with respect to the question of "linkage" among international tax regimes. See David W. Leebon, *Linkages*, 96 AM. J. INT'L L. 5, 24-27 (2002) (noting potential pitfalls of linking distinct issue areas, for example, linking environmental issues to international trade). Using the existing international trade infrastructure to address environmental issues might help answer questions about the World Trade Organization's legitimacy but would also complicate the negotiation

vital to the success of a harmonized tax regime by promoting voluntary taxpayer compliance at the individual level¹²⁹ as well as greater “compliance pull”¹³⁰ at the national level. In other words, both taxpayers and states are more likely to embrace an international tax regime produced by harmonization—thereby having “come into being in accordance with right process”—than one resulting primarily from competition.¹³¹

B. The Benefits of Tax Deharmonization

Tax harmonization produces two benefits. First, it increases efficiency by combating dynamic complexity. Second, it generates the legitimacy that is vital to the success of international tax arrangements. Deharmonization could produce precisely the same results without turning states’ tax regimes into carbon copies of one another.

1. Efficiency

The benefits of tax deharmonization are in some respects no different than those produced by harmonization. This is obviously true with respect to efficiency.¹³² Although the route by which it increases efficiency is precisely the reverse of harmonization, deharmonization targets the same dynamic rule, compliance, and transactional complexity. By prescribing distinct roles for different jurisdictions, deharmonization limits the likelihood that two or more jurisdictions will attempt to cover the same terrain and do so incompatibly.

For example, if a group of states were to coordinate the introduction of a carbon tax, they could avoid conflicts by creating identical rules and institutions in each jurisdiction. If we assume that

process. A related trade-off is sometimes seen in choosing between different international organizations to address a problem. In the international tax context, the broader membership of the United Nations may give it a stronger claim to legitimacy than an organization like the OECD, but the OECD has consistently been a leader on international tax issues. *See* Dean, *supra* note 3, at 662 n.369. The OECD’s success is arguably the result of its more limited membership and the greater focus that limited membership permits. In the tax context, that tension between efficacy and legitimacy may not be particularly pronounced.

129. Because a harmonized regime would create a link between the will of taxpayers and the tax rules that govern them, it may encourage greater voluntary participation than an identical regime that is the product of conflict. *See* Ring, *supra* note 6, at 175 (“[A] strong democratic process with a close link between the citizen-taxpayer and the government may also improve participation in the tax system.”).

130. Franck refers to the capacity of a rule to elicit voluntary compliance at the state level as “compliance pull.” Franck, *supra* note 95, at 713.

131. *Id.* at 706 (emphasis omitted).

132. *See supra* notes 114-123 and accompanying text.

husbanding a carbon tax consumes legislative, judicial, and executive resources, a harmonized regime would exist if each cooperating jurisdiction committed to matching the efforts of the other participants. The result would be a minimum of dynamic complexity and the legitimacy that only cooperation can produce.

Alternatively, they could choose to distribute those functions across different jurisdictions. If each of the three cooperating jurisdictions assumed exclusive responsibility for just one of those three functions, the result in terms of dynamic complexity (and legitimacy) would be the same.¹³³

Of course, there are also meaningful differences between harmonization and deharmonization. Jurisdictions' widely varying characteristics, from the size of their economies to the technological sophistication of their bureaucracies, suggest that particular governments will generally be better suited to filling some roles than others.¹³⁴ As a result, specialization along a variety of axes could produce significant efficiency gains at the governmental level.¹³⁵ The resulting welfare gains would make that asymmetric cooperation both appealing and stable.¹³⁶

To understand why this is true, it may be useful to think of each government's tax apparatus as a freestanding, revenue-raising entity. Today, each of those entities operates on a fully vertically integrated basis, conducting every activity necessary for the imposition of a tax and the collection of income.¹³⁷ From a pure efficiency perspective, this may make no more sense than requiring each member of a community to grow all of their own food.¹³⁸

133. Concentrating functions within particular national governments could produce savings like those touted by the Multistate Tax Commission with respect to its Joint Audit Program. Multistate Tax Comm'n, About the Multistate Tax Commission Audit Program, <https://www.mtc.gov/Audit.aspx?id=578&ItemId=578> (last visited Oct. 23, 2009) ("A single MTC audit takes the place of separate and duplicative audits by member states, and provides obvious economies of scale to the states.").

134. See Bird & Zolt, *supra* note 111.

135. See *supra* note 107 and accompanying text.

136. See Daniel Shaviro, *Why Worldwide Welfare as a Normative Standard in U.S. Tax Policy?*, 60 TAX L. REV. 155, 178 (2007) (suggesting policies that increase worldwide welfare can be stable because they can make winners of all countries).

137. The contentious recent effort to privatize tax collection may be the exception that proves the rule. See Joseph J. Thorndike, *Historical Perspective: The Unhappy History of Private Tax Collection*, TAX NOTES, Sept. 20, 2004, at 1346 (criticizing recent effort to privatize tax collection).

138. Although specialization requires a degree of trust that your neighbor will refrain from relying on dangerous fertilizers to produce his delicious strawberries, it may also allow everyone to eat a healthier diet.

2. Legitimacy

The collective welfare benefits that deharmonization could produce are not the only argument in its favor. Because deharmonization is, like harmonization, a form of affirmative international cooperation, it would have a similarly positive impact in terms of legitimacy.¹³⁹ Both harmonization and deharmonization would produce legitimacy along with the individual-¹⁴⁰ and state-level¹⁴¹ compliance benefits that accompany legitimacy.

That engagement does, however, have a downside. Both harmonization and deharmonization are vulnerable to sovereignty-driven criticism. Of course, “No significant issue in international tax can be discussed without raising the question of sovereignty.”¹⁴² Either form of cooperation requires states to cede autonomy by committing themselves to a particular course of action determined in part by other cooperating states. Formal obstacles to yielding tax sovereignty—such as the United States Constitution’s requirement that “bills for raising [r]evenue . . . originate in the House of Representatives”—could easily transform a political debate over either harmonization or deharmonization into a legal challenge.¹⁴³

V. ADMINISTRATIVE DEHARMONIZATION VS. BASE DEHARMONIZATION

To this point, the discussion has focused on the importance of harmonization for the international tax regime and the potential of tax deharmonization as an alternative route to increased international tax cooperation. Of course, the fact that deharmonization could play a meaningful role in promoting greater harmony offers no guarantee that it will. Taking the measure of the obstacles to deharmonization is important both for evaluating the prospects for deharmonization generally and for determining what types of deharmonization strategies are most likely to succeed. Transaction costs are the primary obstacle for administrative deharmonization. The “benefits principle” may pose a bigger threat for base deharmonization.¹⁴⁴ If deharmonization is to realize its potential, the benefits principle’s

139. See *supra* notes 124-131 and accompanying text (discussing legitimacy implications of harmonization).

140. See *supra* note 129 and accompanying text.

141. See *supra* note 130 and accompanying text.

142. Ring, *supra* note 6, at 156.

143. U.S. CONST. art. I, § 7.

144. See *supra* note 79 and accompanying text.

narrow focus on the economic activity occurring within a given state as the exclusive determinant of taxing jurisdiction must be reconsidered.

A. *Obstacles to Deharmonization*

This Subpart considers the two key impediments to the successful implementation of deharmonization strategies: transaction costs and the benefits principle. Transaction costs are essentially the mirror image of the legitimacy benefits of the state-to-state interactions deharmonization would require. Both the up-front and the ongoing costs of such a system would be considerable. The benefits principle, in a sense the modern equivalent of “colonial self-sufficiency,” is incompatible with disaggregating the multiple roles states play in generating tax revenues.¹⁴⁵

1. Interjurisdictional Transaction Costs

The primary obstacle to achieving the benefits that specialization—or harmonization, for that matter—can produce is the need to coordinate.¹⁴⁶ The principal advantage of uniformity-based approaches to cooperation is that they tend to reduce the need for costly negotiations.¹⁴⁷ In the international tax context, relying on model treaties¹⁴⁸ and invoking the power of informal norms¹⁴⁹ to advance the cause of tax harmonization serve that transaction cost-minimizing role.

Although the transaction cost differential between harmonization and deharmonization remains significant, it is clear that interjuris-

145. See *supra* note 74 and accompanying text. Both the benefits principle and colonial self-sufficiency take for granted that each jurisdiction is entitled to the tax revenue generated by economic activity within its borders.

146. That coordination can be provided by a centralized authority, but it can also emerge spontaneously via the marketplace. The success of free trade, for example, is premised on the notion that governments need not actively direct the activity of market participants but need only level the playing field by eliminating tariffs and other barriers to trade. Simply by opening their borders to trade, governments find the market’s “invisible hand” encouraging businesses to produce goods or services that reflect the relative strengths of each jurisdiction. Unfortunately, specialization in taxation would ask considerably more of governments. Fortunately, they have never been in a better position to meet that burden.

147. The most familiar example of this comes in the real property context. Zoning rules work to keep incompatible uses separated so that there is no need for residents to strike their own deals to ensure compatibility.

148. See Shaviro, *supra* note 82, at 59 (“The global setting of [bilateral tax treaties] lowered transaction costs for individual countries to agree on specific terms of mutual forbearance.”).

149. See *supra* notes 99-106 and accompanying text.

dictional transaction costs, particularly the costs of communication and of acquiring and processing information, have fallen dramatically since the birth of the modern international tax regime. Particularly over the past few decades, the same changes that have driven globalization—and the resulting need for increased international tax cooperation—such as improvements in telecommunications and information technology, have also made intergovernmental coordination far less expensive.¹⁵⁰

In *A New World Order*, Anne Marie Slaughter considers the implications of the fact that “[n]etworks of government officials—police investigators, financial regulators, even judges and legislators—increasingly exchange information and coordinate activity to combat global crime and address common problems on a global scale.”¹⁵¹ In essence, she argues that the vastly increased bandwidth of the connections among states have allowed individuals at all levels of government to collaborate in ways that would have been impossible even in the relatively recent past.¹⁵² Put differently, the transaction costs of intergovernmental cooperation have fallen significantly. Those lower costs open the door to strategies that would once have been prohibitively expensive.¹⁵³

In an era in which intergovernmental transaction costs were higher, it might not have made sense to imagine narrowly focused, possibly short-term international tax arrangements that call on participating nations to play specialized roles.¹⁵⁴ Today, given the ease with which government officials interact on a broad range of issues,

150. The rise of open source software development may be the most powerful example of this change. See *supra* note 4 and accompanying text. Of course, not all costs are equally impacted by technological change. Lawyers and other experts may be more productive thanks to technology, but their services likely remain relatively expensive.

151. SLAUGHTER, *supra* note 13, at 1.

152. The Joint International Tax Shelter Information Centre offers an example of the type of network that has formed with increasing frequency in recent years. See Joint Int’l Tax Shelter Info. Centre, Memorandum of Understanding, <http://www.irs.gov/pub/irs-utl/jitsic-finalmou.pdf> (last visited Oct. 23, 2009). According to the IRS Web site, <http://www.irs.gov/newsroom/article/0,,id=123016,00.html>, this document was signed on Apr. 23, 2004).

153. One could argue that this is true of the emergence of cap-and-trade regimes such as those created by the Kyoto Protocol. See Kyoto Protocol to the United Nations Framework Convention on Climate Change, Dec. 10, 1997, 37 I.L.M. 22 (1998), available at <http://unfccc.int/resource/docs/convkp/kpeng.pdf>. It would be difficult to imagine the Protocol having been developed before the advent of cheap global communications.

154. The increasing ease with which governments can cooperate can be seen domestically at the interstate level. The Multistate Tax Commission’s Joint Audit Program represents an example of how states work together to pool resources and work together to streamline administrative processes. See Multistate Tax Comm’n, *supra* note 133.

there are likely to be circumstances in which states can reasonably provide one another with targeted assistance that addresses idiosyncratic or temporary needs. The systemic changes that have led to the blossoming of transnational networks could also facilitate the emergence of an entirely new order of cross-border tax relationships.¹⁵⁵

States seeking to develop useful deharmonization strategies, like the Coasian farmer and rancher agreeing in principle that a fence should be built to protect crops from cows, must also determine who should bear its cost and how to ensure each party meets its obligations. In some cases, that will implicate the classic bargaining problems of bilateral monopolies, holdouts, and free riders.¹⁵⁶

For example, if, as is commonly assumed, U.S. taxpayers could easily substitute another jurisdiction in their tax avoidance schemes, then entering into TIEAs or tax flight treaties with fewer than all potential substitute jurisdictions simultaneously would be futile.¹⁵⁷ A single holdout would eliminate any potential benefit from TIEAs even if each TIEA partner faithfully abided by its terms. While there is reason to doubt that all such jurisdictions are actually close substitutes for one another¹⁵⁸ and ways of minimizing the danger posed by potential holdouts,¹⁵⁹ the threat of holdouts in this context remains significant.

Another cause for concern is the risk of bilateral monopoly between particular TIEA partners. If the United States needs information about U.S. tax cheats that is available only from one tax haven jurisdiction, both the United States and the tax haven might lay claim to the lion's share of the potential surplus from the transaction.¹⁶⁰ If no third party exists with the capacity to intervene and impose a

155. See SLAUGHTER, *supra* note 13.

156. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 60-63 (1986) (discussing bilateral monopoly, holdouts, and free riders in the nuisance context). Both harmonization and deharmonization are equally susceptible to those failures.

157. See Dean, *supra* note 8, at 958.

158. "Tax havens are not undifferentiated units offering perfectly substitutable services, nor is price the most important point of competition between them." J.C. SHARMAN, *HAVENS IN A STORM: THE STRUGGLE FOR GLOBAL TAX REGULATION* 107 (2006); Dhammika Dharmapala & James R. Hines Jr., *Which Countries Become Tax Havens?* (Nat'l Bureau of Econ. Research, Working Paper No. 12802, 2006) (considering historical and institutional factors determining which countries become tax havens).

159. See, e.g., Dean, *supra* note 8, at 958 (offering "multilateral tax flight treaties" as a potential solution to the "hold out" problem in the tax haven context).

160. Of course, the information could also be obtained by the United States directly. Presumably the costs of doing so would be high. The difference between those costs and the costs the tax haven would incur to acquire the information represent one measure of the surplus to be gained from the information exchange.

reasonable allocation of the surplus, bilateral monopoly may mean that no such surplus will be created.¹⁶¹

Finally, because jurisdictions other than the United States face a similar evasion problem, those jurisdictions would also stand to benefit from the existence of TIEAs even if they are not party to them. For example, if a tax haven jurisdiction signals hostility towards tax evasion by providing information to the United States with respect to U.S. tax cheats, British tax cheats might choose to avoid that tax haven in constructing their tax avoidance schemes. That would permit Britain to stay on the sidelines while the United States creates TIEAs and shares the surplus it creates with its TIEA partners. Britain would enjoy the benefit of less tax evasion with none of the costs.

2. The Benefits Principle

The benefits principle presents a problem that is unique to deharmonization.¹⁶² Even if the surplus that would be generated by a particular cooperative arrangement would be greater than the transaction costs of setting it in motion, there remains the challenge of finding a way to share the efficiency gains produced by the arrangement. Unless each partner happens to derive benefits from the arrangement that more than offset its costs, that could mean cash payments by one state to another. That would represent a clear break with the benefits principle that in some respects is the cornerstone of the modern international tax regime.¹⁶³

161. This is the role traditionally played by courts in the nuisance context.

162. In the simplest case, the benefits principle can be thought of as “a national rental charge for the use of its investment environment and natural resources” imposed on foreign investors. Peggy B. Musgrave, *Interjurisdictional Equity in Company Taxation: Principles and Applications to the European Union*, in *TAXING CAPITAL INCOME IN THE EUROPEAN UNION: ISSUES AND OPTIONS FOR REFORM* 46, 52 (Sijbren Cnossen ed., 2000). The benefits principle also describes the more complex relationship between citizens and residents on the one hand and states on the other. “There is wide agreement that a country has a right to tax the income and wealth of its residents or citizens whose rights to the protection and services provided by the state are matched by their duties to the state, among which is the duty to pay taxes.” PEGGY BREWER RICHMAN, *TAXATION OF FOREIGN INVESTMENT INCOME: AN ECONOMIC ANALYSIS* 23 (1963).

163. Any system that provides a state with an entitlement to a portion of the tax revenues that the benefits principle allocates to another would represent a profound departure from the prevailing approach to assigning tax jurisdiction. Nancy Kaufman observes that in this context “benefit” is not used in the same manner as it is when referring to “benefits taxation.” “Today’s systems of source taxation are not founded on benefit theory, if indeed they ever were. Source taxation finds its justification in the economic connection between the source country and the income arising within its borders.” Kaufman, *supra* note 2, at 202. She suggests that a better term for the quid pro quo between foreign taxpayers and the jurisdiction that hosts that taxpayer’s investment is a “territorial entitlement.” *Id.* at 187.

Even those who agree on nothing else when it comes to international taxation would likely agree that each state should be entitled to revenues derived from economic activity that occurs within its borders.¹⁶⁴ The benefits principle formalizes that parochial impulse by assigning taxing jurisdiction according to the state that “earns” the right to tax economic activity by facilitating that activity. That approach works well if the relative size of each jurisdiction’s tax base serves as a fair proxy for its contribution to a tax, as it presumably would be in a harmonized regime. When a state makes administrative or other contributions that are disproportionate to the size of its tax base, that system breaks down. Because it explicitly disaggregates functions across states, deharmonization requires a more sophisticated mechanism for allocating tax revenues than the benefits principle.

B. How To Deharmonize

Tax deharmonization has already become a significant feature on the international tax landscape. That is true despite the international tax regime’s traditional orientation towards harmonization. Unlocking deharmonization’s potential requires understanding the implications of transaction costs and the benefits principle for both administrative and base deharmonization. As described below, falling transaction costs suggest that the prospects of administrative deharmonization may be gradually improving. Base deharmonization faces what may be a more enduring obstacle in the benefits principle.

1. Administrative Deharmonization

The careful coordination that administrative deharmonization demands of cooperating states is both a blessing and a curse. The close working relationship that would permit one jurisdiction to provide useful administrative assistance to another would be a benefit on its own.¹⁶⁵ Orchestrating that effort, while obviously less expensive than it would have been in the relatively recent past, would not be

164. The typical point of disagreement is precisely how the benefits principle should be operationalized. Even the bold proposal to replace existing source- and residence-based international tax rules with a formulary regime adheres to the basic parameters of the benefits principle. See Julie Roin, *Can the Income Tax Be Saved? The Promise and Pitfalls of Adopting Worldwide Formulary Apportionment*, 61 TAX L. REV. 169 (2007) (considering the implications of recent formulary apportionment proposals).

165. Such a relationship could promote the kind of legitimacy that causes both states and individuals to live up to their obligations. See *supra* notes 129-130 and accompanying text.

costless. Moreover, technological improvements are no cure for the types of bargaining failures, such as bilateral monopoly and holdouts, that affect both harmonization and deharmonization.

Fortunately, not all administrative deharmonization strategies are equally susceptible to those failures. Because they address the particularly thorny enforcement problem of offshore tax evasion, TIEAs occupy the end of a spectrum at which those transaction costs are highest. Other arrangements, particularly those not directed towards enforcement issues, would be less vulnerable. For example, there is no reason that a cost-saving deal to outsource data processing functions would be particularly difficult to negotiate.

There is another, potentially significant, problem created by administrative deharmonization also illustrated by TIEAs. Distributing administrative functions across jurisdictions may create a “lumpy” surplus that disproportionately benefits one state, potentially leaving another worse off than it would have been in the absence of cooperation. It may, for example, be efficient for State A to contribute all of the administrative resources necessary to collect a given tax. Unless State B shares the savings it enjoys from outsourcing those administrative tasks, State A will be made worse off by cooperating.¹⁶⁶ Without some form of compensation State A has no incentive to participate.¹⁶⁷

2. Base Deharmonization

Like administrative deharmonization, base deharmonization may or may not involve complex bargaining dynamics. Unlike administrative deharmonization, which contemplates only transfers of administrative assistance, base deharmonization need not give rise to awkward incentive problems.¹⁶⁸ In a sense, the reverse is true.

Because base deharmonization treats a jurisdiction’s tax base as just one of many resources necessary to generate tax revenues, funds derived from one state’s tax base are likely to find their way into

166. The technical term for that kind of efficiency is Kaldor-Hicks efficiency.

167. If it is most efficient to concentrate all administrative functions in State *A* but the increased costs of administering the taxes of both State *A* and State *B* more than offset the resulting efficiency gains and tax revenues must be allocated in accordance with the benefits principle, some other form of compensation (for example, foreign aid or trade preferences) would be necessary.

168. Redesigning TIEAs to permit the state providing administrative assistance to share in the tax revenues drawn from its partners’ tax base would provide a much needed incentive for that state to cooperate, but would certainly do nothing to eliminate holdouts.

another state's coffers.¹⁶⁹ The resulting cross-border flows of tax revenue are fundamentally inconsistent with a conservative vision of the benefits principle. Rather than treating tax revenues as purely a function of a state's tax base, base deharmonization would allocate revenues in proportion to a state's overall contribution to the production of tax revenue.

If the benefits principle merely serves as a rough proxy for that cumulative contribution, base deharmonization could simply represent a refinement of the benefits principle. To the extent it embraces a normative vision of a jurisdiction's "territorial entitlement" to tax revenues, the benefits principle would mean that base deharmonization is not compatible with prevailing attitudes towards international tax cooperation.¹⁷⁰ The nature of states' commitment to the benefits principle may ultimately be the most important factor in the success or failure of deharmonization-based international tax cooperation strategies.

VI. CONCLUSION

Tax deharmonization offers an alternative approach to international tax cooperation. Some deharmonization strategies, like SACU, have proven more successful than others, such as TIEAs. Acknowledging the role that deharmonization plays in today's international tax regime and working to understand the challenges deharmonization faces may help states break free of the harmonization conundrum. By focusing on the need for increased international tax cooperation, rather than on the lack of cross-border tax uniformity, policymakers may find unexpected opportunities to build fruitful partnerships among even the most mismatched states.

169. The SACU Agreement provides for precisely this sort of compensation, but in the "wrong" direction. South Africa provides the bulk of the administrative resources but nevertheless pays most of the revenues to its partners. That compensation offsets the benefits the free trade zone confers on the large, relatively advanced South African economy and the costs it imposes on the other states. *See supra* note 37 and accompanying text.

170. *See* discussion *supra* note 163.