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# INTRODUCTION: RECONSIDERING THE TAX TREATY

Steven A. Dean\* & Rebecca M. Kysar†

For nearly one hundred years, the international tax regime steadfastly pursued a single nemesis, double taxation. States armed themselves against this common enemy with their weapon of choice, the double tax treaty. Nearly uniform in language and approach, the treaties proliferated to more than three thousand in number,<sup>1</sup> resulting in a secure arrangement between and among states and taxpayers.

Yet in recent years, states have had to expand the war to multiple fronts in the face of globalization, technological changes, evolving taxpayer abuses, and shifts in both domestic and international political pressures. For instance, a growing recognition that the interests of a state and its taxpayers can and do diverge has fueled the Base Erosion and Profit Shifting (BEPS) containment effort led by the Organisation for Economic Co-operation and Development (OECD), culminating in an unprecedented multilateral instrument. Acknowledging that tax havens lack some combination of the resources and the inclination to forestall tax evasion, the U.S. Congress enacted the Foreign Account Tax Compliance Act to compel financial institutions in foreign jurisdictions to step into the breach,<sup>2</sup> resulting in more than one hundred intergovernmental agreements implementing new reporting regimes.<sup>3</sup> The European Commission is currently investigating whether favorable advance transfer pricing rulings granted to corporate taxpayers by certain European countries violate the European Union bar on state aid that distorts competition.<sup>4</sup> These state aid cases have created tension among the

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1. See ORG. FOR ECON. CO-OPERATION & DEV. [OECD], ADDRESSING BASE EROSION AND PROFIT SHIFTING 8 (2013).

2. See I.R.C. §§ 1471–74 (enlisting foreign banks as informants).

3. See *Resource Center: Foreign Account Tax Compliance Act (FATCA)*, TREASURY.GOV, <https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx> (last visited Oct. 29, 2016).

4. See U.S. DEP'T OF THE TREASURY, THE EUROPEAN COMMISSION'S RECENT STATE AID INVESTIGATIONS OF TRANSFER PRICING RULES 1–2 (2016). Among these are investigations regarding Apple and Ireland, Starbucks and the Netherlands, Fiat and Luxembourg, and Amazon and Luxembourg. *Id.* at 2–3.

various jurisdictions that have a claim in taxing profits that have been shifted to tax havens and have the potential to unsettle dispute resolution procedures under bilateral tax treaties.<sup>5</sup>

Whether these developments indicate a rupture of the international tax regime or instead herald its repair is a subject of debate within the tax law community. The articles in this issue grapple with the regime's destabilization and draw what perhaps may be best described as "across the spectrum" conclusions. Important among these, of course, are the implications for the archetypal double tax treaty itself.

At a fundamental level, the viability of the international tax regime might be judged by its fidelity to the concept at the core of the tax treaty: the single tax principle. Encouragingly, Shaviro probes the single tax principle—which allocates income among states to ensure that income is taxed neither more nor less than once—and finds that what appears to be a rule might be better thought of as a standard. As described in *The Two Faces of the Single Tax Principle*, rather than offering the precision of a fifty-five miles per hour speed limit, the single tax principle merely urges states to avoid both excessively taxing cross-border transactions and cavalierly allowing income to escape taxation completely. Shaviro notes that the plasticity of the standard accommodates an understandable degree of ambivalence regarding the single tax principle. States may tolerate—or even facilitate—the avoidance of other states' taxes,<sup>6</sup> and their competitive instincts "frequently outweigh the urge to maximize domestic tax revenue . . . ."<sup>7</sup> His conclusion suggests that the single tax principle may be robust enough to embrace the imperfect states it seeks to serve.

Operationalizing the single tax principle will, nevertheless, be challenging. Kane takes a fresh look at the problem of allocating taxing jurisdiction and hits the reset button by shifting focus from intellectual property to labor. *Location Savings and Segmented Factor Input Markets: In Search of a Tax Treaty Solution* observes that the embattled arm's length method fails to provide reliable answers even when the puzzle presented by intangibles

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5. See *id.* at 19–23.

6. See Daniel Shaviro, *The Two Faces of the Single Tax Principle*, 41 BROOK. J. INT'L L. 1293, 1301 (2016) (noting U.S. willingness to "tolerate[] U.S. companies' use of check-the-box rules to avoid subpart F's checks on the avoidance of other countries' taxes.").

7. *Id.* at 1299.

can be put aside. Considering a pair of possible solutions to the questions raised by labor rents, Kane demonstrates that the headwinds faced by the treaty-based international tax regime neither begin nor end with intangibles. No less important, Kane shows the importance of being willing to question even our most basic assumptions about how the international tax regime—both at the conceptual level, with the arm’s length principal,<sup>8</sup> and at the practical level, with the treaty notion of a permanent establishment<sup>9</sup>—can and should operate.

In *Tax Treaties and the Taxation of Services in the Absence of Physical Presence*, Kirsch offers an additional note of caution, suggesting that, even in the rarified world of international tax, the road to hell can be paved with good intentions. Kirsch demonstrates that a U.N. effort to adapt its model to ensure an appropriate allocation of taxing jurisdiction by preventing profit shifting by multinationals would unintentionally cloud the tax consequences of activities ranging from cutting-edge telesurgery to legal advice to foreign visitors. As Kirsch describes it, efforts to modernize the international tax regime seem uncomfortably like installing self-driving technology in a vintage Model T.<sup>10</sup>

Such challenges can inspire unconventional but potent solutions. Cooperation can be difficult to achieve among heterogeneous states. With “*Thinking Outside the (Tax) Treaty*” Revisited, Rosenzweig evokes the international trade concept of cross-retaliation under the World Trade Organization, in which states gain permission to apply pressure to an adversary’s vulnerable spots with, what might be termed, “cross-cooperation.” Recognizing that states have different tastes in carrots just as they fear different sticks, Rosenzweig envisions a post-bilateral tax treaty

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8. See Mitchell A. Kane, *Location Savings and Segmented Factor Input Markets: In Search of a Tax Treaty Solution*, 41 BROOK. J. INT’L L. 1107, 1113–14 (2016) (proposing that “arm’s length transfer pricing in the case of location savings ought to proceed by compensating local affiliates (where savings are realized) by reference to comparables based on the market of the purchaser of the input rather than the seller of the input.”).

9. *Id.* at 1115 (noting that “everybody tends to take the extent of source tax of the nonresident party as a fixed point (established by Article 5)” of the OECD Model, which outlines the rules on permanent establishment).

10. See Michael S. Kirsch, *Tax Treaties and the Taxation of Services in the Absence of Physical Presence*, 41 BROOK. J. INT’L L. 1143, 1143 (2016) (observing that “modern technological developments have strained long-standing international tax policies and principles. Tax treaties have attempted to keep pace by fitting these new developments within the existing framework.”).

regime with sufficient flexibility to allow states to trade mismatched favors. BEPS, as he notes, represents an opportunity for such an asymmetric system of cooperation to replace the rigid mirroring of the existing framework.<sup>11</sup>

Charting a route no less radical, Marian advocates a reconceptualization of state intervention against taxpayer (and state) abuse of tax treaties. *Unilateral Responses to Tax Treaty Abuse: A Functional Approach* offers a matrix aligning the scope and scale of malfeasance with fitting responses ranging from targeted kill-switch mechanisms in particular treaties to the comprehensive renegotiation of each and every node in a state's treaty network.<sup>12</sup> In that framework, treaty termination becomes an intermediate response suitable for profound but clearly circumscribed failures.

Echoing both Shaviro and Marian's confidence that the trusted building blocks of the international tax regime have the resilience needed to meet today's challenges, Shaheen offers an encouraging perspective on the future of tax treaties. *How Reform-Friendly Are U.S. Tax Treaties?* argues that a range of recently proposed reforms of the U.S. international tax rules embrace the spirit, if not the letter, of U.S. tax treaty obligations. Shaheen then demonstrates how these reforms can be tweaked to satisfy even formalist interpretations of treaty obligations.<sup>13</sup>

Focusing on provisions of the new U.S. Model Tax treaty that condition host-state concessions on a home-state tax burden, Christians and Ezenagu extrapolate possible futures of the international tax regime. Their vision highlights the swirling currents shaping today's tax landscape. Concern regarding tax competition among states lies near the surface of the "kill-switches" they describe. Christians and Ezenagu speculate that domestic

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11. See Adam H. Rosenzweig, "Thinking Outside the (Tax) Treaty" Revisited, 41 BROOK. J. INT'L L. 1229, 1230–31 (2016) ("The BEPS Action Plan represents a truly revolutionary and groundbreaking effort to reform the international tax regime; in fact, it is the first attempt to revisit the fundamental building blocks of the international tax regime since its emergence in the early 1920s.").

12. See Omri Marian, *Unilateral Responses to Tax Treaty Abuse: A Functional Approach*, 41 BROOK. J. INT'L L. 1157, 1177 (2016).

13. See Fadi Shaheen, *How Reform-Friendly Are U.S. Tax Treaties?*, 41 BROOK. J. INT'L L. 1243, 1271 (2016) ("[I]f we must worry about formalism in applying treaty provisions, any exemption system could be easily structured and drafted in a manner that the disallowance of credit for foreign taxes on U.S.-exempt foreign-source income is reached through an exemption basket mechanism (which is but a treaty-compatible limitation on cross crediting).").

political concerns beyond protection of the fisc—political gridlock and the outsized influence of transnational ventures—lurk further below. Tracing the history of such mechanisms, *Kill-Switches in the U.S. Model Tax Treaty* contrasts these innovations against their conceptual predecessors. Thoughtfully and thoroughly, they question whether these innovations represent an embrace or a refutation of the single tax principal.<sup>14</sup>

Brauner indicts BEPS as a disappointingly conservative response to the stateless income scandal that followed on the heels of the 2008 financial crisis.<sup>15</sup> Its fifteen action items underscore the gap between the enormous magnitude of the threat and the scope and scale of the response. Obviously, the architects of the international tax regime could not have envisioned the ascendancy of intellectual property and its outsized role in modern economic life. That their near-century-old regime fails to provide principles robust enough to prevent ubiquitous tax avoidance by sophisticated multinational enterprises should not surprise anyone. *Treaties in the Aftermath of BEPS* laments—and methodically catalogues—the failures of BEPS to articulate modern principles capable of narrowing the distance between the aging international tax regime's goals and its reach.

Dagan presents a dispiritingly plausible explanation for the timidity of the BEPS proposals.<sup>16</sup> *Tax Treaties as a Network Product* observes that the international tax regime, and the treaties that give it shape, exhibit the classic characteristic of a network product: gaining strength by being strong. While the rise of BEPS suggests a window has opened to create a better international tax regime, she notes that the current regime favors states with the greatest global influence (and the loudest voices in the BEPS process). The alternative standard she calls for would reverse that trend, shifting the balance away from the global one percent and toward everyone else.

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14. See Allison Christians & Alexander Ezenagu, *Kill-Switches in the U.S. Model Tax Treaty*, 41 BROOK. J. INT'L L. 1043, 1070–73 (2016).

15. See generally Yariv Brauner, *Treaties in the Aftermath of BEPS*, 41 BROOK. J. INT'L L. 973 (2016).

16. See Tsilly Dagan, *Tax Treaties as a Network Product*, 41 BROOK. J. INT'L L. 1081, 1104 (2016) (“[T]he BEPS initiative could prove to be a decisive moment in the history of international taxation: as it would offer a more comprehensive standard for international tax policy. The BEPS solution, however, does not seem to be comprehensive enough to streamline the entire international tax regime, nor does the BEPS report pay special attention to considerations of justice.”).

Looking beyond the surface to find an explanation for counter-intuitive state action—and inaction—Ring paints an unfamiliar, yet all-too-recognizable, portrait of states as they participate in the international tax regime. Under pressure from a range of interest groups and political pressures not traditionally taken into account in the narrative of state action in the international tax regime—the “ever-present constraint of democracy at home”<sup>17</sup>—states can ultimately fall short on their international tax commitments. *When International Tax Agreements Fail at Home: A U.S. Example* provides a clear roadmap for scholars and policy makers struggling to make sense of a world in which states fail to act in line with settled expectations.

To conclude, states now find themselves confronting both complex internal politics and skepticism from counterparts. Were a cascade of technological change and a wave of public anger over a perceived lack of accountability not enough to disrupt a century of stability, the realization that trusted allies at home and abroad blithely pursue their own agendas intensifies the threat. The perspectives and insights offered here by leading tax scholars offer hope that the international tax regime, and perhaps even tax treaties themselves, can emerge stronger from the current period of instability.

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17. Diane Ring, *When International Tax Agreements Fail at Home: A U.S. Example*, 41 BROOK. J. INT'L L. 1185, 1190 (2016).