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## Panel Four Discussion Transcripts

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## PANEL IV: DISCUSSION TRANSCRIPT

CLAIRE KELLY: Thank you. I think we're going to open up the floor for discussion on this issue now if you have any questions. Yes, Phil.

PHILIP WEST: First of all I comment on someone who I think has the rare distinction of being the only person who is involved in both the only tax case ever to be brought under the NAFTA involving the United States and the *FSC* case, which is . . . and I have to say there are a couple of things about the NAFTA case. One is that it was the most confusing case I was ever involved with because the client's name was Martin Feldman, and the lawyer's name was Marvin Feldman; and I could never get the two correct. It didn't . . . well I probably shouldn't comment on the merits. But, I will say that under the NAFTA, the Assistant Secretary for tax policy in the Treasury Department has granted extraordinary discretion in basically vetoing the ability of an agreed taxpayer to bring a case against another country. In essence, the Assistant Secretary can block a case from even going through arbitration under the NAFTA. Obviously the situation in the WTO is quite different. As Reuven Avi-Yonah pointed out, we've given up the veto that we had under the new dispute resolution procedures. That has led us to the situation that we're in with *FSC*.

On *FSC*, one political observation, David Hariton said yesterday that on deferral, he viewed the whole debate as political. If you look at the political dynamic surrounding the DISC and *FSC*—the DISC was brought in I believe in the Ford Administration, a Republican Administration, and was pushed. Now you have *FSC* being avidly defended by a Democratic Administration and there is a question as to whether this is the new Democrats showing their face, or is this beef and bananas showing their face, or is this something else? I don't know.

One point I wanted to make when Gary Hufbauer commented on the *FSC* earlier was that he said he thought this was a good opportunity for the deferral debate to be opened up. I just think it would be, at the least, the tail wagging the dog, if not a bizarre turn of events to have the exemption credit deferral debate determined by what's essentially a niche export

regime like *FSC*.

The last thing I want to say on *FSC* is that it's exactly right. It's the footnote in the agreement that really creates the difficulty in interpretation. The opinion—I think I have not focused on that before—would also create an impediment to bringing a case against the European exemption systems now. But, it's also the footnote that's imbedded in the agreements. I also hadn't focused on the fact that it is undeniably true that the exemption systems are, to the extent that they're alleviating double taxation, that is at the root of what we think is appropriate for an exemption system to do. And, if the language is so circumscribed that it's only within those boundaries that they get a buy, then maybe there was more there than we focused on.

A couple of narrow points on Ireland and whether that rate is going to be a problem in the EU. I don't know where this is going, but you just kind of hear sometimes behind the scenes, people whisper "just wait." The Irish rate is going to be the subject of some action in the future. It's not so . . . while you're right Paul, I think that right now they've dodged the bullet. Whether that will continue in the future I'm not sure.

On the tax competition in the WTO, for those of you who aren't familiar with it, you may know that the tax havens have made some noise about bringing the OECD member countries into the WTO and challenging their right to move against the tax havens and the WTO. I think it's a fascinating perspective to think that you actually may have a stronger stake. The OECD member countries may have a stronger stake against the tax havens and the WTO. I guess this is where Hugh Ault is going to come in. Maybe the WTO has some merit as a forum for adjudicating that dispute.

On sovereignty, just an observation, you know everyone that's concerned about treating sovereignty in the trade agreement dispute resolution context. In the tax agreement dispute resolution context, which is arbitration under our income tax treaties, there seems to be a building consensus, at least in the business community, that that's something we should do. It's an interesting contrast because if there is political support for treaty sovereignty in that context, you wonder whether there might be, for those to whom consistency is important, less ability to object to the treaty sovereignty in the trade agreement context.

Then the last thing is a question for Hugh. If this general specific analytical framework of the dispute resolution panel is not the right one, what is the right one?

HUGH AULT: No, I didn't say it wasn't the right one. I said it's more easy to articulate in the abstract than it is to apply in individual cases where you don't have the luxury of a pure tax in any sense. When we're down in the nitty gritty of the way tax systems are constructed from historical accident, from conscious policy, from legislative mistake, then you have to try to look at that and extrapolate from that what is the general rule and what is the special rule where you can't have the platonic form to help you. I agree that that's the approach the OECD takes in general terms, that's the approach Reuven Avi-Yonah's article takes, which OECD appreciated very much. But I'm indicating that I think it's a little harder in practice than in the somewhat denatured way that Paul described it.

CLAIRE KELLY: David?

DAVID BRADFORD: I confess I didn't have time to read this paper. So what I've gotten from it is from Paul's exposition, which I thought was terrific. But, that may mean I miss . . . maybe the questions may be dumb. But, the sort of WTO and the general presumption in favor of free trade I think you can think about is motivated by a couple of things. One is, if I put a tax, a tariff, on import of something, that may hurt worldwide welfare for the reasons—standard reasons such as a distortion, et cetera—would fail to exploit all the possible gains from trade. I think probably that general agreement not to do that kind of thing is probably motivated by the next step up, which is once you recognize that people may have a tariff to protect their industry in some respect, then the other guys will retaliate and we'll have a spiraling game, a race to the bottom which will end up in a worse situation than if we didn't, if we simply endured such a thing. I think that maybe keeping that distinction in mind and thinking about how that might apply to the tax area may be useful.

To some extent, what we want to probably do is avoid the kind of competition that will make us all worse off. Now there are provisions that pretty clearly affect worldwide welfare. There was a lot of discussion after the big accelerated deprecia-

tion that went into the first Reagan cuts in 1981. Well that really had major impacts on worldwide capital markets and probably had a bearing on worldwide welfare. That was quite apart from any general political equilibrium response which may be . . . who knows what that impact was.

I agree with you Paul. At that point, I began to think that the nature of this argument is the same one we go through when we go through the whole trade agreement convention goods and services. The logic must carry over into the tax area. However, I'm still not sure that you've hit, if I understand this discussion, really hit the direct analogy for the trade context, which isn't to say that's necessarily the right one either. But the trade context specifically concerns cross-border transactions. I mean there's no objection, I take it, under any of these World Trade Organization provisions to my having a heavy tax on peanut butter, provided it's not just for peanut butter produced in the United States. That's the issue. The analogy here would be whether I tax, have a provision that specifically provides a plus or a minus for, I would think, investment located in a particular country. I think that's what strikes me as the analogy . . . well, on things located in a particular country, and that we might want to avoid provisions for that, which will lead us to have a competitive process that will lead to bad results in that regard.

Somehow I didn't feel like this discussion quite focused on that point. That might be the wrong point; but if you really want a direct analogy with the trades context, it seems to me it's the cross-border aspect that's critical. In particular, I'm very skeptical that you need anything like a normative tax law, Maig Simon's or otherwise, to think about that. That doesn't strike me . . . that strikes me as not quite right. I've made the same point in connection with tax expenditures. Paul will have heard me on that before. Somehow I don't think that's not going to be the key question.

CLAIRE KELLY: Paul, did you want to respond?

PAUL MCDANIEL: Yes. Let me just say, and then I'll start with this prior comment, given in an example in the addendum to the paper; of where I think the European community may run into trouble in the absence of a special provision. Suppose Germany enacts accelerated depreciation—one

immediate write-off for foreign investment in the country but nowhere else. That will run afoul of WTO, I'm pretty sure, and the Code of Conduct.

Now Ireland adopts a rule and says everybody gets one-year depreciation, domestic and foreign. That clearly will not run afoul because that is their general system. At least I will argue that it will not run afoul. That is their general system, even though most of the people around this table would say, "wait a minute . . . that's the most accelerated depreciation you can get." So then Germany, to bring itself back into compliance, enacts accelerated depreciation to domestic investment and now it's all of a sudden okay again. Now that seems to me a strange world where that sort of thing happens, which is why I'm somewhat skeptical that they can proceed with the lack of some sort of norm at some point in time. Having said that, let me hasten to add that in the vast majority of cases, nobody is ever going to question about it one way or the other. Tax credits are going to be easy targets just as they are in the U.S. Tax Expenditure Budget. Maybe I'm not correct about that, but I have the feeling that they may hit that point at some time.

Secondly, just let me comment a little bit more on the sovereignty point. I'm in agreement that a country's tax system is an especially important issue from a sovereignty perspective. What I'm not in agreement with is that a country can run a tax subsidy—an export subsidy through its tax code—and all of a sudden say that it's sovereignty for our taxes that is going to protect this. That is where I did not see the sovereignty argument taking the day. Even though I would agree fully with you that it should take the day where we're talking about these other structural components of the system.

Just a final comment. I must say you made the best argument for the U.S. case I've heard with respect to the exemption system, and perhaps that's why so many European countries have gone to adopting some minimum rate of tax in order to qualify for the exemption system.

CLAIRE KELLY: Thank you. Victor, did you want to take a break now? Do we have any other comments?

VICTOR ZONANA: Any comments from the audience? Anybody have any comments? Charlie?

CHARLES KINGSON: Paul McDaniel said, which I never thought of, that a source rule is a transfer pricing rule too. And what Hugh Ault said, which I *had* thought of, with the 863B, 50/50 split is really totally uneconomic when you have a standard like a chip like Intel which sells itself. If the World Trade Organization is making such a big fuss about *FSC*, why wouldn't they make a fuss about the foreign tax credit system which, to me, gives much greater benefits?

PAUL MCDANIEL: About the foreign tax credit as a whole?

CHARLES KINGSON: No, as applied with the 50/50.

PAUL MCDANIEL: Oh, well of course the World Trade Organization doesn't consider things in the absence of somebody else getting concerned about it. But why the European communities aren't worried about it, I wouldn't . . . I don't understand. I would have thought that they would have found it equally or maybe worse —

CHARLES KINGSON: Yes.

PAUL MCDANIEL: — export subsidies than the *FSC*. But I don't know. Hugh Ault may know more about this, but I've never heard it raised.

REUVEN AVI-YONAH: The context that I've heard is that if you look at the tax expenditure budget, it is a much smaller subsidy than *FSC*, but there's a recent paper by Jim Hynes that argues that there's a much bigger one, and that these numbers are just wrong, and that they just missed the target. My own sense is that, in general, source rules when the *FSC* is more blatant than this stuff, and that's . . . yes.

HUGH AULT: Nobody has brought the case yet. I think Paul is right on that.

PHILIP WEST: Another shot at this. I'm an amateur in this business. It seems to me the idea of a generalized export subsidy, there's got to be something wrong with that as a viewpoint. There's the difference between origin and destination

taxes in our earlier discussion. They're economically equivalent apart from transition, which is important, but economically equivalent in terms of their ongoing subsidy or non-subsidy effect in that they appear to be totally different. Some of the conventional trade arguments are really . . . they've got to be narrower than that. I don't know how to put it in that. They've got to be narrower than that.

CLAIRE KELLY: John?

JOHN STEINES: Just one thought on this 863B issue. Could it be distinct from the FSC regime because it runs in both directions? We have the argument that this isn't just for exporters. It's for importers as well, even though that's not as important empirically.

CLAIRE KELLY: Thank you. We have some time for some questions. Phillip and then Kees.

PHILIP WEST: I think it is good to think about things like this. And in fact, the OECD is now working on a possible multi-lateral agreement in the information exchange area involving some jurisdictions that have committed themselves to reform harmful tax practices and to enter into open information exchange relationships. What is interesting though, is although in this discussion the terms have been used inter-changeably, there's a lot of sensitivity in governments about the distinction between a model bi-lateral and a multi-lateral. And they are very different instruments and in very real ways. And the question of whether this information exchange instrument would be a model bi-lateral or a multi-lateral has been left open. But at least the possibility has been left open that a multi-lateral could result. And it is easy to criticize proposals that are ambitious and I don't want to be guilty of what David was warning us about: just criticizing and not working to improve. But let me just go through a few issues that come to the fore. First off, one thing that we are worried about in the United States in the multi-lateral exchange instrument is the degradation of standards of course. And that is the central issue in any multi-lateral agreement. You move to the lowest common denominator. One issue that is unique to the United States that I think takes some of the juice out of this for us;



Victor you suggested that the instrument could be used. There have been no solutions proposed over the last two days for evasion and avoidance; to address evasion and avoidance. In many ways you could not use a tax treaty for constitutional reasons in the U.S. to address evasion and avoidance because a treaty cannot increase taxes over that which would be payable in the absence of a treaty. And you couldn't use a treaty, for example, to reach agreement on a bi-lateral or multi-lateral anti-abuse rule other than one that limited the benefits in the treaty itself. Now, that's not to say you can't come to agreements in the treaty that would be useful, but we shouldn't ignore that very real constitutional prohibition rooted in the fact that the House doesn't have a say in our treaties and all revenue measures have to originate in the House. Another larger issue is whether we want our treaties to become more and more technical—to become more and more like statutes. Now there has been a noticeable trend that they have been, and that is not universally viewed as a good thing. Years ago, the common perception had been that they have become more general. There have been documents that guide us, more like constitutions, if you will, rather than statutes. There's a trend away from that. I think focusing on things like the triangular case, like hybrid instruments, like some of the other issues you referred to, would move us further down that road. A couple of more technical comments . . . In your paper Victor, you referred to the problem of treaties. Bi-lateral treaties potentially being consistent with anti-abuse rules. The U.S. position of course, which is the position of most, at least, OECD members is that that's not the case. Treaties are not inconsistent with CFC rules and, in fact, the OECD committee on fiscal affairs is about to consider a revision to the commentaries to make absolutely clear that that is the case. Retroactively effective.

VICTOR THURONYI: I don't think I said they were.

PHILIP WEST: Okay. Well let me not overstate that then. But just for the point of clarifying that. To the extent that it is a fault of bi-lateral treaties that they're incomplete in their coverage, from the U.S. perspective, again, that is not necessarily a bad thing. We have a smaller treaty network than many other countries and, while a larger treaty network is in theory desirable, we don't view, as some countries do, a treaty

as a trophy to be entered into. We're a little bit stingy with the countries that we enter into treaties with. We use our treaty relationships, as David said, for foreign policy purposes to some extent. And that is not necessarily a bad thing. And you addressed in your paper incomplete tax coverage. To state the obvious, that's a different issue, of course, from incomplete country coverage. And it is not clear how a multi-lateral treaty would itself address the problem of incomplete tax coverage. Let's see. Flexibility, you say, would be enhanced by negotiating a multi-lateral, but changes to an agreement that—and this goes to Diane's point about how you would get agreement, changing a document that has 100 signatories—may not be the most flexible instrument in the world. And again I agree with Hugh that the problem could be inconsistent interpretation, which could be ameliorated to some extent with the multi-lateral. But it raises some of the sovereignty issues that Diane alluded to. From the U.S. perspective, there may not be much to lose in light of the recent case law, and that West and others don't seem to be going our way anyway. And finally just to endorse what Hugh said, multi-lateral coordination is what we need, but it is unclear to me how a multi-lateral treaty is the right vehicle for enhancing multi-lateral cooperation. Thanks.

KEES VAN RAAD: Just a brief four points I want to raise. I think I generally agree with the goals and the results that Victor Thuronyi advocated, but not necessarily with the way and the methods suggested. The first basis as far as multi-lateral treaties are concerned—indeed if one reads closely the Nordic convention—seems to be just a compilation of the seven or eight treaties that they had before bi-laterally. I mean, the saving is primarily in some of the language. But the number of exceptions is just a compilation of the exceptions that they have included in the bi-lateral thing. So the time within the European Union to work efficiently towards a multi-lateral instrument will not be there until we have arrived at some basic harmonization; not necessarily of tax statutes or such, but at least of policy choice we make. And in absence of that, I do not really see how much you accomplish by just accumulating bi-lateral rules. Second observation: within the European union, indeed at various times, they have considered to develop a multi-lateral convention. I think right now they are working at something much more attainable and that is a multi-lateral

agreement that just focuses on non-discrimination between resident and non-resident tax payers. Indeed, to eliminate as Hugh Ault clearly described, the growing body of case law developed by the EC court and so by taking care of the problems themselves, they are trying their hand at such an agreement. But just focusing on non-discrimination is going to be, if I am correctly informed, a great expansion of the OECD Article 24-type non-discrimination clause—much more specific and elaborate with regard to the differential treatment of non-resident taxpayers. With regard to the role of the OECD commentary and the problems which are created by the increasing number of additions which clearly surpass the level of clarification, I simply refer to the partnership report which is more or less incorporated in the commentary without hardly any change, except for Article 23 the OECD model itself. Of course, the correct solution is one described by Hugh Ault in the Austrian German treaty—that in the treaty itself you refer to the OECD, the OECD model, and the OECD commentary. Because the OECD commentary and the model itself are like the famous Baron Von Munchausen story, where he cannot lift himself from the mud by just pulling at his own hair. So you need a higher authority to obtain the level that you are after. What one could do—and that is something that I discussed at the Eilat IFA (International Fiscal Association) Congress just over a year ago—is that when the OECD arrives at a comprehensive update of its commentary, since effectively the OECD member countries subscribe to that update at that time, you could write the update in a multi-lateral agreement and have the countries simply sign that. And through that multi-lateral agreement which would overwrite expressly different provisions in existing bi-lateral treaties, you would accomplish the varied result one tries now to accomplish through updating the commentary and hoping that courts and government authorities are willing to give the same weight to these updates as the OECD Committee of Fiscal Affairs will give to it. Final observation: the international agency created by a multi-lateral convention for interpreting the core treaty terms. In 1977, the EC Commission issued a directive on a change of information. And it was agreed earlier that this directive would be accompanied by another directive dealing with arbitration. On the one hand, the governments were going to get more information. On the other hand, the taxpayers would get the means to correct

any economic limitations resulting from this increase or change in information. Well, the arbitration agreement took 13 more years, and it was telling that the agreement was not an EC agreement. It was just a simple multi-lateral agreement among the EU members, and by not making it an EC agreement, the Members kept the agreement outside the reach of the EC court—because they were very afraid of what the court might say of how countries were going to interpret and apply this very convention. So this whole development doesn't make one very optimistic about how easily countries agree on much larger issues involving all sorts of treaty provisions outside of the transfer pricing sphere. Thirty days from now, Claus Vogel will be given a Feschrift and, in this Feschrift, I submitted a contribution which outlines how long it could, in the long run, accomplish a result like that. And I am sort of learning from the long way that arbitration has come to us within the European Union, with respect to transfer pricing. I start out with a voluntary bi-lateral approach that countries who will set up on the bi-lateral treaties a voluntary way of having courts and competent authorities submit interpretation issues to a panel of experts for the two countries. If that works well, it can be expanded to more than two countries, and perhaps within the European Union because the EC treaty stipulates that effective avoidance of double taxation is a simple requirement within the union. So, the European Union seems to be the sort of proper organization to sponsor such an initiative. So perhaps financially, because you know the cost of operating such a panel will be more than the individual countries will be willing to bear. That could also be a reason for having the European Union take the initiative in setting up such a initially voluntary panel. And if it works well, and countries get comfortable with the idea that their revenue is partially decided upon by outside authority, that may turn into such a panel as you suggested in your paper. But again, from experience within the Union so far, I do believe that one cannot underestimate the difficulties in countries giving up their sovereignty where tax is concerned. That is necessarily going to be very difficult.

CLAIRE KELLY: We're a little over time now, but if there's anything you would like to say to respond, or if there are any other questions? Well, it is my turn to turn the mike back over to Victor Zonana.

