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How Nations Share

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ABSTRACT

Every nation has an interest in sharing the gains they help create by participating in globalization. Citizens should be very interested in discovering how well their governments fare in claiming an adequate share of this international income stream, since a government that cannot or will not exert its taxing jurisdiction internationally is potentially missing out on a very large and very productive source of revenue. Yet it is all but impossible for citizens to observe exactly how, or how well, their governments navigate this aspect of economic globalization. The vast majority of international tax law plays out in practice through a series of intergovernmental dispute resolutions that are handled in complete secrecy through diplomatic channels, subject to no oversight by any judicial or legislative body and subject to no scrutiny by the taxpaying public. This Article shows that in thus obscuring public observation of international tax law as it develops, the structure of the international tax regime prevents citizens from comprehensively assessing the quality of their own nation's tax systems. Without more information to determine what, if anything, one's government ultimately claims from the massive stream of income created by international trade and investment, it is impossible to use any policy assessment tools, such as standards of economic efficiency and fairness, to talk coherently about the tax system. The Article concludes that at a time when national economic and political fortunes are experiencing high stress, uncertainty, and volatility, we need much better information about how international tax law develops and works out in practice.

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INTRODUCTION

Every nation that creates the financial and legal institutions that facilitate international trade and investment has an interest in sharing in the resulting economic gains. Much is at stake: with annual global trade in commercial services of $3.3 trillion,[1] in goods of $12 trillion,[2] and in capital flows of as high as $20 trillion in recent years,[3] governments have a lot to gain or lose depending on their ability to lay claim to these flows as a source of revenue. As some 60% of global trade occurs within multinational firms,[4] a government that cannot or will not exert its taxing jurisdiction internationally, whether by structural design or through negotiated dispute settlement, is potentially missing out on a very large and very productive income stream.

Individuals should be very interested in discovering how well their governments fare in claiming an adequate share of this international income stream. Governments that fare poorly will be forced to look ever more intensely to income that is "trapped" by national physical and institutional boundaries—namely, the kind of income that arises from working and buying goods in domestically controlled and monitored markets, rather than the kind that is earned as it passes through multiple jurisdictions with widely varying levels of regulatory oversight. This typically means ever-increasing reliance on payroll and consumption taxes.[5] Across the world, these taxes are becoming paramount, dwarfing national collections from other sources.[6]

To the extent the shift from capital to labor and consumption is by design, citizens may monitor their national policies by observing and contesting the rules

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1. WORLD TRADE ORGANIZATION, INTERNATIONAL TRADE STATISTICS 2010, at 6 (2010), *available at* http://www.wto.org/english/res_e/statis_e/its2010_e/section1_e/its10_highlights1_e.pdf.

2. *Id.* at 10 tbl.1.4.

3. Int'l Monetary Fund, *The Fund's Role Regarding Cross-Border Capital Flows* 6 fig.1 (Int'l Monetary Fund, Working Paper, 2010), *available at* http://www.imf.org/external/np/pp/eng/2010/111510.pdf.

4. *See, e.g.*, Gregory Corcos, Delphine M. Irac, Giordano Mion & Thierry Verdier, *The Determinants of Intra-Firm Trade* 2 (Centro Studi Luca D'Agliano Development Studies, Working Paper No. 267, 2008), *available at* http://www.dagliano.unimi.it/media/wp2008_267.pdf ("About every third transaction in international trade occurs within a multinational firm. An additional third has at least one multinational as a party to the transaction"); *see also* John Neighbour, *Transfer Pricing: Keeping It at Arm's Length*, OECD OBSERVER, Jan. 2002, *available at* http://www.oecdobserver.org/news/fullstory.php/aid/670/Transfer_pricing:_Keeping_it_at_arms_length.html (noting that "more than 60% of world trade takes place within multinational enterprises").

5. For a discussion, see Allison Christians, *Global Trends and Constraints on Tax Policy in the Least Developed Countries*, 44 U. BRIT. COLUM. L. REV. 239 (2010).

6. *Id.* at 247–61.

their governments lay down through regulation. But to the extent the shift occurs as a result of negotiated settlements that deviate from the regulatory regime, citizens are deprived of information that is critical to an assessment of the tax system as a whole. Individual taxpayers may benefit when governments decline to tax their international income as a result of negotiated dispute resolution. But society may well question whether it too benefits from these private gains. For this reason, the public accounting of how government allocates burdens among taxpayers in practice, through the resolution of disputes, has been characterized as a matter of fairness to taxpayers as a group.[7]

In the case of international income, it is the disputes and their resolutions, and not the law on the books, that constitute the international tax regime. Yet it is all but impossible for citizens to observe exactly how, or how well, their governments navigate this aspect of economic globalization. International bargains struck in the formal or "hard law" of cross-border tax agreements may be freely accessed and observed.[8] But these tax agreements provide only a design for allocating international income among nation states. It is the application of these agreements that determines how revenues are allocated in practice. This application has taken place over the years through hundreds of thousands of interpretive decisions, the vast majority of which are not accessible to the public.[9] Instead, international tax disputes are mostly delegated to institutions that resolve issues in informal, "non-law" ways, with minimal public access to the decision-making process and its

7. Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695, 710 ("[T]he importance of the administrability or practicality of a tax system reflects the notion that a tax system that appears equitable is not so if it is not enforceable in a manner that reaches equitable results."). Of course this is not a uniquely American idea; instead, the connection between equitable enforcement and equity in the tax system as a whole appears to be universal. *See, e.g.*, COMMITTEE OF PUBLIC ACCOUNTS, HM REVENUE AND CUSTOMS' 2009–10 ACCOUNTS: 2010–11, H.C. 502, at 3 (U.K.), *available at* http://www.parliament.uk/pagefiles/54525/CRC%20Final.pdf ("The average taxpayer has a right to assurance that the Department has done all it can to maximise returns to the Exchequer when resolving disputes over large companies' tax liabilities. While we acknowledge the Department's legal duty to respect taxpayer confidentiality, we expect the Department to seriously consider the scope for greater transparency over its procedures for resolving such disputes, so that public confidence in the fairness of settlements with large companies is assured.").

8. To some, the term "hard" is superfluous to the use of the term "law," but the redundancy distinguishes this kind of traditionally understood law from the possibility of soft law, discussed *infra*. *See, e.g.*, Jan Klabbers, *The Redundancy of Soft Law*, 65 NORDIC J. INT'L L. 167 (1996).

9. *See, e.g.*, Lara Friedlander & Scott Wilkie, *Policy Forum: The History of Tax Treaty Provisions—And Why It Is Important To Know About It*, 54 CANADIAN TAX J. 907, 910 (2006) ("There is only a limited body of readily available precedent or history that can help to inform interpretive decisions on the intent and application of tax treaties, to ensure that they reflect the legal and economic decisions taken to outline and define countries' reciprocal tax accommodations.").

outcomes.[10] As a result, international tax law in practice features little or no "law."[11]

A regime of "soft law" institutions has arisen as a substitute.[12] These institutions, especially the thirty-member Organisation for Economic Cooperation and Development (OECD), purport to both guide the various players in specific disputes and serve as points of reference to the public for understanding the development of the law.[13] The OECD aggregates the preferences of its members

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10. The outcomes of international tax dispute settlements constitute legal resolutions in the sense that they are undertakings by government officials under their designated authority to implement the law. *See, e.g.*, U.S. Model Income Tax Convention of Nov. 15, 2006, [1 IRS Forms] Tax Treaties (CCH) art. 25 (2007) [hereinafter U.S. Model], *available at* www.irs.gov/pub/irs-trty/model006.pdf (empowering a competent authority in each country to implement the treaty by mutual agreement); Organization for Economic Cooperation and Development, OECD MODEL TAX CONVENTION ON INCOME AND CAPITAL art. 25 (Org. for Econ. Co-operation & Dev. 2010) [hereinafter OECD Model], *available at* http://www.oecd.org/dataoecd/25/24/47213736.pdf (same). Even so, these resolutions lack a law-like character in the sense that they are nonreviewable by other legal institutions, they are ostensibly nonprecedential, they are largely inaccessible to anyone outside the decision-making process, and they are even susceptible to rejection by the aggrieved taxpayer. *See infra* Part II.

11. International legal practice in general shares a problem of systemic access to interpretive outcomes of treaty-based disputes, but in taxation governments appear to be unusually reluctant to divulge their practice through the publication of digests, diplomatic notes, agreements, etc. *See, e.g.*, RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 325 reporters' note 3 (1987) ("Ascertaining state interpretive practice may present difficult problems of research. A few countries, including the United States, publish digests of their international practice, which ordinarily include diplomatic notes and other actions reflecting treaty interpretation. These compilations may not be complete, however, particularly as to interpretation by agencies of the government other than the one that publishes them. Furthermore, their publication is often long delayed. In most countries no systematic reports of practice are available."). The recent addition of third-party delegation in the form of international tax arbitration promises more decision making in, but no greater information about, international tax disputes.

12. The international law literature frames soft law as norms that are not thought of as law per se, but compel a law-like sense of obligation in states. *See, e.g.*, C.M. Chinkin, *The Challenge of Soft Law: Development and Change in International Law*, 38 INT'L & COMP. L.Q. 850 (1989); David M. Trubek, Patrick Cottrell & Mark Nance, *"Soft Law," "Hard Law," and European Integration*, *in* LAW AND NEW GOVERNANCE IN THE EU AND THE US 65, Gráinne De Búrca & Joanne Scott eds., 2006) (suggesting that a hybrid approach, seeking both hard and soft elements, is needed in analyzing issues of international law). However, some scholars reject the notion of soft law and argue that law is necessarily a binary concept. *See, e.g.*, Klabbers, *supra* note 8; Kal Raustiala, *Form and Substance in International Agreements*, 99 AM. J. INT'L L. 581 (2005). For a discussion about the significance of using this term to describe the OECD and its work in international taxation, see Allison Christians, *Hard Law, Soft Law, and International Taxation*, 25 WISC. INT'L L.J. 325 (2007).

13. In this respect, international tax law reflects the soft law nature of much international financial law. *See generally* David Zaring, *Informal Procedure, Hard and Soft, in International Administration*, 5 CHI. J. INT'L L. 547 (2005); David Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*, 33 TEX. INT'L L.J. 281 (1998).

about the scope and content of international tax law by issuing commentary, guidelines, best practices, and the like.[14] This informal, nonbinding guidance acts as a peripheral focal point that locates public discourse over international tax policy in the abstract. It also removes focus from the concrete process of decision making through which governments are actually engaging in the allocation of global wealth. In this manner, the informal nature of most international tax guidance precludes observation of the transformation of law on the books to law in practice.[15]

We could know much more about how global gains are actually shared, as opposed to merely how they are designed to be shared, if we had better access to the processes and outcomes of international tax dispute resolutions themselves, instead of the filtered version we get through soft law. A comparative analysis of the institutional choices that have been made in developing international tax guidance reveals that such knowledge has been sacrificed to some unspecified goal or goals. Perhaps the primary goal is to ensure taxpayer confidentiality, or perhaps it is to preserve political autonomy and flexibility in policymaking. Without more information about the practice of international tax dispute resolution, we cannot easily ascertain what goals are being pursued. Further, if we cannot be sure what goals are being pursued, it will be impossible to know whether we have made the appropriate institutional choices in pursuing them.[16]

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14. The OECD uses "dialogue, consensus, peer review and pressure" to develop international tax norms defining appropriate international tax practices, which are disseminated in the form of reports, recommendations, and guidelines. *See, e.g.*, OECD, OECD'S CURRENT TAX AGENDA JUNE 2010, at 3 (2010), *available at* http://www.uscib.org/docs/CTPA_Brochure_June_2010.pdf; *see also* Fabrizio Pagani, *Peer Review: A Tool for Global Co-operation and Change*, OECD OBSERVER No. 235 (Dec. 2002), *available at* http://www.oecdobserver.org/news/fullstory.php/aid/881/Peer_review.html; Christians, *supra* note 12. It has been identified as "the single most important builder of business regulatory epistemic communities." JOHN BRAITHWAITE & PETER DRAHOS, GLOBAL BUSINESS REGULATION 29 (2000).

15. *See, e.g.*, Terence C. Halliday & Bruce G. Carruthers, *The Recursivity of Law: Global Norm Making and National Lawmaking in the Globalization of Corporate Insolvency Regimes*, 112 AM. J. SOC. 1135 (2007); *see also* Andrea Bianchi, *Textual Interpretation and (International) Law Reading: The Myth of (In)Determinacy and the Genealogy of Meaning*, *in* MAKING TRANSNATIONAL LAW WORK IN THE GLOBAL ECONOMY 34, 35–36 (Pieter H.F. Bekker, Rudolf Dolzer & Michael Waibel eds., 2010) ("[T]he interpretive process, far from being merely the produce of linguistic analysis, is deeply embedded in a societal context where different actors interact with one another. Any serious attempt to investigate the genealogy of meaning cannot overlook this fundamental characteristic of the interpretive process. This should be a cause for shifting the focus of analysis from the alleged inherent properties of the text to the interpretive communities whose strategies ultimately determine what a text means.")

16. *See generally* NEIL K. KOMESAR, IMPERFECT ALTERNATIVES: CHOOSING INSTITUTIONS IN LAW, ECONOMICS, AND PUBLIC POLICY (1994) (arguing that all institutional mechanisms for problem solving—whether the political process, the adjudicative process, or the market—present costs and benefits in the achievement of goals, so in choosing how society should pursue its legal, economic, or policy goals, it is a mistake to simply weigh the costs and benefits of a single institution; rather, the analysis must be made in comparative

The aim of this Article is to demonstrate that the soft institutional structure of international tax law has a high social cost, namely, in obscuring public observation of international tax law as it develops, and therefore obscuring the allocation of global wealth across nations in practice. All of this obscurity means that citizens cannot realistically determine their own nation's claims to the gains produced through globalization, and therefore citizens cannot comprehensively assess the quality of their national tax systems. Without more information to determine what, if anything, one's government ultimately claims from the stream of income created by international trade and investment, it is impossible to use any policy assessment tools, such as standards of economic efficiency and fairness, to talk coherently about the tax system.[17]

This Article examines the social cost of obscurity by exploring the existence and the importance of the missing information. Part I describes the context of international tax disputes: how and why they arise, whose interests are at stake, and how these interests are represented in the resolution process. Part II analyzes how nations have designed international tax dispute resolution using mostly nonobservable, often diplomatic processes and outcomes. Part III demonstrates how "soft law" tries to mediate the phenomenon of nonobservability and argues that the international tax regime does not adequately compensate for the obscurity it helps create in international tax law. The Article concludes that some ground would be gained by altering the norms supporting the existing paradigm, but the necessary reform is fiercely resisted by those who benefit from the status quo.

I. WHY NATIONS FIGHT OVER TAX REVENUES

Extracting tax revenues is one way nations can share in the gains from economic globalization. But tax policy experts worry that if too many countries are successful in such extraction, international business and investment flows will be stifled, to the economic detriment of everyone.[18] This fear creates much contestation over how and how much revenue nations should attempt to extract from international commercial and investment activity.[19] Early efforts to organize and coordinate transnationally amidst the emergence of modern economic globalization led most

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terms).

17. Thus the design of dispute resolution in international taxation is an information barrier that creates a high cost for effective policy assessment and reform. If the information sought was unknowable, one might conclude that this is the classically lamentable but unavoidable problem created by researching a topic involving great complexity. *See, e.g.*, LEE SMOLIN, THREE ROADS TO QUANTUM GRAVITY 146 (2001) ("[T]he hardest thing about science is what it demands of us in terms of our ability to make the right choice in the face of incomplete information."). However, as this article demonstrates, the necessary information could be known if governments exerted the effort to record and publish it.

18. *See, e.g.*, OECD, OECD TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS 17 (2010) [hereinafter OECD TRANSFER PRICING GUIDELINES], *available at* http://www.oecd.org/document/24/0,3746,en_2649_33753_1915490_1_1_1_1,00.html ("[D]ouble or multiple taxation can create an impediment to cross-border transactions in goods and services and the movement of capital.").

19. *See, e.g.*, Daniel N. Shaviro, *Rethinking Foreign Tax Creditability*, 63 NAT'L TAX J. 709, 710 (2010) (discussing the "battle of the acronyms" that characterizes traditional efficiency-based tax policy analysis).

of the world's countries to reject in principle, if not in practice, the direct taxation of international trade in goods by means of tariffs.[20] The guiding tax principle of this movement, later expressed in the "Washington Consensus," was that tariffs stifle international trade and thereby destroy opportunities for economic growth.[21] The solution was to free trade from tax, while nations' remaining tax bases "should be broad and marginal rates should be moderate."[22] Translated into practice, this limited nations to collecting most of their revenues from a combination of personal and corporate income taxes and personal consumption taxes.[23]

There is no international consensus to date that income taxes on international business and investment should go the way of tariffs.[24] However, there is a strong

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20. Consensus on free trade emerged from the gatherings of experts at Bretton Woods who created the General Agreement on Tariffs and Trade (GATT) in 1945, to which 147 countries are current signatories through the World Trade Organization. General Agreement on Tariffs and Trade, Oct. 30, 1947, T.I.A.S. No. 1700, 55 U.N.T.S. 187; *see also* Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, 1867 U.N.T.S. 14. The GATT seeks to foster international trade by eliminating national tax and nontax barriers. *See* Christians, *supra* note 5. Despite the widespread adherence to these principles, all countries continue to impose tariffs, and some countries, especially very poor ones, continue to rely heavily on the revenue generated from these taxes. *See, e.g.*, Thomas Baunsgaard & Michael Keen, *Tax Revenue and (or?) Trade Liberalization* 1 (IMF Working Paper, June 2005), *available at* http://www.imf.org/external/pubs/ft/wp/2005/wp05112.pdf (stating that "revenue recovery [replacing trade taxes with other forms of taxation] has been extremely weak in low-income countries (which are those most dependent on trade tax revenues)").

21. John Williamson, *What Washington Means by Policy Reform*, *in* LATIN AMERICAN ADJUSTMENT: HOW MUCH HAS HAPPENED? 7, 14–15 (John Williamson ed., 1990). Williamson described a set of ten policies, later referred to as the Washington Consensus, which he observed as being generally advocated for by the economic agencies of the U.S. government and the international financial institutions in Latin America. The term came to represent a comprehensive agenda for economic reform, perhaps contrary to Williamson's original intentions.

22. *Id.* at 12.

23. *See* Christians, *supra* note 5. Other taxes, including those laid on estate and gift transfers, property, and other items, are also available, but nations typically do not rely as heavily on these forms of taxation as they do on income and consumption taxes. *See* Michael Keen & Alejandro Simone, *Tax Policy in Developing Countries: Some Lessons from the 1990s and Some Challenges Ahead*, *in* HELPING COUNTRIES DEVELOP: THE ROLE OF FISCAL POLICY 302 (Sanjeev Gupta, Benedict Clements & Gabriela Inchauste eds., 2004).

24. However, clear signals have been sent in international policy circles that income taxation, especially corporate taxation, is in disfavor. At a 2009 conference hosted by the U.S. Council for International Business, the Director of the OECD's Centre for Tax Policy and Administration stated that countries wishing to pursue pro-growth tax strategies should "avoid like hell" both corporate taxation and progressive income taxation. Statement of Jeffrey Owens, The OECD's Evolving Role in Shaping International Tax Policy, Washington D.C. (June 2, 2009) (transcript on file with author); *see also* Roger H. Gordon, *Can Capital Income Taxes Survive in Open Economies?*, 47 J. FIN. 1159 (1992) (suggesting that they cannot); Thomas F. Field, *If the Corporate Tax Has No Future, Is Tax Competition a Threat?*, WORLDWIDE TAX DAILY, Mar. 1, 2000, at 42-1 (at a Canadian Tax Foundation conference, a panelist "invited . . . attendees to 'pick the date on which the last OECD

consensus that overlapping jurisdictional tax claims can significantly impede economic growth.[25] Even so, nations have not successfully negotiated a multilateral income tax coordinating regime akin to the World Trade Organization (WTO). The primary means for cooperation on income taxation can instead be found in a large collection of mostly bilateral agreements, which have been bound together using transnational network-based collaboration rather than supranational delegation.[26] It is this collection of agreements that form the ground for international tax disputes and their resolution.[27]

A. How Nations Agree To Share Revenues

Agreements among countries over taxes are necessary because there are two generally accepted theoretical bases of sovereign jurisdiction over taxation, neither of which are constrained by national boundaries.[28] The first of these is taxation based on individual residence or citizenship status; the second, on the presence of activity or assets within a geographic territory.[29] The United States employs both jurisdictional bases in its tax system. It imposes taxation on individuals and corporate entities on "all income from whatever source derived" (residence based

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member country will abolish the corporate income tax.'" One conference speaker "bet on 10 years from now," while another suggested 20, adding that "[t]he corporate income tax is in deep trouble, . . . and I think there are genuine questions as to whether it can survive 20 years."); Bev Dahlby, *Globalisation and the Future of the Corporate Income Tax* (Austl. Tax Studies Program, Discussion Paper No. 9, 2002), *available at* http://ideas.repec.org/p/nsw/discus/09.html (arguing that globalization puts downward pressure on corporate income taxation and may lead to abandonment of foreign tax credit system in favor of exemption system as capital is increasingly invested abroad).

25. *See* Christians, *supra* note 5.

26. For a discussion of this unique institutional infrastructure through which the world's wealthiest countries continuously renegotiate, and disseminate globally, a set of mutually agreeable income tax standards, see Allison Christians, *Networks, Norms, and National Tax Policy*, 9 WASH. U. GLOB. STUD. L. REV. 1 (2010).

27. In the United States, most but not all of these agreements are "treaties," that is, agreements that are signed by the President and ratified upon the advice and consent of two-thirds of the Senate. U.S. CONST. art. II, § 2, cl. 2. U.S. income and estate and gift tax treaties generally take this form. *See, e.g.*, Allison Christians, *Taxing the Global Worker: Three Spheres of International Social Security Coordination*, 26 VA. TAX REV. 81, 89 (2006). However, the United States is also party to other forms of international agreements, such as "executive agreements," which are entered into by the President pursuant to a statutory grant of authority approved by a majority of Congress as a whole rather than by a Senate supermajority vote. *Id.* at 85–92. U.S. tax information exchange agreements and social security agreements are typically executive agreements. *See* I.R.C. § 274(h)(6)(C)(i) (2006) (authorizing information exchange agreements); 42 U.S.C. §§ 301–1206 (2006) (authorizing social security totalization agreements).

28. For an argument that the acceptance of these jurisdictional bases constitutes customary international law, see REUVEN S. AVI-YONAH, INTERNATIONAL TAX AS INTERNATIONAL LAW: AN ANALYSIS OF THE INTERNATIONAL TAX REGIME (2007).

29. *See, e.g.*, KLAUS VOGEL, KLAUS VOGEL ON DOUBLE TAX CONVENTIONS 3 (3d ed. 1991) (arguing that international law permits taxation of foreign transactions when there is a sufficient connection between an individual and a taxing state such as through residence, habitual abode, citizenship, and situs of capital).

taxation),[30] as well as on income derived by foreign persons from investments and business activities carried out in the United States (source-based taxation).[31] Most industrialized countries claim some form of residence- and source-based jurisdiction over taxation, so overlaps of national tax laws can occur easily and frequently.[32]

But the mere fact that national income tax laws will inevitably overlap creates no automatic ground for international tax disputes or their resolution.[33] If unrelieved, jurisdictional overlaps would simply inure either to the benefit (through arbitrage) or detriment (double or multiple taxation) of taxpayers who engage in international business and investment activity.[34] Because both jurisdictions have recognizably valid claims to tax, or not to tax, as the case may be,[35] there is no natural recourse for governments or taxpayers against arbitrage or double taxation, just as there was no recourse for governments against the imposition of tariffs by trading partners prior to the existence of multilateral agreements collectively abolishing, or at least regulating, those taxes.[36] Instead, recourse must generally be constructed through the development of law.[37]

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30. I.R.C. § 61(a) (2006); *see also* I.R.C. §§ 1, 11(a) (2006) (imposing tax on incomes of individuals and corporations, respectively); Treas. Reg. §§ 1.1-1(a)–(b) (2003). Most OECD countries impose some form of residence-based taxation, though many (including the United States) provide certain statutory exemptions for foreign income, and many provide for exemption of foreign income under treaty. *See generally* ALLISON CHRISTIANS, SAMUEL A. DONALDSON & PHILIP POSTLEWAITE, UNITED STATES INTERNATIONAL TAXATION: CASES AND MATERIALS (2d. ed., 2011).

31. I.R.C. §§ 871, 881–882 (2006).

32. The simultaneous claim of residence and source bases of jurisdiction (as well as the designation of resident versus foreign) virtually ensures overlap, as a taxpayer's home country claims residence-based tax on income earned in a foreign country, while the foreign country claims source-based tax on the same item. Overlaps can also occur when countries have overlapping or conflicting rules for determining the source of an item of income or the residence of a taxpayer. For a discussion, see CHRISTIANS ET AL., *supra* note 30, at ch. 3.

33. On the contrary, no alleviation of overlapping jurisdictional claims, tax-based or otherwise, should be expected since "anarchy" is a fundamental feature of the international landscape. Barbara Koremenos, Charles Lipson & Duncan Snidal, *The Rational Design of International Institutions*, 55 INT'L ORG. 761 (2001).

34. Taxpayers may benefit from uncoordinated tax regimes through arbitrage by planning their affairs to exploit inconsistent independent legal regimes; conversely, taxpayers are aggrieved by uncoordinated tax regimes when both jurisdictions lay claim to the same type of tax on the same income item. *See generally* Reuven S. Avi-Yonah, *Commentary*, 53 TAX L. REV. 167 (2000); Adam H. Rosenzweig, *Harnessing the Costs of International Tax Arbitrage*, 26 VA. TAX REV. 555 (2007).

35. The proposition that countries have recognizably valid claims to refrain from taxation has been debated by the OECD, which has asserted what it characterizes as an "internationally agreed" standard for the design of national tax regimes. *See Tax: Laws in Some Countries Do Not Meet Global Standards*, OECD, http://www.oecd.org/document/49/0,3746,en_21571361_44315115_46998769_1_1_1_1,00.html.

36. Some of the trade agreements to which the United States is a party include most-favored nation and broad antidiscrimination provisions, which may authorize challenges to national tax regimes on the grounds that they are protectionist. *See, e.g.*, General Agreement on Trade in Services, art. II, Apr. 15, 1994, 1869 U.N.T.S. 183 ("[E]ach Member shall

Relief from jurisdictional overlap does not require international coordination, however. Nations can and often do resolve jurisdictional overlaps unilaterally, using domestic statutes.[38] Unilateral solutions generally take one of two forms: nations either provide an exemption from national income for certain types of income that may be taxed by other countries, or they provide a deduction or credit against domestic taxes for the foreign taxes paid.[39] The United States provides both: the U.S. Code includes numerous exemptions for certain types of wage income earned by U.S. persons abroad[40] and for certain types of domestic income

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accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country."). Although there are limitations, the possibility exists that individuals could bring a challenge to U.S. tax law under these agreements, as was done successfully in the case of the FSC/ETI regime. *See, e.g.*, DAVID L. BRUMBAUGH, A HISTORY OF THE EXTRATERRITORIAL INCOME (ETI) AND FOREIGN SALES CORPORATION (FSC) EXPORT TAX-BENEFIT CONTROVERSY (2006); Michael Daly, *WTO Rules on Direct Taxation*, 29 WORLD ECON. 527, 529–30 (2006) (discussing the potential for WTO-based challenges against national tax laws). U.S. tax treaties typically include language preventing individuals from using other agreements to pursue relief from taxation that is covered by the tax treaty. These provisions are based on language in the U.S. Model which provides "that any question arising as to the interpretation or application of this Convention and, in particular, whether a taxation measure is within the scope of this Convention, shall be determined exclusively in accordance with the provisions of Article 25 (Mutual Agreement Procedure) of this Convention . . . ." U.S. Model, *supra* note 10, art. 1.

37. That is, assuming that countries desire to mitigate the problem of double taxation through cooperation rather than competition. *See, e.g.*, OECD TRANSFER PRICING GUIDELINES, *supra* note 18, at 18 ("In a global economy, coordination among countries is better placed to achieve these goals than tax competition."); *see also* Shaviro, *supra* note 19 (arguing that a competitive approach is necessary since nations have to expect noncooperation from other nations).

38. In addition, taxpayers may attempt to engage in "self-help" by unilaterally revising a tax position in one country to correlate with tax treatment imposed in another. An example of this kind of self-help occurs in transfer pricing cases. *See infra* text accompanying notes 61–63. In such a case, when one country has imposed a pricing adjustment, the taxpayer makes a correlative adjustment in the other by simply filing an amended tax return. If the return is not challenged by the tax administration, it appears that the taxpayer has successfully helped itself to a unilateral solution to double taxation. However, this kind of self-help is not usually legally sanctioned. In the United States, the transfer pricing regulations prohibit the filing of amended returns in such cases. Treas. Reg. § 1.482-1(a)(3) (2011) ("[N]o untimely or amended returns will be permitted to decrease taxable income based on allocations or other adjustments with respect to controlled transactions."). Internal Revenue Service (IRS) enforcement agents are trained to examine amended returns for signs of unauthorized self-help. *See* IRM 4.60.2.5 (Jan. 1, 2002) ("[Agents] should look for foreign initiated adjustments that U.S. taxpayers may have used to reduce their U.S. tax liability. [Agents] may find these adjustments by scrutinizing: Foreign tax credits; Intercompany accounts; Changes to transfer prices, management fees, license fees, or any intercompany charged expenses.").

39. *See generally* Shaviro, *supra* note 19.

40. The foreign earned income exclusion generally allows U.S. persons to exclude from their income for U.S. tax purposes a portion of wages and housing costs earned or incurred abroad. I.R.C. § 911 (2006). For a discussion, see CHRISTIANS ET AL., *supra* note 30, at 44–54.

earned by foreign persons,[41] and a credit or deduction (at the taxpayer's election) for certain foreign taxes paid.[42] Whether in the form of exemption, credit, or deduction, the effect of these domestic law rules is to cede the jurisdiction to tax over a specific item of income that otherwise would be included in the domestic tax calculation.[43]

Unilateral solutions may solve the problem of jurisdictional overlap, but they can be detrimental if the concessions they entail are not reciprocated by other countries, or, worse, if the concessions are made even in the absence of overlap. Coordinated reciprocity ensures that both countries share the benefits of unilateral tax concessions. Thus, in granting a foreign tax credit, the United States cedes its jurisdiction to tax on the basis of residence, making the credit a "present of revenue to other countries" for which the ability to impose source-based taxation on U.S. persons is preserved.[44] That "present of revenue" is reciprocated only if individuals from the other country pay source-based taxes in the United States that are relieved by a foreign tax credit in their home countries. If a foreign country does not provide a tax credit or similar mechanism for relieving double taxation of their residents, business and investment in the United States will be disadvantaged compared to doing business and investment in the home country. Coordinating by means of an international agreement is one way to attain the desired reciprocity.[45]

Worse than lack of reciprocity (from the perspective of tax revenues, at least) is the possibility for total nontaxation that can easily be created through unilateral exemption of foreign income. For example, the U.S. exemption for income earned by U.S. persons visiting other countries is beneficial for individual taxpayers in that it prevents their home country, the United States, from imposing income taxes on their wages.[46] This is helpful to the taxpayer if the foreign country imposes income taxation on these wages, since it eliminates the possibility of double taxation in the same manner that the foreign tax credit does.[47] But if the foreign country does not

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41. *See* I.R.C. § 871(h)–(i), (k) (2006) (exempting from U.S. tax certain interest and dividends received by non-U.S. persons); § 871(j) (2006) (exempting certain gambling winnings by non-U.S. persons).

42. *See* I.R.C. §§ 901–905 (2006). Typically the taxpayer elects to take a credit rather than a deduction for foreign taxes paid, since the credit provides a greater offset than the deduction.

43. In the case of exemptions, credits, and deductions for U.S. persons with respect to income earned abroad, the jurisdiction that is ceded is that based on the residence of the taxpayer. Conversely, in the case of exemptions, credits, and deductions for foreign persons with respect to income earned in the United States, the jurisdiction that is ceded is that based on the geographic source of the income, that is, the territorial jurisdiction.

44. This is how the foreign tax credit was characterized when it was first introduced by the United States, since no other county had a similar credit at the time. *See, e.g.*, EDWIN R. A. SELIGMAN, DOUBLE TAXATION AND INTERNATIONAL FISCAL COOPERATION 132, 135 (1928); *see also* H. David Rosenbloom & Stanley I. Langbein, *United States Tax Treaty Policy: An Overview*, 19 COLUM. J. TRANSNAT'L L. 359 (1981).

45. *See, e.g.*, Elisabeth A. Owens, *United States Income Tax Treaties: Their Role in Relieving Double Taxation*, 17 RUTGERS L. REV. 428 (1963).

46. *See* I.R.C. § 911 (2006).

47. The foreign country is entitled to keep all of the tax levied on the wages, again owing to the ceding of residence-based tax jurisdiction by the United States, but the United

impose taxation on the wages, the taxpayer is doubly advantaged in not having to pay taxes to either country.

This is a too-generous exemption. By rewarding U.S. persons who work overseas in jurisdictions that do not impose income taxes on wages earned by foreign workers, the exemption introduces an inequity in tax treatment based solely on the location in which wage income is earned. It thereby violates the principle of horizontal equity that is thought to be best achieved with an ability-to-pay income tax system.[48] Any kind of exemption, while eliminating the potential for jurisdictional overlap, also raises this possibility of over-generosity to the point of creating inequity, depending on the rules adopted by foreign countries. A more tailored approach to resolving jurisdictional overlap can be achieved by dividing a revenue stream among countries. [49]

States can (and does) unilaterally enforce a reciprocal arrangement by taxing foreign individuals on wages they earn in the United States. *See* I.R.C. § 871(b) (imposing taxation on the income earned by individuals in connection with a trade or business in the United States, including that earned from employment). For a de minimis exception to the rule, see § 864(b).

48. *See, e.g.*, Dennis J. Ventry, Jr., *Equity Versus Efficiency and the U.S. Tax System in Historical Perspective*, *in* TAX JUSTICE: THE ONGOING DEBATE 25 (Joseph J. Thorndike & Dennis J. Ventry, Jr. eds., 2002). The violation of equity principles has led various leaders to oppose the continuation of section 911 over the years, but the entrenched interests of its beneficiaries has kept the statute alive in pursuit of international competitiveness. *See* Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222, 120 Stat. 345 (codified as amended in scattered sections of 26 U.S.C.) (increasing the amount of the foreign income exclusion but simultaneously introducing a new cap on the housing cost exclusion that significantly lowers the amount a person can exclude); Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in scattered sections of 26 U.S.C.) (fixing the exclusion as part of an initiative to broaden the tax base); Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (codified as amended in scattered sections of 26 U.S.C.) (temporarily freezing the exclusion); Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (codified as amended in scattered sections of 26 U.S.C.) (reinstating the provision); Foreign Earned Income Act of 1978, Pub. L. No. 95-615, 92 Stat. 3099 (codified as amended in scattered sections of 26 U.S.C.) (repealing the exclusion entirely); *President's Tax Message Along with Principal Statement, Detailed Explanation, and Supporting Exhibits and Documents Submitted by the Secretary of the Treasury Douglas Dillon in Connection with The President's Recommendations Contained in His Message on Taxation at Hearings Conducted by Comm. on Ways and Means H.R.*, 87th Cong. 8 (1961) (statement of President John F. Kennedy) (recommending elimination of the foreign income exclusion in order to preserve "tax equity" between persons living and working in the United States and those abroad); Letter from the IRC Section 911 Coalition, to Senator Bill Thomas, Chairman, House Ways & Means Comm. (June 4, 2004), *available at* www.sifma.org/workarea/downloadasset.aspx?id=822 (rejecting proposed limitations on the section 911 exclusion on the grounds that the exclusion "could shift tens of thousands of jobs now held by U.S. citizens working abroad to foreign nationals and significantly increase the financial burden on U.S. multinationals, reducing their ability to keep pace with their foreign competitors").

49. On the other hand, recourse for some international tax problems has been compelled through modeling, peer pressure, and even coercion rather than law. *See* Allison Christians, *Sovereignty, Taxation and Social Contract*, 18 MINN. J. INT'L L. 99 (2009) (discussing OECD tax havens initiative); Vaughn E. James, *Twenty-First Century Pirates of the*

Tax treaties emerged as the instrument of choice for both designing reciprocal jurisdictional concessions and preventing overly generous concessions. Tax treaties are international agreements, generally between two countries, under which the signatory countries agree to the taxation each will impose on the activities carried out between their respective jurisdictions.[50] Currently, the United States has income tax treaties with sixty-eight countries; gift, estate, or combined estate and gift tax treaties with seventeen countries; and social security tax agreements with twenty-four countries.[51] The primary role of these treaties is to create, from the valid competing jurisdictional claims of the United States and these respective treaty partners, both the legal ground for international tax disputes and the obligation of governments to resolve them.

B. Tax Agreements Lead to International Disputes

Once a tax treaty is in effect, a taxpayer has the legal structure in place from which to mount a challenge to the tax practices of the treaty partners. Thus, international tax disputes generally arise over the interpretation of language contained in tax treaties.[52] The dispute occurs because the governments, having previously agreed in principle upon revenue sharing, subsequently take opposing positions with respect to a specific levy under the arrangement. The dispute becomes a legal matter when the taxpayer alleges that one of the treaty parties has imposed a tax in contravention of the treaty terms.[53]

Caribbean: How the Organization for Economic Cooperation and Development Robbed Fourteen CARICOM Countries of Their Tax and Economic Policy Sovereignty, 34 U. MIAMI INTER-AM. L. REV. 1 (2002).

50. The vast majority of international tax agreements are bilateral. However, there are a few regional multilateral tax treaties currently in force. *See, e.g.*, Convention Between the Nordic Countries for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital, Sept. 23, 1996, 2263 U.N.T.S. 87; Agreement Among the Governments of the Member States of the Caribbean Community for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Profits, or Gains and Capital Gains and for the Encouragement of Regional Trade and Investment, July 6, 1994, 2259 U.N.T.S. 251; Treaty on the Avoidance of Tax Duplication and Control of Tax Evasion Amongst the States of the Arab Economic Unity Council, Res. 649, Dec. 3, 1973.

51. The United States also has tax information sharing agreements with twenty-six countries, but these do not allocate the tax base, and therefore they do not give rise to the kinds of disputes discussed herein. The social security agreements are executive agreements that allocate the right to collect social security contributions and the obligation to pay social security benefits in the case of cross-border workers. For a periodically updated listing of the status of the U.S. tax treaty network, see *Current Status of U.S. Tax Treaties and International Tax Agreements*, 41 Tax Mgm't Int'l J. (BNA) 146 (Mar. 9, 2012). For a discussion of the executive agreement structure and features of social security agreements, see Christians, *supra* note 27.

52. Individuals can also raise challenges to U.S. tax laws under other U.S. international agreements, such as trade agreements, but these are much more rare. *See supra* note 36 and accompanying text.

53. *See, e.g.*, U.S. Model, *supra* note 10, art. 25 (stating that a dispute arises when "a person considers that the actions of one or both of the Contracting States result or will result for such person in taxation not in accordance with the provisions of this Convention . . . .").

A taxpayer's goal in raising an international tax dispute is typically for the two governments to allocate the right to tax to one of the two jurisdictions, thereby eliminating a double imposition of tax.[54] In some cases, the dispute can be resolved if just one of the two governments act, while in others, both governments will have to coordinate by making correlative adjustments.[55] However, the desired result of dispute resolution can also be complete nontaxation (sometimes referred to as "double non-taxation" in order to evoke the role of the treaty in bringing about the result).[56] This can occur when, pursuant to the terms of the treaty, one government would impose taxation in a particular situation but the other would not. In such cases, the taxpayer wants the two governments to allocate the right to tax to the latter jurisdiction, thereby achieving bilaterally what exemption typically achieves unilaterally.

In double taxation cases, the taxpayer is said to be theoretically indifferent to the allocation of the taxing jurisdiction, so long as some resolution is achieved.[57] This may be the case when the resolution of the dispute will result in a single level of tax paid to either one government or the other but not both.[58] Of course, the taxpayer is not indifferent to the extent she suffers a double imposition of taxation until the governments agree, and other factors, such as currency positions or risks, may make a specific resolution more or less favorable from the taxpayer's point of view. In addition, the taxpayer may not be indifferent if the allocation does not conform

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54. *See, e.g.*, Owens, *supra*, note 45, at 430 (noting that because of generous unilateral rules, U.S. tax treaties often have a limited role in relieving double taxation, most of which involves "matters of detail and definition").

55. *See supra* note 38.

56. *See, e.g.*, Rosenzweig, *supra* note 34, at 560 ("Although double taxation has been the primary focus of concern in the field of international tax law, the potential for double *non*-taxation also arises in the international setting."); *see also* Michael Lang, *General Report*, 89A CAHIERS DE DROIT FISCAL INTERNATIONAL [STUD. INT'L FISCAL L.] 73 (2004) (exploring double nontaxation and its current and potential curtailment in international tax law).

57. *See, e.g.*, Richard E. Caves, MULTINATIONAL ENTERPRISE AND ECONOMIC ANALYSIS 223 (3d ed. 2007) ("Neutrality depends on who pays what tax, not which government collects it."). Taxpayers assume that resolution of tax disputes must occur due to the existence of the treaty, even though the inclusion of a dispute resolution mechanism is not a foregone conclusion for treaties in general. In fact, one study concludes that only half of international agreements have dispute resolutions at all. Barbara Koremenos, *If Only Half of International Agreements Have Dispute Resolution Provisions, Which Half Needs Explaining?*, 36 J. LEGAL STUD. 189, 189 (2007). One conclusion is that even with all of the faults and shortcomings ascribed to the current dispute resolution offerings for international tax disputes, the alternative could be even less appealing to taxpayers and governments alike: "[W]hat happens when states have a dispute and there is no dispute resolution provision? The Treaty of Versailles created the Permanent Court of International Justice, which was replaced by the International Court of Justice (ICJ). So the standard international law answer is that the ICJ is the default court lurking in the background." *Id.* at 190–91.

58. *See, e.g.*, Joel Slemrod, *Location, (Real) Location, (Tax) Location: An Essay on Mobility's Place in Optimal Taxation*, 63 NAT'L TAX J. 843, 854 (2010) ("[I]n most cases a taxpayer is indifferent to which country taxes are remitted, but from a national welfare point of view it is better, other things equal, that taxes are paid to it rather than to another country.").

to domestic or treaty law in accordance with the taxpayer's expectations.[59] In a case of double nontaxation, the taxpayer is not typically indifferent, and instead seeks a specific allocation of the taxing jurisdiction.[60]

An example from the most common subject of tax treaty disputes, transfer pricing, is illustrative.[61] Transfer pricing refers to the setting of prices between—and therefore the allocating of profits and losses among—related members of a group of associated companies.[62] The effect of transfer pricing rules is to divide revenues between countries in a generally acceptable way.[63] Most countries have adopted domestic rules requiring companies to set such prices "at arm's length,"

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59. *See, e.g.*, Jean-Philippe Chetcuti, *Arbitration in International Tax Dispute Resolution*, INTER-LAWYER LAW FIRM DIRECTORIES (2001), http://www.inter-lawyer.com/lex-e-scripta/articles/tax-arbitration.htm#_ftn22.

60. While double taxation is typically viewed as the principal reason that governments enter into tax treaties in the first place, double nontaxation may be fast becoming the prevailing norm. *See, e.g.*, Steven A. Dean, *The Incomplete Global Market for Tax Information*, 49 B.C. L. REV. 605, 649 (2008) (explaining that modern treaties emphasize tax minimization at the expense of combatting tax avoidance). Research in this area is difficult owing to the lack of statistical data on the kinds of disputes that arise under tax treaties, as described herein.

61. Transfer pricing is repeatedly cited as the most prevalent, and most costly, subject in international tax disputes. *See, e.g.*, Chloe Burnett, *International Tax Arbitration*, 36 AUSTL. TAX REV. 173, 174 (2007) ("In terms both of frequency of cases and the amount of money at stake, the major international tax disputes have been over transfer pricing, where a difference between what each tax authority, and the taxpayer, considers to be the arm's length price usually leads to a form of double taxation."); *see also* INTERNAL REVENUE SERVICE, COMPETENT AUTHORITY STATISTICS (Jan. 2012) [hereinafter, "U.S. MAP STATISTICS"], (on file with the author); *Dispute Resolution: Country Mutual Agreement Procedure Statistics for 2008 and 2009*, OECD CENTRE FOR TAX POLICY AND ADMINISTRATION, http://www.oecd.org/document/25/0,3746,en_2649_37989739_46501785_1_1_1_1,00.html [hereinafter OECD MAP Statistics (2009)]. It is also the subject of the largest disputes between taxpayers and the IRS. *See, e.g.*, I.R.S. News Release IR-2006-142, at 9 (Sept. 11, 2006), *available at* http://www.irs.gov/newsroom/article/0,,id=162359,00.html (announcing IRS's $3.4 billion settlement of a twelve-year transfer pricing dispute with Glaxo SmithKline in a case which "represents the largest tax dispute in the history of the Internal Revenue Service").

62. *See, e.g.*, OECD TRANSFER PRICING GUIDELINES *supra* note 18, at 19 ("Transfer prices are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises"). As an oversimplified but useful example, consider a multinational business headed by a parent company organized in the United States, with a subsidiary organized in Foreign Jurisdiction (FJ). The U.S. parent manufactures goods for sale by the subsidiary in FJ at a cost of $100 and a retail sales price of $150. The cost of $100 and the profit of $50 is allocated between the two companies by setting a price at which the FJ subsidiary will purchase the goods from the U.S. parent company. To allocate all of the profits to the United States, the parent would charge the FJ subsidiary a price of $150; to do the opposite, the price would be set at $100.

63. *See, e.g.*, Yariv Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes*, 28 VA. TAX REV. 79, 83 (2008) ("An arm's length based transfer pricing regime, such as ours, permits relatively peaceful division of revenues between countries.").

that is, reflecting to some degree the prices independent companies would be expected to set under similar circumstances.[64] This approach to transfer pricing requires each of the members of a controlled group to be treated as if they were independent entities.[65] The independent entity approach allows countries to divide the profits among all of the nations in which a multinational company does business.[66]

Arm's length transfer pricing results in double taxation when one country interprets the standard in a way that claims more profit than the taxpayer has initially allocated to it.[67] When a country requires such an adjustment, a corresponding adjustment is typically needed from the other country (or countries) in which the group operates, in order to prevent the double tax.[68] An international dispute arises either when the first country is unwilling to reverse its initial adjustment or the other country or countries are unwilling to make the necessary correlative adjustments.[69] It is in the taxpayer's discretion to determine which course to pursue.[70]

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64. In the United States, the rules are found in section 482 of the Internal Revenue Code and accompanying regulations. OECD members have generally subscribed to the U.S. method. *See* OECD TRANSFER PRICING GUIDELINES, *supra* note 18, at 18–20 ("OECD member countries have chosen this separate entity approach as the most reasonable means for achieving equitable results and minimising the risk of unrelieved double taxation. . . . OECD member countries continue to endorse the arm's length principle as embodied in the OECD Model Tax Convention (and in the bilateral conventions that legally bind treaty partners in this respect) . . . ."); *see also* Avi-Yonah, *supra* note 34, at 167.

65. Article 9 of the OECD Model and the U.S. Model, Associated Enterprises, recites the arm's length standard as follows:

> Where: a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State; or b) the same persons participate directly or indirectly in the management, control, or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations that differ from those that would be made between independent enterprises, then any profits that, but for those conditions, would have accrued to one of the enterprises, but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

OECD Model, *supra* note 10, art. 9; U.S. Model, *supra* note 10, art. 9.

66. *See, e.g.*, OECD TRANSFER PRICING GUIDELINES, *supra* note 18, at 17 ("[C]ountries need to reconcile their legitimate right to tax the profits of a taxpayer based upon income and expenses that can reasonably be considered to arise within their territory with the need to avoid the taxation of the same item of income by more than one tax jurisdiction.").

67. This is typically accomplished by the tax administration's determination of an "adjustment" to the taxpayer's prices on the grounds that they do not reflect an arm's length deal. *See* Treas. Reg. § 1.482-1(b) (2011).

68. *See* U.S. Model, *supra* note 10, art. 9 (calling for a correlative adjustment when the two countries agree to an initial transfer pricing adjustment).

69. The OECD developed its transfer pricing guidelines in order to "encourage[] the acceptance of common interpretations" of the OECD Model provisions governing transfer pricing, with the goal of "reducing the risk of inappropriate taxation and providing satisfactory means of resolving problems arising from the interaction of the laws and

The example of transfer pricing illustrates how international tax disputes can arise when countries agree to cooperate among themselves in allocating international income. It also demonstrates that there are several parties to an international tax dispute that have different stakes in the outcome, namely, the taxpayer and the multiple governments that have laid justifiable, if overlapping, jurisdictional claims. These parties have distinctly unique roles in the process of international tax dispute resolution.

C. Odd Man Out: The Sidelining of the Taxpayer

Because tax treaties generally operate to allocate the taxing jurisdiction between nations, a treaty dispute necessarily involves the two or more governments that are parties to the treaty. These disputes also always involve a taxpayer (whether an individual or entity), whose tax situation brings about the facts that gave rise to the disputed tax liability, such as in the case of a transfer pricing adjustment.[71] But the tax treaty does not create a right for a taxpayer to sue a foreign government in the event of a perceived treaty violation.[72] Instead, tax treaties generally provide the taxpayers only an additional administrative remedy for treaty noncompliance, namely, the right to present the case to a treaty administrator, designated by the treaty as the "competent authority."[73] Once so presented, it is up to the competent authority, and not the taxpayer, to pursue the matter further.[74]

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practices of different countries." *See* OECD TRANSFER PRICING GUIDELINES, *supra* note 18, at 19.

70. If one course fails, the taxpayer is free to pursue another, but he may be limited by various statutes of limitations or requirements of exhausting particular administrative remedies in the affected countries.

71. *See, e.g.*, OECD Model, *supra* note 10, art. 25 (describing the taxpayer's role in initiating dispute resolution under a treaty).

72. This was confirmed by the U.S. District Court in *Komet v. Finland*, No. 99–6080(JWB), 2002 WL 741620 (D.N.J. Feb. 1, 2002) (dismissing a suit filed by a Finnish company against the government of Finland pursuant to the U.S.-Finland tax treaty, on the ground that Finland had not waived its sovereign immunity under the treaty).

73. The standard authorizing language is found in Article 25 of the U.S. and OECD Models: "Where a person considers that the actions of one or both of the Contracting States result or will result . . . in taxation not in accordance with the provisions of this Convention, it may, irrespective of the remedies provided by the domestic law of those States . . . present [the] case to the competent authority . . . ." OECD Model, *supra* note 10, art. 25; U.S. Model, *supra* note 10, art. 25. As discussed more fully *infra*, the treaty does not prevent the taxpayer from using other tax appeals procedures allowed under domestic law.

74. OECD Model, *supra* note 10, art. 25; U.S. Model, *supra* note 10, art. 25 (each stating that "The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention.").

Both models add that "Any agreement reached shall be implemented notwithstanding any time limits" under the domestic law of the Contracting States, while the U.S. Model adds "other procedural limitations" to this phrase, and also adds as a third statement that "Assessment and collection procedures shall be suspended during the period that any mutual agreement proceeding is pending." OECD Model, *supra* note 10, art. 25; U.S. Model, *supra* note 10, art. 25.

Thus, while international tax disputes are first and foremost inter-nation disputes—and therefore subject to the same administrative, political, and institutional issues that governments face in other transnational regulatory contexts—international tax disputes feature a unique role for indirect or third-party interests.[75] The taxpayer initiates an international tax dispute by bringing a claim to a competent authority, but it is the competent authorities alone that directly engage in the dispute and its resolution. The taxpayer is interested in having the governments resolve the problem, but once the claim has been laid, the taxpayer's role becomes one of observer, at best.[76] The aggrieved taxpayer acts as both an instigator and a third wheel in international tax disputes, creating a triangle of interests in the pursuit of resolution.

The peripheral role played by aggrieved taxpayers in international tax disputes distinguishes tax treaties from other international agreements involving cross-border business and investment, such as investment treaties[77] and trade agreements.[78] Most international investment treaty disputes involve individuals from one country who, under authority granted by these agreements, may bring a direct challenge against a foreign government.[79] While the individual's home country may be interested in the outcome of the dispute and may support the individual's case, the individual harmed by the treaty violation is the primary disputing party, and thus faces the direct costs of its resolution. In the other extreme, trade agreements are brought by government officials in their own discretion.[80] Individuals and companies that are impacted by what they view as

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75. For a discussion of the issues faced by governments in pursuing other areas of transnational regulation, see generally BRAITHWAITE & DRAHOS, *supra* note 14.

76. Kerwin Chung & Richard McAlonan, *Competently Negotiating the U.S. Competent Authority Process*, 59 TAX EXEC. 257, 262 (2007).

77. Investment treaties are international agreements that protect private investment flowing between the signatory countries by, for example, preventing governments from imposing burdensome transferability rules or expropriating assets or gains. *See Bilateral Investment Treaties*, OFFICE OF THE U.S. TRADE REPRESENTATIVE, http://www.ustr.gov/trade-agreements/bilateral-investment-treaties. Investment treaties may be bilateral (between two countries) or multilateral (among three or more countries). The United States is currently party to forty bilateral investment agreements. *See Bilateral Investment Treaties Index*, TRADE COMPLIANCE CENTER, http://tcc.export.gov/Trade_ Agreements/Bilateral_Investment _Treaties/index.asp.

78. These include the GATT and the GATS, among other WTO agreements, as well as bilateral and regional trade agreements such as NAFTA.

79. *See Bilateral Investment Treaties*, *supra* note 77. ("BITs give investors from each party the right to submit an investment dispute with the government of the other party to international arbitration. There is no requirement to use that country's domestic courts."); *see also* Susan D. Franck, *Development and Outcomes of Investment Treaty Arbitration*, 50 HARV. INT'L L.J. 435, 435 (2009) ("Investment treaty arbitration permits foreign investors to sue host governments for damages those governments allegedly caused to their investments. A typical claim might involve an investor demanding over US $300 million from a host state for governmental action such as regulating financial markets or instituting environmental protection measures.").

80. *See, e.g.*, Chris Brummer, *Why Soft Law Dominates International Finance—and Not Trade*, 13 J. INT'L ECON. L. 623, 626 (2010) ("[T]he WTO can, through its panels, authorize

violations of trade agreements may petition their national trade representative to take action, but they cannot typically compel such action.

In contrast, governments are compelled to resolve international tax disputes once an individual taxpayer files a claim.[81] Once a claim is made, the competent authority is obliged to review it and determine whether there is an instance of taxation not in accordance with the convention, and, if so, to endeavor to resolve the issue by directly negotiating with the other competent authority or authorities.[82] Since the taxpayer is not a primary disputing party in an international tax treaty dispute, she may face fewer costs in seeking resolution. This is not to say that taxpayers face no costs in raising an international tax dispute. In levying the charge of a treaty violation, the taxpayer will be required to file documentation outlining the violation and showing to the satisfaction of at least one of the two competent authorities that there is in fact a valid issue.[83] However, the taxpayer is not responsible for the legal and administrative costs incurred by the governments as they engage in dispute resolution.[84]

The individual's role as direct or indirect participant can be expected to influence her perception of what alternatives ought to be made available in pursuit of resolution. When an individual is a direct participant in a dispute, one may expect her to be conscious of the cost of various resolution strategies, and she will be expected to seek the single form of resolution that is perceived to offer the best chance to reach the desired outcome at the lowest cost. For example, in an investment treaty dispute, investors may generally choose among a number of distinct arbitration institutions.[85] Presumably, investors research which of the options is most likely to achieve the desired result at the least cost before filing a request for arbitration under the treaty. Similarly, in a trade dispute, the trade representative can be expected to weigh the costs of litigation against the likelihood and benefits of success. Conversely, the taxpayer in an international tax dispute may equally seek the best chance to reach the desired outcome, but her interest in the costs of the various alternatives is one step removed from that of the investor in the investment treaty dispute or the national representative in a trade dispute, each of whom determines whether to litigate under its own sole discretion.[86]

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states that are harmed by uncured rule violations by other states to retaliate by suspending equivalent concessions or other obligations under the covered agreements.").

81. *See id.* at 625. Countries have thus used tax treaties to tie their own hands, obligating themselves to resolve disputes on behalf of their taxpayers.

82. *See* U.S. Model, *supra* note 10, art. 25.

83. This documentation may involve extensive legal and accounting fees.

84. *See, e.g.*, Hugh Ault, *Improving the Resolution of International Tax Disputes*, 7 FLA. TAX REV. 137, 147 (2005); Michael J. McIntyre, *Comments on the OECD Proposal for Secret and Mandatory Arbitration of International Tax Disputes*, 7 FLA. TAX REV. 622, 642–43 (2006).

85. Franck, *supra* note 79, at 443 ("[I]nvestors can generally elect to arbitrate before one or more of the following: (1) an *ad hoc* tribunal organized under the United Nations Commission on International Trade Law ("UNCITRAL") Arbitration Rules, (2) the Stockholm Chamber of Commerce, or (3) a tribunal organized through the World Bank's ICSID.").

86. As effectively a free rider to the international tax dispute resolution process, it may be in the interest of the taxpayer to increase the administrative costs to governments in pursuing dispute resolution, if the effect of the additional costs is to achieve faster or more

In addition to the taxpayer's unique role in the international tax dispute process, the affected governments have unique goals and constraints that affect the design of dispute resolution in this area. Tax treaties bind governments to an essentially zero-sum game. In an individual case, one government stands to lose in revenue what the other stands to gain.[87] When trade and capital flows between the countries are roughly reciprocal, the losing and gaining of revenues can be expected to stay roughly even between the two countries, but when trade and capital flows tend to move more in one direction, the outcomes will not be even.[88] Governments might view the costs and benefits of their treaty obligations differently for different countries, over time. If so, we may expect governments to bind themselves somewhat loosely to positions taken in tax treaties. The design of international tax dispute resolution reflects these taxpayer and government goals, constraints, and expectations.

II. How Nations Resolve the Disputes They Facilitate

When an international tax dispute arises, a taxpayer currently encounters four avenues to resolution.[89] The first two resolutions, domestic administrative and judicial review, are available to taxpayers without recourse to a treaty. Tax treaties introduce two alternative dispute resolution processes, namely, the mutual agreement procedure, in which the competent authorities of each treaty partner negotiate a settlement, and third-party arbitration, in which an arbitration panel is empowered to make determinations in pursuit of settlement by the competent authorities. Of these four alternatives, judicial review offers the only "hard" law of international taxation. The other alternatives each typify a form of decision making without law, in the sense that none purports to provide rules that act as constraints

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favorable resolution to the taxpayer. The taxpayer may not be completely indifferent to increasing government costs, for example if increased dispute resolution costs between the governments causes cases to backlog, delaying resolution. But that dispersed outcome will not likely have the same effect as the direct costs of dispute resolution faced personally by a party to an investment treaty dispute. *See* Chetcuti, *supra* note 59.

87. This seems distinct from both investment treaty disputes and trade agreement disputes.

88. *See* Allison D. Christians, *Tax Treaties for Investment and Aid to Sub-Saharan Africa: A Case Study*, 71 BROOK. L. REV. 639, 639–44 (2005).

89. All of these are ex-post dispute resolution processes, invoked after an unfavorable determination by a tax authority. It should be noted that some ex-ante mechanisms exist for the purpose of preventing a dispute from arising. Private letter rulings, which are discussed *infra*, represent one form of ex-ante dispute resolution mechanism which has long been available to U.S. taxpayers. More specific to international tax law, the IRS engages taxpayers in additional ex-ante dispute resolution in cases involving intercompany transfer pricing. Using "advance pricing agreements" (APAs), the IRS allows multinational corporations to negotiate with the Service unilaterally or bilaterally in conjunction with the tax authorities of other countries to achieve a mutually acceptable transfer pricing methodology and thereby prevent future transfer pricing disputes. *See* I.R.S. Announcement IRB 2010-15 (Apr. 12, 2010), *available at* http://www.irs.gov/pub/irs-utl/irb10-15.pdf. Bilateral APAs are entered into pursuant to the authority of the mutual agreement procedure in existing tax treaties. *See infra* text accompanying note 135.

on future behavior outside of the immediate dispute.[90] Each of these hard and non-law alternatives presents advantages and disadvantages for taxpayers, for governments, and for the development of international tax law as a regime.

A. Let Taxpayers Fight with the Revenue Authority

The right of taxpayers to challenge domestic tax assessments as they would outside of the treaty context is not curtailed by the presence of a treaty. Thus, in the event of a dispute over a country's imposition of a tax, a taxpayer could choose to pursue the matter through the domestic appeals process in the appropriate country. For example, if a foreign taxpayer was assessed a tax by the United States that the taxpayer thought was in contravention of the treaty, the taxpayer could choose to appeal the assessment according to U.S. tax procedural rules.[91] Likewise, a U.S. taxpayer could choose to seek an adjustment of a foreign tax by recourse to the foreign appeals process.

In the United States, any taxpayer may challenge tax assessments through a wholly internal administrative review that can culminate in a final and binding determination without recourse to judicial review.[92] If the taxpayer successfully negotiates an agreement through this internal appeals process, the matter concludes with a "closing agreement," which represents the taxpayer's deal with the IRS.[93] Closing agreements are nonreviewable and binding on both the taxpayer and the IRS: the issues they resolve cannot generally be revisited by the government, nor can they be modified or set aside in a subsequent lawsuit.[94]

Closing agreements have both a legal nature and a nonlegal nature.[95] Because they represent positions taken by the IRS, they seem in some respects like other

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90. *See, e.g.*, Jamison E. Colburn, *Agency Interpretations*, 82 TEMP. L. REV. 657, 684 (2009) (arguing that agency-issued guidance in the United States is soft law because it specifies rules for conduct despite its ostensibly non-binding nature).

91. These rules are described in Treas. Reg. § 601.103 (2011).

92. *See id.* § 601.103(c)(1), (2) (permitting administrative appeal); *see also id.* § 301.7121-1(a) (authorizing the IRS to "enter into a written agreement with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal revenue tax for any taxable period ending prior or subsequent to the date of such agreement. A closing agreement may be entered into in any case in which there appears to be an advantage in having the case permanently and conclusively closed, or if good and sufficient reasons are shown by the taxpayer for desiring a closing agreement and it is determined by the Commissioner that the United States will sustain no disadvantage through consummation of such an agreement.").

93. I.R.C. § 7121 (2006); Treas. Reg. § 301.7121-1 (2011).

94. Treas. Reg. § 301.71721-1(c) (2011) ("A closing agreement . . . shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact— (1) The case shall not be reopened as to the matters agreed upon or the agreement modified by any officer, employee, or agent of the United States, and (2) In any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside, or disregarded.").

95. Thus, they are like many agency interpretations in that "whether they carry the force of law or not is often deeply unclear." Colburn, *supra* note 90, at 660.

forms of IRS declarations, such as private letter rulings, which have been found by courts to be legal in nature and therefore subject to public disclosure.[96] On the other hand, the closing agreement is a negotiated settlement that reflects considerations other than interpretation of the substantive law, most especially "litigation hazards," the risk taken by the IRS that its position against the taxpayer may be rejected in subsequent judicial review.[97] Perhaps because of this aspect of their nature, closing agreements are specifically protected from disclosure to the public, including against Freedom of Information Act (FOIA) requests.[98]

In this context, the FOIA is generally intended to promote public access to undertakings by government agencies that could have implications for legal regimes. Thus, "[t]he Freedom of Information Act is premised on the theory that in order for democracy to function properly, citizens must have access to government information, particularly where access might be 'needed to check against

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96. This was not so until a series of Freedom of Information Act (FOIA) requests resulted in a determination, however. *See* Taxation with Representation Fund v. IRS, 646 F.2d 666, 682–84 (1981); Fruehauf Corp. v. IRS, 566 F.2d 574, 574, 577 (1977); Tax Analysts & Advocates v. IRS, 505 F.2d 350; 350–51, 55 (1974).

97. Interview with Anonymous IRS Appeals Team Manager (Apr. 27, 2010) (notes on file with the author) ("When we are faced with an appeals issue, we employ facts, law, and litigation hazards in equal measures."); *see also* SUSAN A. BERSON, FEDERAL TAX LITIGATION 1-70.21] (2003 ed.) ("[A]n appeals officer has the discretion to consider the hazards of litigation . . . ."); *IRS Appeals: To Docket or Not To Docket*, TAX LAWYER'S BLOG (July 18, 2009), http://blog.pappastax.com/index.php/2009/07/18/irs-appeals-to-docket-or-not-to-docket/ ("Unlike their lower level counterparts in the Audit division, IRS Appeals officers . . . can consider what is known as "hazards of litigation" in arriving at a settlement with the taxpayer . . . . Consequently, one of the most important things a tax lawyer does in a docketed case is create doubt in the mind of the Appeals officer that the IRS will prevail at trial. This is a decidedly different function than what a tax lawyer, CPA or Enrolled Agent is called upon to do when representing his or her client in an audit examination. An IRS examination is, or at least endeavors to be, an objective exercise: The taxpayer presents records and documents in support of the entries he made on his tax return and the IRS evaluates those records and documents for accuracy and adequacy. On the other hand, the appeals process, especially in docketed cases, is more subjective. Taxpayers who are represented by tax lawyers who know this have a distinct advantage over taxpayers who are not. If a case is not docketed (i.e., a written protest was filed rather than a Tax Court petition), an Appeals officer will generally not be as concerned with hazards of litigation because the case is not on a direct path to trial.").

98. *See* S. REP. NO. 94-938, pt. 2, at 307 (1976); H.R. REP. NO. 94-658, pt. 2, at 316 (1976). Subject to some exceptions, taxpayer "returns and return information" are protected from public disclosure. I.R.C § 6103(a) (2006). Return information is defined broadly, and includes any information gathered by the IRS in assessing tax liability or collecting a tax. *Id.* § 6103(b)(2)(A); *see also* McQueen v. United States, 264 F. Supp. 2d 502, 516 (S.D. Tex. 2003); LaRouche v. U.S. Dep't of Treasury, 112 F. Supp. 2d 48, 54 (D.D.C. 2000) ("The [Tax Reform Act of 1976] defines returns and return information in the broadest way."); United States v. Barrett, 837 F.2d 1341, 1342 (5th Cir. 1988). The Code currently includes closing agreements within this protection. *See* I.R.C. § 6103(b)(2)(D) (including in the definition of return information "any agreement under section 7121, and any similar agreement, and any background information related to such an agreement or request for such an agreement").

corruption and to hold the governors accountable to the governed.'"[99] Despite this broad goal, the FOIA does not guarantee access to every administrative declaration on matters of taxation or otherwise. For example, the FOIA does not grant a right of access when federal agency records are protected from disclosure by statute, if certain requirements are met.[100] This is the case for closing agreements, so these compromises between taxpayers and the IRS, which likely comprise the vast majority of domestic administrative appeals, are not reviewable by other agencies or accessible to the public, and they do not create precedent.[101]

Even so, examples of tax treaty issues that taxpayers attempted to resolve through domestic administrative appeals may be gleaned from cases, which arise when the appeals process fails to provide the taxpayer the desired result.[102] Thus, in *Abeid v. Commissioner*, after an Israeli citizen residing in the United States won the California lottery but failed to include the winnings in income, the IRS assessed a deficiency, which the taxpayer (unsuccessfully) opposed using the U.S.-Israel income tax treaty.[103] The taxpayer had greater success in *Compaq Computer Corp. v. Commissioner*.[104] In that case, the taxpayer had unsuccessfully appealed an IRS deficiency notice on the grounds that it was owed additional U.S. tax credits under the U.S.-U.K. tax treaty, but the taxpayer won the refund in Tax Court.[105]

These cases are not necessarily representative of the types of treaty-based disputes that taxpayers can appeal domestically, but they demonstrate the point that taxpayers can and do pursue relief of international tax disputes through domestic administrative channels. The public may not be able to observe law as it unfolds through domestic administrative appeals, but this process is an important focal point for considering what constitutes international tax law, as well as a point of reference for comparing how other forms of international tax dispute resolution fit into the legal regime.[106] Of course, these cases also demonstrate that when a

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99. Pacific Fisheries, Inc. v. United States, 539 F.3d 1143, 1147 (9th Cir. 2008) (quoting John Doe Agency v. John Doe Corp., 493 U.S. 146, 152 (1989)).

100. 5 U.S.C. § 552(b)(3) (1976).

101. I.R.C. § 6105 (prohibiting disclosure in the case of tax returns and return information, including closing agreements).

102. *See, e.g.*, Colburn, *supra* note 90, at 661 ("We have long sought by means of judicial review to check the discretion delegation creates.").

103. Abeid v. Comm'r, 122 T.C. 404 (2004). For the U.S.-Israel tax treaty, see Convention with Respect to Taxes on Income, Nov. 20, 1975, U.S.-Isr., TIAS, as amended by protocols.

104. Compaq Computer Corp. v. Comm'r, 113 T.C. 363 (1999).

105. *Id.* at 366 (arising after "petitioner made an informal claim for refund . . . . [and] [r]espondent disallowed the refund"). For the U.S.-U.K. tax treaty, see Convention on Double Taxation, July 24, 2001, U.S.-U.K., T.I.A.S. No. 13,161.

106. The inability to observe administrative appeals is viewed as problematic in other countries as well. *See, e.g.*, COMMITTEE OF PUBLIC ACCOUNTS, *supra* note 7, at 6–7 ("There is little transparency for the taxpayer over the way that tax disputes with large companies are resolved. While we recognise the Department's obligation to ensure taxpayer confidentiality, the Department should consider the scope for increasing transparency in the area of large and complex tax cases and for assuring Parliament and the public that due process in the resolution of these cases is being followed.").

taxpayer fails to come to an agreement using this internal appeals process, the courts remain a viable dispute resolution alternative.[107]

B. Let Taxpayers Litigate

As demonstrated by the examples above, judicial review may arise when a taxpayer who has exhausted administrative remedies without satisfaction brings the case to court for resolution. Taxpayers may also choose to forego administrative appeal and file for refund directly in the Federal Court of Claims or District Court, provided certain conditions are met.[108] Administrative appeals that end up in court, as well as refund suits brought by taxpayers directly in court, undoubtedly represent a small fraction of the international tax disputes that arise between taxpayers and the IRS. Thus, in the entirety of U.S. jurisprudence, including both state and federal courts, fewer than 160 cases involving tax treaty disputes have been adjudicated.[109] Even so, judicial review plays a significant role in international tax dispute resolution, as there are collectively at least 4000 cases interpreting and applying tax treaties around the world.[110]

Judicial review has its benefits and its drawbacks as a dispute resolution mechanism, both for governments and taxpayers, as well as for the observers of tax policy. A main public benefit of judicial review is that it can contribute to an

107. If a tax deficiency is assessed but not paid, the taxpayer may file for a redetermination in the Tax Court, but the case usually goes through IRS appellate review prior to Tax Court proceedings. This is not a legal requirement, but likely represents an effort to achieve greater settlement of cases and reduce the court's case load. *See, e.g.*, *IRS Appeals: To Docket or Not To Docket*, *supra* note 97 ("[T]he Tax Court is under no obligation whatsoever to redirect the case to Appeals. The fact that it does so in nearly every instance is evidence of its great desire to get cases settled."). If the taxpayer pays an assessed deficiency and files a claim for refund that is either denied or not acted upon by the IRS within six months, the taxpayer may file a suit for refund in either the U.S. District Court or the U.S. Claims Court. Treas. Reg. § 601.103(c)(3) (2011).

108. Principally, the requirements consist of paying the assessed deficiency and filing a refund claim with the IRS first, since the District Court and Court of Claims are both refund jurisdictions only. *See* I.R.C. § 7422(a) (2006) ("No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof."); 28 U.S.C. § 1491 (2006) ("The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department . . . ."); 28 U.S.C. § 1346(a)(1) ("The district courts shall have original jurisdiction, concurrent with the United States Court of Federal Claims, of: (1) Any civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws.").

109. Lexis search conducted by the author (database on file with author).

110. ZVI DANIEL ALTMAN, DISPUTE RESOLUTION UNDER TAX TREATIES 5 (2006).

understanding of how the tax law works out in practice: when a tax dispute goes to trial, the public gains access to at least some of the facts, the issues, the arguments, and the reasoning of the various parties and decision makers. Access may also be had to the various inputs such as briefs, motions, and other accompanying documentation. Thus, judicial review is empirically observable: its imperfections can be studied and analyzed over time both by parties to the process, if they so wish, as well as by detached observers who have an interest in understanding or improving the adjudication process.[111]

Judicial review also creates precedent, which not only contributes to the body of law but also influences the frequency and scope of future cases. Judicial review of tax treaty disputes provides the only source of interpretation of international tax laws that is both accessible to the public and capable of claiming the status of legal authority.[112] Judicial review provides both legal interpretation and a basis for future strategic decision making by taxpayers, their advisors, and governments.[113]

Judicial review of tax treaty disputes is controversial since it involves a unilateral interpretation of a bilateral agreement. Much scholarly attention has been paid to outlining principles for tax treaty interpretation, and some scholars have paid express attention to the issues raised by resting interpretive power in domestic courts.[114] Interpretive problems have been attributed to the possibility that different

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111. Some of these principles are reminiscent of Lon Fuller's general principles for recognizing law in a society, or Richard Posner's views on the ability of common law to reach an efficient conclusion. More recently, Robert Howse explores the idea that "any legal system, if it is going to be effective, has to be able to evolve incrementally through practice." Robert Howse, *Moving the WTO Forward—One Case at a Time*, 42 CORNELL INT'L L.J. 223 (2009).

112. *See, e.g.*, RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 325(2) (1987) ("[S]ubsequent practice between the parties in the application of the agreement[] are to be taken into account in its interpretation.").

113. As one political scientist and former tax law practitioner explains it,

> Practitioner tax manuals stress the importance of relevant precedent. Favorable precedent makes litigation more likely, while unfavorable precedent would discourage challenging a post audit assessment. Thus, precedent acts as an influence on whether or not to sue the IRS and forum choice.
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> . . . [T]he more favorable the precedent is to the taxpayer, the greater likelihood litigants will sue the IRS. . . . The more favorable the precedent is to a particular forum, either the Tax Court or the District Court; the greater the likelihood litigants will choose that particular forum.

ROBERT M. HOWARD, GETTING A POOR RETURN: COURTS, JUSTICE, AND TAXES 35, 39–40 (2009).

114. *See* John F. Avery Jones, Charles J. Berg, Henri-Robert Depret, Maarten J. Ellis, Pierre Fontaneau, Raoul Lenz, Toshio Miyatake, Sidney I. Roberts, Claes Sandels, Jakob Strobl & David A. Ward, *The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model–I*, 1984 BRIT. TAX REV. 14; Russell K. Osgood, *Interpreting Tax Treaties in Canada, the United States, and the United Kingdom*, 17 CORNELL INT'L L.J. 255 (1984); Sidney I. Roberts, Great-West Life Assurance Company v. United States*: Exploration of the U.S. Interpretation of Treaties*, 30 CAN. TAX J. 759 (1982); Robert Thornton Smith, *Tax Treaty Interpretation by the Judiciary*, 49 TAX LAW. 845 (1996); John A. Townsend, *Tax Treaty Interpretation*, 55 TAX LAW. 219 (2001);

countries may take incompatible institutional approaches to tax law, to law in general, and to judicial interpretation;[115] that national courts will tend to advance their own political, social, or economic interests in the interpretation of treaties;[116] or that national courts are more interested in resolving disputes than enforcing the intent of the parties to the treaty.[117] Even within countries, different courts may take inconsistent positions with respect to the relevant sources of authority and the appropriate tools of interpretation.[118] Finally, there is no guarantee that the courts of one jurisdiction will treat the decisions of the courts of other jurisdictions as relevant, much less precedent-setting, even in the case of the same treaty.[119]

Despite the interpretive problems associated with the unilateral interpretation of tax treaties by the judiciary, judicial review is an important part of the development of international tax law. Together, domestic administrative and judicial review mechanisms create a foil against which to compare the alternative forms of tax dispute resolution provided by tax treaties. Because the ratio of judicial decisions to other forms of outcomes appears very low, these alternatives are equally, if not of greater, significance in the tax treaty interpretation analysis.[120]

Kenneth J. Vandevelde, *Treaty Interpretation from a Negotiator's Perspective*, 21 VAND. J. TRANSNAT'L L. 281 (1988).

115. *See* Smith, *supra* note 114, at 848; RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 325 reporters' note 4 (1987) ("Courts and administrative agencies in the United States frequently interpret international agreements. The courts seek to avoid giving to an international agreement a meaning in domestic law different from its international meaning. Nonetheless, in a science as inexact as the interpretation of agreements, differences will inevitably emerge. To some extent these are due to differences in the approaches to interpretation in different legal systems.").

116. *See* Smith, *supra* note 114, at 848.

117. *See* Vandevelde, *supra* note 114, at 282.

118. For instance, in the United States, the use of interpretive resources varies widely from case to case. Some courts reference Technical Explanations, OECD guidance, and domestic regulations issued under specific tax treaty authorizations, while others use documents from the congressional record and the text of other double tax conventions as a source of interpretation. *Compare*, Xilinx, Inc. v. Comm'r, 598 F.3d 1191 (9th Cir. 2010), Haver v Comm'r, 444 F.3d 656 (D.C. Cir. 2006), DHL Corp. v. Comm'r, 285 F.3d 1210 (9th Cir. 2002), Magimot v. Comm'r, No. 1590–08S, T.C. Summ. Op. 2009-183 (2009), Clayton v. United States, 33 Fed. Cl. 628 (1995), *and* Elmendorf v. Comm'r, 43 T.C.M. (CCH) 466 (1982) (each referencing only the text of the treaty and the Technical Explanation), *with* Barclays Bank PLC v. Franchise Tax Bd., 512 U.S. 298 (1994), Collins v. Comm'r, 3 F.3d 625 (2d Cir. 1993), Snap-On Tools, Inc v. United States, 26 Cl. Ct. 1045 (1992), Great-West Life Assurance Co. v. United States, 678 F.2d 180 (Ct. Cl. 1982), United States v. Vanderhorst 587 F. Supp. 29 (N.D. Ohio 1984), *and* Farina v. Comm'r, T.C. Summ. Op. 2009-23 (2009), *available at* http://www.ustaxcourt.gov/InOpHistoric/andrea.sum.WPD.pdf (each referencing only the text of the treaty and the congressional record).

119. *See, e.g.*, United States v. A.L. Burbank & Co., 525 F.2d 9, 15 (2d Cir. 1975) (stating that the Canadian interpretation of U.S.-Canada tax treaty is not determinative in U.S. court). The same is true for administrative interpretations. *See, e.g.*, Johansson v. United States, 336 F.2d 809, 812 (5th Cir. 1964) (stating that the interpretation of terms in Switzerland-U.S. tax treaty by Swiss tax authorities is not binding on U.S. courts).

120. For example, while there are fewer than 200 U.S. court decisions involving tax treaty interpretation, several hundred matters are submitted for resolution under the treaty-authorized mutual agreement procedure discussed *infra* Part II.C; the number of

C. Let Diplomats Work It Out

The first and most used treaty-based form of international tax dispute resolution is the "mutual agreement procedure" (MAP).[121] Mutual agreement is a century-old diplomatic solution, a standard form of the informal diplomatic dispute resolution language that is used in most of the world's treaties.[122] The tax treaty MAP came into being in the early days of tax treaty history and has become the industry standard through the Model Tax Convention promulgated by the OECD.[123]

The MAP generally allows a taxpayer who is aggrieved by an apparent misapplication of a tax treaty by one of the treaty signatory countries to request a designated bureaucrat—the competent authority—to engage in efforts to resolve the problem directly with the counterparty's designated competent authority.[124] If the competent authority determines that the taxpayer's request is appropriate, the competent authority will directly consult with its foreign counterpart with a view toward finding an equitable solution.[125] A taxpayer may also request the competent authority to consider an issue simultaneously with domestic appeals processes in certain circumstances.[126]

The product of competent authority resolution may take one of two forms: a taxpayer-specific competent authority agreement or a non-taxpayer-specific, generalized competent authority agreement. The former is an agreed-upon decision on an individual case; the latter is a generalized statement, typically characterized as procedural, and is meant to "clarify or interpret treaty provisions."[127] The former consists of unpublished agreements that are applied only to the individual taxpayers in resolution of their cases, while the latter results in public documents meant to be relied upon by other taxpayers.[128] Finally, generalized competent authority agreements comprise a tiny minority of all competent authority agreements; the United States currently has just thirty-three published agreements with just fourteen countries.[129]

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administrative appeals is unknown but likely also comparatively substantial.

121. The standard U.S. MAP provision is found in the U.S. Model, *supra* note 10, art. 25, and the OECD Model, *supra* note 10, art. 25.

122. Virtually all treaties include a provision for informal diplomatic consultation as the primary method of dispute resolution. *See* Koremenos, *supra* note 57, at 201 tbl.1.

123. *See* Christians, *supra* note 88 (discussing the origins and role of the OECD Model).

124. The United States has designated the Secretary of the Treasury as the U.S. Competent Authority, and the Secretary currently delegates this authority to the IRS Deputy Commissioner (International), Large and Mid-Size Business Division. I.R.S. Deleg. Order 4-12 (Rev. 13), IRM 1.2.43.13 (July 1, 2010).

125. U.S. Model, *supra* note 10, art. 25; OECD Model, *supra* note 10, art. 25 ("The competent authority shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State . . . .").

126. Rev. Proc. 96-13, 1996-3 I.R.B. 31.

127. *Competent Authority Agreements*, IRS, http://www.irs.gov/businesses/small/international/article/0,,id=137376,00.html (last updated Feb. 15, 2011).

128. The IRS publishes these in the Internal Revenue Bulletin and posts them on its website. *Internal Revenue Bulletin*, IRS, http://www.irs.gov/irb/.

129. *Competent Authority Agreements*, *supra* note 127.

In contrast to the publicly available but comparatively rare generalized competent authority agreements, the U.S. competent authority reviews and resolves several hundred individual cases that culminate in several hundred unpublished taxpayer-specific competent authority agreements each year. The U.S. competent authority received a total of 1422 new cases from 2007 to 2011. [130] In 2011, the U.S. competent authority received 279 new MAP requests and at the end of the year, it had a backlog of 686 unresolved MAP cases pending.[131] This appears to be a large caseload—certainly compared to the international tax cases handled by the U.S. judiciary—and it is growing exponentially.[132] Globally, the competent authority caseload is in the thousands each year.[133]

Most of the cases resolved by competent authorities involve contestations over the application of the arm's length transfer pricing standard.[134] Of the cases received by the U.S. competent authority in 2009, 48% were transfer pricing cases, up from 39% of the cases in 2008 but down from a five-year high of 52% in 2005.[135] The IRS has a closing inventory of 329 as yet unresolved MAP-initiated transfer pricing disputes on the docket and an additional 395 MAP-initiated disputes on issues other than transfer pricing.[136] Many of these include "advance pricing agreements," which are ex-ante transfer pricing agreements with individual taxpayers that are meant to foreclose the possibility of future disputes.[137]

The competent authority process is a significant body of decision making on arguably the most important matters of international tax policy and practice. On the basis of transfer pricing disputes alone, the competent authority is a key force in the allocation of global wealth. Perhaps due to their pivotal role, the expertise of the competent authorities—not only in respect of subject matter but also with regard to geographic specialization—is viewed as "extremely valuable."[138]

Given the volume and importance of this caseload, it was perhaps inevitable that at some point, access to taxpayer-specific competent authority agreements would be sought. *Tax Analysts*, a U.S. publisher of tax news and reports, initiated a FOIA

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130. U.S. MAP STATISTICS, *supra* note 61, at tbl.1. On average, between 2007 and 2011, 284 new cases were received by the U.S. competent authority each year. *Id.* Most MAP requests are to resolve transfer pricing disputes, but MAP is also invoked to resolve other disputes, such as where the taxpayer should be considered to be a resident or where an income item should be sourced. *Id.*

131. *Id.*

132. As there are no statistics on the international tax dispute cases handled through IRS appeals, a comparison cannot easily be made between competent authority and domestic administrative review in this regard.

133. While worldwide statistics are not available, the OECD collects basic MAP statistics from its member (and some non-member) countries. *See* OECD MAP Statistics (2010), *supra* note 61. In 2009, OECD countries reported receiving a total of 1599 new competent authority requests. *Id.* At the end of 2009, OECD countries reported a collective inventory of 3413 pending cases. OECD MAP Statistics (2010), *supra* note 61.

134. *See supra* note 61.

135. Author's calculations based on data provided in U.S. MAP STATISTICS, *supra* note 61.

136. *Id.* §§ 1, 4.

137. *See supra* note 89 and accompanying text.

138. *See, e.g.*, Chung & McAlonan, *supra* note 76, at 257.

request in 2000 to compel the IRS to release these documents.[139] The IRS did not respond to *Tax Analysts*' request, but almost immediately thereafter, Congress passed a new statute ensuring the confidentiality of all competent authority requests, procedures, and outcomes and effectively preventing the *Tax Analysts* request from going forward.[140] In explaining the adoption of this statute, the House Report stated that "[i]t is the understanding of the conferees that competent authority agreements (also referred to as mutual agreements) generally do not contain an explanation of the law or application of law to facts. Instead, such agreements are negotiated arrangements to resolve issues of double taxation."[141] As such, Congress determined that these agreements were exempt from FOIA under one of the nine enumerated exemptions, and the enactment of a new tax statute was intended to confirm that exemption.[142]

Because of these protections, and in contrast to judicial review, the MAP process defies empirical observation of the tax law as it is implemented in practice. The competent authority process is obscure, not well understood, unaccountable to those other than the competent authorities themselves, and rife with administrative and procedural issues.[143] Because of all of these features, it is also resistant to study. Tax law administered through the competent authority can only be understood if the decision maker releases comprehensive guidance or statistics.[144] To date, these administrators have chosen to share very little.[145]

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139. 106 CONG. REC. 26,993 (2000) ("A publisher of tax related material and commentary has made a FOIA request for the disclosure of competent authority agreements. The request has been pending since March 14, 2000. The IRS has not denied the request, nor has it produced any documents responsive to the request. At this time, no suit has been filed to compel disclosure of these documents, although such a suit may be brought in the future."); *see also id.* at 26,993 n.45 ("The initial FOIA request of March 14, 2000, covered all competent authority agreements executed for the United States from January 1, 1990, to date. In response to a request from the Department of Treasury, by letter dated April 17, 2000, the FOIA request was narrowed to cover competent authority agreements executed between 1997 and 1999. The right to pursue the 1990 through 1996 agreements, however, was reserved.").

140. I.R.C. § 6105.

141. 106 CONG. REC. 26,994. The conundrum for international tax law is that since there is no judicial or other review of competent authority decision making, there is no possibility for testing the basic assumption that these agreements refrain from explaining law or applying law to facts.

142. *See id.* at 26,993 ("In general, the FOIA provides that any person has a right of access to Federal agency records, except to the extent that such records (or portions thereof) are protected from disclosure by one of nine exemptions or by one of three special law enforcement record exclusions. Exemption 3 of the FOIA allows the withholding of information prohibited from disclosure by another statute if certain requirements are met." (citation omitted)).

143. *See, e.g.*, Chung & McAlonan, *supra* note 76, at 263.

144. This problem, inherent to agency review in general, drives the production of guidance in the domestic context. An interview with an IRS appeals team manager revealed the importance of and emphasis on creating taxpayer guidance from matters that are resolved through internal appeals. Specifically, the team manager described the preparation and pending release of appeals settlement guidelines (ASG), stating that "once we get that guidance out, at least they will know what appeal's position will be, in terms of what we

The result is that thousands of tax issues will be resolved without creating any additional certainty for taxpayers, their advisors, or even future administrators.[146] The reason articulated for protecting the confidentiality of competent authority agreements is that these are closing agreements, equivalent to the product of successfully negotiated appeals under the domestic administrative process. However, the argument has not been conclusively made why the competent authority process, if it can indeed be compared to any domestic process at all, should be compared to appeals instead of judicial review, or for that matter, other forms of IRS private guidance that are made publicly available while preserving the necessary confidentiality.

For example, the role of the competent authority agreements in contributing to the evolutionary development of international tax law may be compared to the role of private letter rulings (PLRs) in tax practice before their publication was compelled by the FOIA.[147] At that time, it would not have been unusual for a junior associate in a law firm's tax group to hear that certain advice was being considered for the appropriate tax treatment of a transaction or activity using—as guidance—a PLR that had been obtained either by a partner in the firm or by a friend or colleague of a partner in another firm, in connection with a client matter.[148] Outside of this circle, the IRS position was unknown, but within, the insiders had some knowledge of how the IRS was likely to decide on an issue, despite repeated admonitions that such rulings were not to be relied upon as precedent.[149]

Precedent or not, private letter rulings provided taxpayers guidance on what to expect from the IRS, and they were used as such in firm practice.[150] Now that PLRs

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think is a reasonable resolution [of valuation in transfer pricing cases]. . . . An ASG is the appeals position, where we promote for consistency purposes. Our consistency is a major element of what we try to employ for service within appeals. We have a responsibility to work these issues out and develop a formalized response. This is strictly an administrative remedy, providing a taxpayer information as to what our counsel would likely be, as to the government's position, this is what appeals is going to do with these issues when you bring them our way. . . . As to the guidelines themselves, some are redacted, but we take great pride in maintaining transparency. . . . So we try to make sure the ASG is as transparent as we can make it." Interview with Anonymous IRS Appeals Team Manager, *supra* note 97. The problem articulated in this domestic paradigm is of course compounded internationally, where there is no structure for independent judicial review of agency actions.

145. Canada's Revenue Agency has disclosed relatively more information in annual MAP Reports, but this is still in a broad overview format. For the most recent report, see CANADA REVENUE AGENCY, MUTUAL AGREEMENT PROCEDURE: PROGRAM REPORT 2010–2011, *available at* http://www.cra-arc.gc.ca/tx/nnrsdnts/cmp/mp_rprt_2010-2011-eng.pdf.

146. Presumably there are internal memoranda that create institutional memory, which may be passed along to future competent authorities.

147. *See supra* note 96 and accompanying text.

148. This experience is offered as an anecdote from the practice of the author, and has been confirmed as familiar through conversations with other practicing attorneys both in the United States and internationally.

149. *See* I.R.C. § 6110(k)(3) (2006) (a private ruling "may not be used or cited as precedent"); Goodstein v. Comm'r, 267 F.2d 127, 132 (1st Cir. 1959) (IRS commissioners may ignore a ruling issued to another taxpayer on which the present taxpayer relied).

150. Putting the taxpayer on notice of the IRS's likely position is typically viewed as a positive contribution to the development of law. *See, e.g.*, Interview with Anonymous IRS

are published, even with identifying and sensitive information redacted pursuant to statutory requirements,[151] all taxpayers have the benefit of knowing to some degree—and more importantly, to roughly the *same* degree—how the IRS, as a key implementer of the law, is likely to respond to given sets of facts and circumstances. With the competent authority becoming an increasingly important decision maker in matters of international tax law, the same difference in access is likely occurring currently as did in the pre-publication days for PLRs.

Instead of seeking greater public access, however, the trend in international tax dispute resolution seems to be going in the opposite direction. This is mainly owing to the introduction of third-party delegation in tax treaties, which is referred to as arbitration even though it appears in practice to constitute a process that is more like expert determination.

D. Let Experts Tell the Diplomats What To Do

Arbitration is a relatively new twist to the relatively old way of doing things through MAP, but it is a popular alternative form of dispute resolution in other international agreements, especially those concerned with economic matters.[152] Even so, arbitration under tax treaties features marked differences from general practice in terms of the goals it seeks to achieve, in its design, and in its implementation. These differences combine to produce the most important difference between international tax arbitration and other forms of international arbitration: the international tax arbitration process is designed to be completely inaccessible to the public. In other words, international tax arbitration is intentionally designed not to produce international tax law.

1. Why Arbitrate?

Arbitration in tax treaties is perhaps most distinguished from international arbitration in general in that it is ostensibly intended primarily to put pressure on existing forms of dispute resolution, rather than to provide a usable alternative form of resolution. Arbitration was introduced to international tax practice in response to complaints about the MAP process.[153] For example, commentators suggested that the MAP process takes too long to resolve cases and can fail to produce results since the competent authorities are only obliged to attempt to reach agreement—there is no penalty should they fail in that endeavor. Arbitration was promoted as a means of imposing such a penalty.

Thus international tax arbitration is claimed by its designers to be a threat rather than a promise. Its intended role is as a stick to compel competent authorities to

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Appeals Team Manager, *supra* note 97.

151. *See* I.R.C. § 6110.

152. Seventy-five percent of international economic agreements contain arbitration provisions, a high ratio compared to environmental, human rights, and security agreements, of which just 20 to 27% of treaties contain such provisions. Koremenos, *supra* note 57, at 201 tbl.1.

153. *See generally* GUSTAF LINDENCRONA & NILS MATTSSON, ARBITRATION IN TAXATION (1981); MARIO ZUGER, ARBITRATION UNDER TAX TREATIES (2001).

come to agreement reasonably and in a timely manner.[154] The prospect of arbitration is meant to "keep governments honest" in their competent authority dealings with each other.[155] The role of arbitration in international taxation is thus not to independently resolve tax disputes but rather to act as a means of forcing recalcitrant competent authorities to resolve these disputes themselves. This may seem like an odd reason to set up the kind of institutional infrastructure that will be needed to actually implement the arbitration provided for in tax treaties.

The fact that the necessary institutional infrastructure is indeed currently being assembled belies arbitration's intended role as enforcer of the current status quo. Governments do not typically create dispute resolution procedures that they will not use.[156] It should not be surprising that despite assurances that arbitration is a method of last recourse that will be used rarely, if at all, in international tax, countries are in fact gearing up by creating procedures and assembling lists of arbiters.[157] The urgency of having the "right" arbitrators does not seem to be lost on international tax practice: the assembling of experts suggests that governments expect arbitration to arise and do not want to be strategically unprepared when the time comes.[158] Moreover, the OECD has suggested that arbitration will yield cases

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154. For this reason, international tax arbitration is repeatedly referred to as a "supplement," "extension," or "enhancement" of the MAP process. *See What Is a Mutual Agreement Procedure?*, OECD, http://www.oecd.org/document/51/0,3343,en_2649_33753_36158963_1_1_1_1,00.html; ORGANIZATION FOR ECONOMIC CO-OPERATION & DEVELOPMENT, *Commentary on Article 25*, *in* MODEL TAX CONVENTION ON INCOME AND ON CAPITAL: CONDENSED VERSION, 354, 371 (2010) [hereinafter OECD MODEL COMMENTARY] (describing arbitration as "an extension of the mutual agreement procedure that serves to enhance the effectiveness of that procedure by ensuring that where the competent authorities cannot reach an agreement on one or more issues that prevent the resolution of a case, a resolution of the case will still be possible . . .").

155. Telephone Interview with Anonymous Former U.S. Competent Authority (May 31, 2007) (notes on file with the author).

156. *See* Koremenos, *supra* note 57, at 192 ("[S]tates and other international actors shape institutions to solve the specific problems they face.").

157. *See* Memorandum of Understanding Between the Competent Authorities of Canada and the United States of America [hereinafter Canada-U.S. Arbitration MOU], *available at* http://www.irs.gov/pub/irs-utl/2010_arbitration_mou_nov_8-10_-_final.pdf (outlining the procedures to be used in arbitration disputes arising under the Canada-U.S. tax convention); *Resolving Canada-U.S. Double Tax Disputes Through Arbitration—New Guidance*, KPMG, (Dec. 1, 2010), http://www.kpmg.com/ca/en/IssuesAndInsights/ArticlesPublications/TNF/Pages/tnfc201038.htm ("The Canada Revenue Agency (CRA) and Internal Revenue Service (IRS) recently released details on the new procedure to be followed by the Canadian and U.S. competent authorities for cases proceeding to arbitration under the Canada-U.S. tax treaty. The first wave of double taxation cases that have recourse under the procedure will become eligible for it on December 15, 2010. The newly issued details, released in the form of a memorandum of understanding (MOU) and a set of operating guidelines, offer the first comprehensive guidance to taxpayers on how the procedure will be implemented.").

158. The selection of arbiters is typically seen as pivotal in shaping the outcome of arbitration. *See, e.g.*, Susan D. Franck, *Development and Outcomes of Investment Treaty Arbitration*, 50 HARV. INT'L L.J. 435, 448 (2009) ("Arbitrator selection is a critical aspect of investment treaty arbitration."); William W. Park, *Arbitrator Integrity: The Transient and the Permanent*, 46 SAN DIEGO L. REV. 629, 632 n.4 (2009) ("[J]ust as 'location, location,

and—more importantly—"experience."[159] The OECD has not explained how even repeated arbitration proceedings can reasonably turn into guidance and experience for the field when the entire process and all arbitration outcomes will be confidential. It is clear that the arbitration process is likely to increase in use and importance going forward, despite all assurances regarding its minor, supporting role. Yet, it is this envisioned role that has driven the design of international tax arbitration to date.

2. International Tax Arbitration: Not Much Like Arbitration.

In its ostensibly supportive role, international tax arbitration is accordingly characterized by a number of unconventional features. The first of these is the process for initiating arbitration, which rests power to compel state action in the hands of individual taxpayers. In most international disputes governed through arbitration, one of the two parties to the dispute may compel the other party to arbitrate, but in international taxation, it is the taxpayer, a nonparty to the dispute, who is empowered to compel the parties to arbitrate.[160] Specifically, when taxpayers have initiated competent authority assistance and the competent authorities have failed to agree within a two-year period, the taxpayer has the right to compel the competent authorities to submit unresolved issues to arbitration.[161] Having been compelled to arbitrate, the competent authorities must agree upon the scope and content of unresolved issues to be arbitrated.[162]

The design of arbitration tribunals is also much less structured in the case of international tax disputes, as compared to other international disputes. The OECD Model is not explicit about the arbitration process, leaving the matter open to bilateral negotiation. However, the Commentary to the OECD Model makes clear that what is currently contemplated involves ad hoc arbitration tribunals composed of private sector professionals (tax lawyers, accountants, and perhaps economists) whose job will consist of making determinations with respect to specific issues

location' comprise the three key elements in sustainable real estate value, so it has been observed that 'arbitrator, arbitrator, arbitrator' endure as the most critical factors in the integrity of any arbitration.").

159. *What Is a Mutual Agreement Procedure?*, *supra* note 154 ("[S]ince these procedures are new, there has been limited guidance and experience in their use . . . . This lack of experience may change in the near future if more cases line up for arbitration and the OECD considers changes to the OECD Model Tax Convention to update guidance on supplementary dispute resolution mechanisms for MAP.").

160. For a discussion of arbitration processes in international tax law, see McIntyre, *supra* note 84.

161. OECD Model, *supra* note 10, art. 25(5) ("Where . . . a person has presented a case to the competent authority . . . and . . . the competent authorities are unable to reach an agreement to resolve that case . . . within two years from the presentation of the case . . . any unresolved issues arising from the case shall be submitted to arbitration if the person so requests.").

162. OECD MODEL COMMENTARY, *supra* note 154, at 371 ("This process is not dependent on a prior authorization by the competent authorities: once the requisite procedural requirements have been met, the unresolved issues that prevent the conclusion of a mutual agreement must be submitted to arbitration.").

submitted to them by the parties.[163] These arbiters will be chosen by internal government processes and will be paid by the parties to the arbitration (i.e., the governments, not the taxpayers).[164]

The intended outcome of arbitration also appears dissimilar from other international contexts in that decisions are meant to be binding on the parties but not the taxpayer—should the taxpayer disagree with the arbitration panel's result, he or she may reject it and turn to other available remedies.[165] This design appears to serve at least two goals: first, to preserve the main dispute resolution function within the competent authority process, and second, to preserve the taxpayer's right to pursue domestic remedies, as guaranteed by treaty. The OECD thus contemplates a flow of decision making that starts and ends with the competent authorities, with arbitration on specific issues only.[166]

This makes international tax "arbitration" look more like expert determination than alternative dispute resolution.[167] The arbitration tribunal is meant to return decisions to the competent authorities, who are to "reflect" these decisions in their MAP-initiated agreements.[168] These decisions are intended only to bind the

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163. *Id.* ("[T]he resolution of the case continues to be reached through the mutual agreement procedure, whilst the resolution of a particular issue which is preventing agreement in the case is handled through an arbitration process. This distinguishes the process established in [applicable tax treaty provisions] from other forms of commercial or government-private party arbitration where the jurisdiction of the arbitral panel extends to resolving the whole case.").

164. Canada-U.S. Arbitration MOU, *supra* note 157, at para. 15 ("The fees and expenses will be borne equally by the competent authorities. Neither competent authority will charge a taxpayer for costs associated with arbitration.").

165. OECD Model, *supra* note 10, art. 25(5) ("Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States.").

166. OECD MODEL COMMENTARY, *supra* note 154, at 377 ("The arbitration decision is only binding with respect to the specific issues submitted to arbitration.").

167. *See* S. Isabella Chung, *Developing a Documentary Credit Dispute Resolution System: An ICC Perspective*, 19 FORDHAM INT'L L.J. 1349, 1378 (1996) (The "defining characteristic" of expert determination "is that of a neutral expert rendering an opinion based upon documentary submissions," rather than of mediation per se.); Susan D. Franck, *The Role of International Arbitrators*, 12 ILSA J. INT'L & COMP. L. 499, 503 (2006) ("If parties wish to have a decision-maker who is an expert in a particular industry who exercises commercial judgment but does not engage in legal analysis, they might avoid arbitration entirely and instead choose expert determination."); Loukas A. Mistelis, *ADR in England and Wales*, 12 AM. REV. INT'L ARB. 167, 202–04 (2001) (describing the nature of expert determination as a form of dispute resolution); *What Is Expert Determination?*, WIPO.INT, http://www.wipo.int/amc/en/expert-determination/what-is-exp.html ("Expert determination is a procedure in which a dispute or a difference between the parties is submitted, by agreement of the parties, to one [or more] experts who make a determination on the matter referred to it [them]. The determination is binding, unless the parties agreed otherwise."). Typically, expert determination, like arbitration in general, is pursued only upon the consent of both parties to the arbitration. *See id.* ("Expert determination under the WIPO Expert Determination Rules can only take place if both parties have agreed to it.").

168. OECD MODEL COMMENTARY, *supra* note 154, at 376 ("[T]he decisions reached in

competent authorities with respect to the specific case at hand, and the OECD suggests that while nothing can prevent competent authorities from using past arbitration decisions in future competent authority negotiations, neither does anything compel such use.[169]

Finally, the strict confidentiality intended for tax arbitration is in sharp contrast to arbitration in other fields, which have confidentiality safeguards in place but which also yield to some amount of study.[170] For example, a "Top 50" listing of international arbitration cases is readily available online, including names of the parties, amounts in dispute, and some amount of facts and reasoning regarding the dispute.[171] Of course, none of these is a tax arbitration case. According to one former competent authority, confidentiality is the key to successful use of arbitration: "If you are going to publish decisions, this is a deal killer."[172] Thus, if the design of tax arbitration as laid out by the OECD is to be followed, it appears that information involving tax treaty disputes will never be open to public scrutiny.[173]

An alternative possibility is that the parties to international tax arbitration will selectively make available various amounts of information from their cases. This could happen if other countries do not accept the U.S. Congress's view on the confidentiality of competent authority agreements. Similarly, other countries might have different interpretations of what is required in terms of confidentiality in arbitration. In addition, perhaps some arbitrators themselves, or other contributors to the process, such as expert witnesses, might release information, either advertently or inadvertently. In the WTO context, this appears to have been a

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the arbitral process will be reflected in the mutual agreement that will be presented to [the taxpayer]."). It is perhaps for this reason that technical tax expertise of arbiters, rather than their experience in judging or arbitration, is of major focus of the potential parties to arbitration. *See* Canada-U.S. Arbitration MOU, *supra* note 157, at para. 6 ("The competent authorities will appoint members who have significant international tax experience. They need not, however, have experience as either a judge or an arbitrator.").

169. OECD MODEL COMMENTARY, *supra* note 154, at 377 ("Whilst nothing would prevent the competent authorities from solving other similar cases (including cases involving the same persons but different taxable periods) on the basis of the decision, there is no obligation to do so and each State therefore has the right to adopt a different approach to deal with these other cases.").

170. *See* McIntyre, *supra* note 84 at 632.

171. *Arbitration Scorecard 2007: Top 50 Treaty Disputes*, LAWJOBS.COM, http://www.lawjobs.com/newsandviews/LawArticleFriendly.jsp?id=900005555705&slreturn=1.

172. Telephone Interview with Anonymous Former U.S. Competent Authority, *supra* note 155.

173. A website called *Tax-arbitration.com* is illustrative: it contains long lists of arbitration decisions involving tax-related investment agreement disputes and tax-related WTO disputes, as well as space for including "tax treaty arbitration" and "EC/EU tax law arbitration." For both of the latter, the site is "not yet available." That appears to be contemplated as a permanent state for tax treaty dispute resolution under the current status quo. If so, it seems also likely that future tax-related disputes will no longer find their way through bilateral investment agreements or WTO provisions, as taxpayers seek to benefit from the private gains accorded by confidentiality. *Cases*, TAX-ARBITRATION.COM, http://tax-arbitration.com/page13.php.

relatively common practice.[174] In time, we may have some kind of body of tax arbitration cases to review, yet it is likely to be unsystematic to a large degree, and the possibility exists that some taxpayers might find it useful to disclose information in an opportunistic way. Experience with tax arbitration will bring these potential benefits and drawbacks to light.

It may be that, as promised, the threat of arbitration will speed up dispute resolution under the MAP process. But it is equally plausible to anticipate that, with the same amount or possibly even less precedent than that offered by the competent authority process, taxpayers will feel the same or even less certain about their tax positions with arbitration as a possible means of dispute resolution. There are also additional costs to be considered in establishing arbitration as an institutional matter. The arbitration process compounds the administrative review process with a cost that will be borne by the taxpaying public and not the taxpayer whose issue created the dispute.[175] The competent authority resolution efforts will be duplicated by private arbitrators, multiplying the costs.[176] Since the taxpayer can reject the arbiter's decision, the extra cost incurred could be wasted.[177] But the most challenging aspect seems to be the elimination of the possibility for public access to the law as it develops through competent authority cases, ensuring further duplication of effort by future decision makers. In short, the problems raised by arbitration are both troubling in and of themselves and a reminder that the "old" way of diplomatic resolution through the MAP process is itself still a process involving many unanswered questions.

III. SOFT LAW'S CUSHIONING ROLE

It is in the midst of all of this mostly nonlaw dispute resolution that soft law emerges as a central player in the development of international tax law. Soft law has claimed this place because both hard law and nonlaw are imperfect alternatives for developing international law.[178] Soft law mediates between the need for more legal certainty, which is served imperfectly by hard law decision making through

174. *See* Howse, *supra* note 111 (stating that though the rule is confidentiality, parties to WTO disputes are voluntarily posting pleadings online and agreeing in some cases to have oral testimony written up online).

175. Using arbitration in other contexts as a guide, tax arbitration is likely to be potentially very beneficial for the private sector that has consistently promoted it over several decades. These include pecuniary benefits such as consulting and advocacy fees, but it also includes less quantifiable yet likely no less valuable intangible benefits, such as professional prestige—benefits which already play out in the form of participation in international norm creation through such institutions as the International Fiscal Association. *See* Christians, *supra* note 26.

176. The International Chamber of Commerce, which describes itself as "the voice of world business championing the global economy as a force for economic growth, job creation and prosperity," is also the current situs of major international arbitration conventions and institutions, and this industry is likely to expand ever further if tax treaty arbitration in fact takes place. *What Is ICC?*, ICCWBO.ORG, http://www.iccwbo.org/id93/index.html.

177. *See* McIntyre, *supra* note 84.

178. *See generally* KOMESAR, *supra* note 16.

judicial review, and the desire for confidentiality in tax matters, which is imperfectly served through the production of nonlaw through administrative and competent authority resolutions.

The goal of soft law is to attempt to serve both needs by creating a space for international tax law to emerge more abstractly, without too much detail about the specific disputes as they arise, and without binding rulemaking. But soft law also creates many barriers to understanding the development and outcome of tax law, since the development of soft law itself unfolds through institutional choices. Soft law is thus another imperfect alternative to the hard and nonlaw of international taxation, and one that is historically understudied. In order to understand the institutional costs and benefits of using soft law as an alternative to hard law and nonlaw, the goals and limitations of hard law and nonlaw must be compared.

A. The Problem with Hard Law

Hard law through judicial review can provide the most detailed information about the allocation of profits among countries because it unfolds in a public process. This is so even if the case settles prior to culmination in a written determination, such as in the dispute between GlaxoSmithKline, a U.K.-based multinational company, and the U.S. IRS.[179] Prior to the settlement, the parties filed briefs and motions with the Tax Court that provide a detailed account of the tax dispute in the case.[180] These documents include information that identifies the taxpayer's business structure and locations, amounts in dispute, details of the reason for the dispute, details about the taxpayer's industry and market issues, details about Glaxo's transfer pricing methodology, and arguments of each party in favor of their substantive legal and procedural positions in the case.[181]

Access to cases like *Glaxo* provides rich material for undertaking an analysis of transfer pricing as a legal regime and drawing conclusions about the evolving status of the law.[182] Instead of being limited to a review of the abstract rules found in statutes and regulations, the case allows observers a glimpse into a concrete application of law by taxpayers and governments. From the case, commentators observed several problematic issues of international interpretation and implementation of agreed-upon standards, identified major issues faced by multinational companies, and found evidence of "a wider trend in transfer pricing

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179. *See* I.R.S. News Release IR-2006-142, *supra* note 61.

180. *See GlaxoSmithKline Holdings Petitions Tax Court on Transfer Pricing Issues*, 2004 Tax Notes Today 67-14 (April 7, 2004) (available through Lexis by searching for the citation "2004 TNT 67-14") (petition for redetermination of deficiency); *IRS Files Answer in GlaxoSmithKline Suit*, 2004 Tax Notes Today 107-10 (May 28, 2004), (available through Lexis by searching for the citation "2004 TNT 107-10") (IRS answer to Glaxo petition); *Government Files Position Supporting Its Position on APAs* (available through Lexis by searching for the citation "2005 TNT 65-57") (brief filed by the IRS in support of motion to deny summary judgment requested by Glaxo).

181. *See* sources cited *supra* note 180.

182. *See* Pim Fris & Sébastien Gonnet, *A European View on Transfer Pricing After Glaxo*, TAX PLANNING INT'L, Nov. 2006, at 2 (noting in particular that its analysis was undertaken on the basis of "publicly available information only").

in the U.S. practice."[183] The *Glaxo* case may or may not be representative of transfer pricing disputes or applicable more broadly to the field of international tax law.[184] Yet a series of cases with *Glaxo*'s amount of public detail would go further in providing more bases for conclusions.

Despite (or perhaps because of) the glimpse it provides into how individual taxpayers and governments develop international tax law through practice, judicial review is the least-used method of international tax dispute resolution.[185] There may be a number of reasons for this choice. The very public nature of judicial review itself may be a primary reason; the interpretive issues of unilateral judicial review may be another. In addition, taxpayers may seek an alternative to both domestic administrative and judicial review if they believe that domestic administrators and judges are bound to legal interpretation and cannot go beyond the terms of domestic or treaty law to find a resolution; moreover, these decision makers will be unable to resolve a treaty dispute if resolution requires cooperative action by both governments.[186] Administrative alternatives, especially those created by treaty, may offer more flexibility and a broader power, for example by expressly authorizing "the elimination of double taxation in cases not provided for" by law.[187]

For any of these or other reasons, taxpayers have sought methods other than judicial review to resolve international tax disputes, and governments have responded with several alternatives. For observers of tax law, however, these

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183. *Id.* at 8.

184. *See id.* at 5 ("Like many other transfer pricing disputes, the Glaxo case is very representative of the misunderstandings between taxpayers and tax administrations in relation to the interpretations and perceptions about value creation within a firm.").

185. Other dispute resolution alternatives comprise the vast majority of international tax disputes, with case law playing a significant yet relatively more restricted role. This is probably typical for international disputes in general. *See* BRAITHWAITE & DRAHOS, *supra* note 14, at 184 (noting that most GATT disputes are settled between the parties, but even so, far more cases are disposed of through GATT dispute resolution processes than through courts).

186. This happens regularly in cases involving disputes over transfer pricing, where an adjustment made by one country will often require a correlative adjustment by another in order to prevent double taxation. *See, e.g.*, Chung & McAlonan, *supra* note 76, at 258.

187. U.S. Model, *supra* note 10, art. 25(3). In addition, some remedies may be closed to taxpayers unless they seek competent authority review when it is available. For instance, the United States prohibits the availability of tax credits unless the taxpayer "exhausts all effective and practical remedies, including invocation of competent authority procedures available under applicable tax treaties, to reduce, over time, the taxpayer's liability for foreign tax (including liability pursuant to a foreign tax audit adjustment)." Treas. Reg. § 1.901-2(e)(5)(i) (2004). Moreover, the taxpayer may be denied competent authority assistance if the taxpayer previously engaged in self-help. Rev. Proc. 2006-54, §12(6), 2006-2 C.B. 1035, 1046 (stating that U.S. competent authority will deny assistance if the taxpayer "was found to have acquiesced in a foreign initiated adjustment that involved significant legal or factual issues that otherwise would be properly handled through the competent authority process and then unilaterally made a corresponding correlative adjustment or claimed an increased foreign tax credit, without initially seeking U.S. competent authority assistance").

alternatives are much less satisfying than judicial review because they typically result in the resolution of cases without law.

B. The Problem with Nonlaw

In contrast to the detailed record created through the judicial review process, all other forms of international tax dispute resolution processes are confidential and result in outcomes that are not publicized.[188] This means that for most of the decisions made in international tax, there is no way to observe the issues that arose, the amounts in controversy, the reasoning of the parties, or even the identity of the disputing taxpayers. The obscurity of this institutional structure precludes observation of the day-to-day allocation of global wealth through taxation. The question for international tax policy is what goals are served by all of this obscurity.

The primary goal for dispute resolution through processes that yield nonbinding and nonaccessible outcomes appears to be taxpayer confidentiality. Taxpayer confidentiality is a tenet of income taxation both in the United States and in other countries.[189] Ironically, the protection of taxpayer confidentiality, so important in U.S. tax policy, has become a major subject of global contestation, as countries try to impose some restrictions on how helpful nations can be in protecting taxpayers from disclosure of their financial, and therefore tax-relevant, matters.[190] Even so, when it comes to dispute resolution, protecting taxpayer confidentiality continues to be articulated as of utmost importance. [191]

A secondary, if unstated, goal that drives the institutional preference for nonlaw outcomes in international tax disputes is likely policy flexibility. That is, governments theoretically seek to cooperate in the important task of allocating income across competing jurisdictions, but they may also prioritize their autonomy in exercising their jurisdiction to the exclusion of other countries where possible.[192]

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188. The minor exception is generalized competent authority agreements, which are published by the IRS. *See Competent Authority Agreements*, *supra* note 127.

189. *See* COMMITTEE OF PUBLIC ACCOUNTS, *supra* note 7.

190. This creates the paradox of a world in which taxpayer confidentiality is of utmost importance except when it is not, that is, when confidentiality impedes the exercise by some countries of their claimed tax jurisdiction. *See* Christians, *supra* note 49 (discussing the theoretical and philosophical problems caused by countries that have traditionally claimed sovereign autonomy over the right to tax when faced with "tax havens" that have decided, often through democratic political processes, to protect individuals from the tax jurisdictions of their own home countries).

191. *See* Telephone Interview with Anonymous Former U.S. Competent Authority, *supra* note 155; COMMITTEE OF PUBLIC ACCOUNTS, *supra* note 7 (discussing the inability of the U.K. Parliament to obtain information about the outcomes of tax disputes from the U.K. Department of Revenue because the latter "has a legal duty not to disclose taxpayer details, except in certain limited circumstances. This applies to all taxpayers, whether they are an individual or a publicly quoted company. This inevitably makes it difficult to obtain assurance that the Department resolves tax disputes appropriately.").

192. One may consider this a designed means of defecting from international agreement, which could theoretically be consistent with national self-interest, even if it imposes a cost on other countries. *See, e.g.*, Daniel Shaviro, *Why Worldwide Welfare as a Normative*

Designing a dispute resolution system that allows governments to negotiate without leaving behind a public record of wins and losses may protect that autonomy, as well as protect policymakers from public criticism.[193]

The problem with resolving disputes with a minimal record in this manner is that it hides the development of international taxation as a legal regime.[194] This is not to prescribe a sacred nature to the "rule of law" but to recognize that the choices made for resolving international tax disputes has an impact on how taxpayers, governments, and the public react to and interact with this legal regime.[195] Further, the hidden nature of international tax dispute resolution may also hide disparities within and across nations as international tax issues are resolved in ways that benefit only the elite few who participate directly in the process.[196]

One way that tax law administrators traditionally balance the confidentiality desired by individual taxpayers with the need for a coherent rule structure is through guidance. Guidance may be issued in the form of rules and regulations as well as rulings on specific cases, sometimes with identifying details redacted. Issuing guidance is a major job of the IRS, as evidenced by the millions of pages of regulations, notices, letters, manuals, rulings, revenue procedures, etc., that make up the bulk of administrative tax practice in the United States. In support of the contribution this kind of documentation provides for the development of law, some commentators have called upon the IRS to issue regulations interpreting tax treaties.[197] This is effectively a call for more hard law, and it raises again some of the problems inherent in using the hard law solution of judicial determinations in the international context. But even if such problems could be solved, it seems unlikely that countries will rigorously pursue more hard law as suggested.

Standard in U.S. Tax Policy?, 60 TAX L. REV. 155, 166 (2007) (suggesting that cooperation in tax matters might serve long-term national interests but appearing to cooperate while defecting definitely serves short-term ones).

193. The public reaction to other international agreements, especially free trade agreements, and the outcomes of well-publicized trade disputes for the various players may serve—consciously or unconsciously—as a warning for tax policymakers in this regard.

194. *See* Colburn, *supra* note 90, at 700 ("H.L.A. Hart, Joseph Raz, and other modern positivists began an era of theorizing about law's necessary and sufficient elements. That era is ending, though, in good part because they ignored the real sources of most law in complex societies—agencies." (citation omitted)).

195. *See* John K.M. Ohnesorge, *The Rule of Law*, 3 ANN. REV. L. & SOC. SCI. 99 (2007); *see also* Jason Webb Yackee, Book Note, *The Reasons Requirement in International Investment Arbitration: Critical Case Studies*, 103 AM. J. INT'L L. 629, 629 (2009) ("[I]f one ends up on the losing side, one wants . . . to know the reasons why.").

196. Studies of the international arbitration process in other contexts show just how important and entrenched social hierarchy can be to dispute resolution through arbitration, and we must anticipate similar features will characterize international tax arbitration. *See* YVES DEZALAY & BRYAN G. GARTH, DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER (William M. O'Barr & John M. Conley eds., 1998).

197. *See* Michael S. Kirsch, *The Limits of Administrative Guidance in the Interpretation of Tax Treaties*, 87 TEX. L. REV. 1063 (2009). *But see* Craig M. Boise, *Optimal Tax Treaty Administrative Guidance*, 88 TEX. L. REV. 175 (2010). The IRS issued regulations in some of its earliest tax treaties but the practice was discontinued. T.D. 8856, 2000-1 C.B. 298.

The reason for countries to exercise restraint in issuing more hard law is that they are currently filling the gap between individual taxpayer disputes and the need for publicly accessible tax law via another format—namely, "soft law." Instead of issuing domestic guidance, the United States and its peer countries have chosen network-based collaboration as a means of building "global consensus" on tax norms.[198] These norms are not legally binding, yet they elicit various degrees of cooperation globally, and, more importantly, they serve as a substitute for greater transparency in international tax dispute resolution.

C. The Promises and Perils of Soft Law

Soft law is effectively a third way between the hard law of treaties and judicial interpretation and the nonlaw of diplomatic dispute resolution. Soft international tax law embodies three vital characteristics that distinguish it from hard law and nonlaw, providing governments with an alternative mechanism for achieving national and international goals. First, soft law is used to aggregate and publicize the experiences of competent authorities in the form of informal guidance, providing a filtered substitute for the publication of competent authority agreements themselves. Second, soft law serves as an even more effective means of cooperating while preserving autonomy than that provided through nonlaw dispute resolution, at least for countries that can effectively opt out of cooperation without penalty. Finally, and related to the first two characteristics, soft law serves as a buffer between civil society and government, protecting political actors from public observation of sensitive social, political, and economic relationships among countries.[199] These three characteristics demonstrate that the institutional design of international tax dispute resolution reflects more goals than simply that of relieving double taxation on a case-by-case basis.

1. Soft Law as Aggregator and Filter

Perhaps soft law's most evident role in international taxation is as an aggregator and disseminator of the experiences, knowledge, and, above all, preferences of the member countries of the OECD. Most soft international tax law emerges from the OECD in its self-described role as "market leader in developing [tax] standards and guidelines."[200] The OECD creates international tax norms by providing a forum for

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198. By "norms," I refer to the expression of principles to define or outline appropriate ways for governments to impose taxation on international activities.

199. There are likely other characteristics of soft law that make it additionally attractive as an alternative to hard law and nonlaw in international tax dispute resolution, but these three seem to be principle features.

200. OECD, OECD'S CURRENT TAX AGENDA, *supra* note 14, at 5. Each year, national representatives who constitute the principal decision-making group in the OECD reaffirm their view that this institution plays a critical role in developing policy in a globalized world. *See* Press Release, OECD, Meeting of the Council at Ministerial Level ¶ 14 (May 21–22, 1996), *available at* http://www.g7.utoronto.ca/oecd/oecd96.htm ("Ministers conclude that the OECD is an essential component of the multilateral system . . . [with a] vital role . . . in reinforcing democracy and demonstrating the values and dynamism of the free market.").

collaboration among its members, documenting the results of collaboration in various reports and guidelines, and then disseminating and implementing these results as norms using peer pressure, monitoring, benchmarking, technical assistance, and similar soft law mechanisms.[201] The OECD has been so successful in this regard that it has created debate about whether its guidance should be considered effectively binding on states, even if it is not technically law.[202]

Issuing guidelines on practices favored by its members allows the OECD to fulfill a function similar to that played by domestic administrators in issuing regulations or other forms of generalized guidance.[203] OECD guidance may not be hard law, but the OECD nevertheless asserts its legitimacy in guiding both taxpayers and tax administrations on grounds that its guidance represents international consensus on best practices.[204] Creating consensus allows OECD

U.S. lawmakers, though sometimes ambivalent about the direction of particular OECD initiatives, nevertheless have described the institution as an appropriate forum for building consensus positions on tax policy and vital for achieving compliance with U.S. tax law. *See* Margaret Milner Richardson, Comm'r, Internal Revenue Serv., Remarks at the International Fiscal Association U.S.A. Branch Annual Meeting (Mar. 2, 1995) (transcript available at http://www.unclefed.com/Tax-News/1995/Nr95-19.html) ("[A]ttaining international consensus on transfer pricing [through the OECD] is absolutely essential to appropriate compliance in the area."); Stuart E. Eizenstat, Deputy Sec'y, U.S. Dep't of the Treasury, Remarks to the Tax Executives Institute Midyear Conference (Mar. 20, 2000) (transcript available at http://www.treasury.gov/press-center/press-releases/Pages/ls476.aspx) (expressing support for use of the OECD to create consensus for taxation of e-commerce).

201. *See, e.g.*, OECD, OECD Information Disclosure, at http://www.oecd.org/document/26/0,3343,en_2649_37467_33945946_1_1_1_37467,00.html (stating that the OECD produces "'soft' laws [that] are nonetheless effective thanks to the OECD's highly developed process of peer review"); *The OECD's Peer Review Process: A Tool for Co-Operation and Change*, OECD, http://www.oecd.org/peerreview ("Among the OECD's core strengths is its ability to offer its members a framework to compare experiences and examine 'best practices' in a host of areas from economic policy to environmental protection."); *see also* BRAITHWAITE & DRAHOS, *supra* note 14, at 546–47 (discussing the importance of modeling and other mechanisms in creating global norms); Christians, *supra* note 49 (discussing mechanisms for creating international tax norms through the OECD).

202. *See* Frank Engelen, *Some Observations on the Legal Status of the Commentaries on the OECD Model*, 60 IBFD BULL. 105 (2006) (arguing that states can, by implicit conduct, bind themselves to OECD guidance as a matter of international law); David R. Tillinghast, Commentary, *Commentaries to the OECD Model Convention: Ubiquitous, Often Controversial; but Could They Possibly Be Legally Binding?*, 35 TAX MGM'T INT'L. J. 580, 581 (2006) (characterizing interpretive tax guidance issued by the OECD as soft law).

203. This might be evidence of the kind of "covert harmonization of administrative method led by experienced tax bureaucrats" that global regulation experts expect may have more success with inherently international tax problems, such as transfer pricing. BRAITHWAITE & DRAHOS, *supra* note 14, at 108; *see also* Yariv Brauner, *An International Tax Regime in Crystallization*, 56 TAX L. REV. 259, 263 (2003) ("[M]ost rules comprising international taxation are very close to being de facto harmonized.").

204. For example, in the area of transfer pricing, the OECD claims legitimacy for its guidelines by stating that "the arm's length principle . . . is the international transfer pricing standard that OECD member countries have agreed should be used for tax purposes by MNE

member countries to create more certainty in international tax practice by setting a path for states to comply, and to compel taxpayers to comply, with international norms.[205] At the same time, it makes defection from the norms more costly even if defection would be equally legitimate.[206]

Finally, soft international tax law does more than aggregate and compel adherence to preferences: it also acts as a filter for experience through practice. This is beneficial because nonlaw is administratively extremely costly to provide, especially if no one learns from it. For this reason, it is not reasonable to believe that no one in fact learns from it.[207] Instead of disseminating international tax experientially, such as by publishing individual case decisions, countries are sharing the knowledge they gain from experience by writing this knowledge into abstract rules that can be applied to future cases.[208] In this way the administrative

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groups and tax administrations." OECD TRANSFER PRICING GUIDELINES, *supra* note 18, at 31.

205. For example, as the best source of information on the preferences of OECD member countries, the transfer pricing guidelines and the commentary on the OECD Model provide taxpayers and governments (whether OECD members or not) convenient and accessible explanations and guidance. Nothing prevents a country from diverging from the path, but there is no support—technical, administrative, or political—for such defection. As a result, countries that seek to implement divergent preference in these areas will face high political, social, and even administrative costs.

206. *See, e.g.*, Avi-Yonah, *supra* note 34, at 170 ("[T]he freedom of most countries to adopt international tax rules is severely constrained, even before entering into any tax treaties, by the need to adapt to generally accepted principles of international taxation. . . . For example, Mexico recently had to abandon its long tradition of applying formulas in transfer pricing and adopt rules modeled after the OECD guidelines in order to be able to join the OECD. South Korea similarly had to change its broad interpretation of what constitutes a permanent establishment under pressure from the OECD. And Bolivia had to abandon its attempt to adopt a cash flow corporate tax because it was ruled not creditable in the United States. Even the United States is not immune to this type of pressure to conform, as can be seen if one compares the 1993 proposed regulations under 482, which led to an international uproar, with the final regulations, which reflect the OECD guidelines."); Brauner, *supra* note 203, at 272 ("dissimilarity [of rules across states] results in additional compliance and transactional costs for multinationals."). This phenomenon can be compared to the use of "structural systems," such as third-party withholding, as an efficient way to "reduce prohibited behavior" in the administration of domestic tax laws. Lederman, *supra* note 7, at 696–98.

207. *See generally* Colburn, *supra* note 90.

208. The OECD's issuance of guidelines for transfer pricing is illustrative of this phenomenon. *See* OECD TRANSFER PRICING GUIDELINES, *supra* note 18. These guidelines are lengthy, running several hundred pages and encompassing seemingly all aspects of transfer pricing analysis, including the theory and historical framework for the arm's length standard, detailed rules for determining arm's length prices, and administrative approaches to avoiding and resolving transfer pricing disputes. Yet observers have noted that the guidelines are "not very detailed." Fris & Gonnet, *supra* note 182, at 5. This is because the transfer pricing guidelines are abstract in nature, providing generalized guidance about how transfer pricing "can," "could," or "should" be done, rather than specific, factually detailed accounts of how transfer pricing has in fact been done. For example, see OECD TRANSFER PRICING GUIDELINES, *supra* note 18 at 59, 63–64 ("Parts II and III of this chapter respectively describe 'traditional transaction methods' and 'transactional profit methods' that

adjudication of international tax disputes ends up having precedential value in effect (at least when so desired by the parties involved), even if indirectly.

However, soft law is not a panacea for taxpayers or administrators despite its aggregating, filtering function. On the contrary, "[t]he system today does not provide tax administrators, treaty drafters, and taxpayers with the necessary guidance required to reduce uncertainty and prevent further disputes."[209] If soft law mediates between the need for certainty and the need to protect confidentiality, it seems that the balance is currently in favor of the latter to the detriment of the former. The OECD itself acknowledges the all-important function served by observation of the law as it is implemented through practice: "Aggressive tax planning is a major risk to the revenue base of many countries. *As shown by some recent cases and settlements*, numbers are vast."[210] The OECD's insight seems accurate: no amount of abstraction through soft law can replace the knowledge created by cases and settlements.

This suggests that soft law also meets other goals. These may be practical in nature. For example, it may be that the norm of confidentiality in international taxation is so strong that soft law is the least imperfect method for disseminating knowledge gained from international tax practice on a global scale.[211] However, it is at least equally likely that the goals met by using soft law are political in nature. This makes analysis difficult, since we cannot easily observe nations as they engage in the creation of tax norms.[212] But some of the basic features of soft law illuminate why it may be a preferred political choice in the context of global economic competition.

2. Soft Law Facilitates Fairweather Regulation

Soft law may be politically attractive first and foremost because of its nonbinding nature, which gives countries more ability to cooperate or withdraw than they might have in forms contained in hard law format, such as in a treaty.[213] Using soft law, countries can establish patterns and structures for future behavior without tying their own hands in precedent. Internationally influential countries can create priorities and best practices for international tax law and then change them if and when circumstances warrant.[214]

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can be used . . ."; "a minor difference in the property transferred in the controlled and uncontrolled transactions *could* materially affect the price"; "regard *should* be had to the effect on price of broader business functions other than just product comparability . . ." (emphasis added)).

209. ALTMAN, *supra* note 110, at 5.

210. *Tackling Aggressive Tax Planning Through Improved Transparency and Disclosure*, OECD, http://www.oecd.org/document/46/0,3746,en_2649_33767_46987758_1_1_1_1,00.html (emphasis added).

211. *See* KOMESAR, *supra* note 16.

212. Christians, *supra* note 26.

213. *See, e.g.*, Brummer, *supra* note 80, at 625, 630 ("[S]tates may face considerable reputational costs where they do not honor their treaty obligations"; in contrast, "[t]he absence of any formal obligation [in a soft law structure] enables a cheap exit from commitments, and by extension permits opportunism wherever it suits a country.").

214. The ability to effect change likely depends on the relative strength of the particular country. For instance, the United States is seen as central to OECD policy initiatives such

The discretion to cooperate or withdraw delivers an institutional benefit, allowing countries to substitute compromise for law.[215] Much as the competent authorities are expressly authorized to resolve international tax cases even if not in accordance with the law on the books,[216] and IRS appeals officers can negotiate deals with taxpayers that reflect considerations other than strictly legal interpretation,[217] soft law allows countries to negotiate from a position where compromise is possible because it will not be subject to public scrutiny. Instead, compromise will be characterized as consensus and marketed as best practices. National administrators can exert much control over the direction of national tax policy using consensus formed in this way.[218] Soft law thus spares tomorrow's governments from being constrained by today's compromise, and allows governments to make mistakes in practice without permanent damage, yet preserves institutional memory in the documentation of best practices.

Of course, the characteristics that give countries flexibility to cooperate or withdraw from tax norms may erode the power of soft law to compel compliance. If OECD countries defect from the international tax norms they helped to create, the structure of "global consensus" will be in danger of being completely undermined. The structure is already threatened by the exclusive nature of the OECD membership, especially the omission of several key global players such as China, India, and Brazil. The OECD has acknowledged that expansion is needed in order to claim truly global consensus, but with expansion comes more contestation and potentially less ability to reach compromise positions.

3. Soft Law Obscures Power Politics

Finally, soft law may be a politically attractive institution for the economically and politically powerful countries that produce it because it enables them to allocate international tax revenues without the criticism that might arise from greater public scrutiny.[219] The ability to control information in this manner allows institutions like the OECD to frame public discourse on international tax policy

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that the early failure and later success of the OECD's campaign against tax havens is attributed to the withdrawal and then recommitment of the United States to this project over time.

215. The discretion to cooperate or withdraw may also deliver individualized social benefits, such as the protection of political capital in the international community. That is, with collaboration taking place behind the closed doors of soft law institutions, positions can be taken and changed by political actors without fear of embarrassment through exposure. *See* Brummer, *supra* note 80, at 632 ("Simply put, most soft law agreements are usually framed in conditional language ('parties intend to' or 'strive to achieve') and are not legal instruments as a matter of international law; parties have thus not committed to anything that could harm or erode a state's national reputation. Regulators retain flexibility in managing their own affairs since no legal obligations are assumed and parties are given the opportunity to learn about the impact of certain policy choices over time.").

216. OECD Model, *supra* note 10, art. 25.

217. *See supra* note 95 and accompanying text.

218. *See* Christians, *supra* note 26, at 33–34.

219. This reflects a traditional realist view that international standards derive from power rather than law. *See, e.g.*, KENNETH N. WALTZ, THEORY OF INTERNATIONAL POLITICS (1979).

according to the priorities of its members, whether or not these priorities are in fact universally shared.[220]

Observers of the international tax regime may suspect that poor states suffer from the current allocation of international tax revenues, but inequities cannot be easily documented as in other treaty contexts where the adjudication process is more open. In the absence of results documented from country experiences, observers will have difficulty drafting a manual for how developing countries can work within the system to gain advantage.[221] This may be one reason why independent groups are calling for greater transparency in multinational disclosure standards: more information from disclosure is a substitute for the kind of information about the allocation of tax revenues that could be gleaned from disclosure of international tax dispute resolution outcomes.[222] The ability to control information may even be growing in importance as power is shifting globally.

These main features of soft law—its aggregating and filtering effect, as well as its political advantages—have, to date, made soft law a preferred means of mediating between the problems presented by hard law and nonlaw in international tax disputes. But perhaps the most important reason for the persistence of soft law is its practical invisibility to civil society. Most of society outside of the international tax community simply has no awareness of the way soft law exerts itself in shaping international tax law and consequently allocating tax revenues internationally. Indeed, within the tax community, and even within the international tax community, there is extremely limited knowledge of and interest in the OECD as a quasi-administrative, quasi-adjudicative body. This status quo may change amidst a broader public awareness of some of the problems created for governments and civil society as a result of global economic competition. As societies become aware of the high costs of ignorance about how taxes are actually distributed internationally, perhaps a greater interest will arise in the institutional structure of international tax law.

CONCLUSION

If we want to know how nations share in the prosperity created by globalization, we need much better information about how international tax law allocates revenues across countries with equally valid claims. Access to the ways governments actually resolve international tax disputes and the outcomes of these

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220. For example, this framing has allowed the OECD to concentrate public discourse on certain issues, such as island tax havens, rather than others, such as the challenges faced by developing countries in implementing transfer pricing standards. *See* Allison Christians, *Taxation in a Time of Crisis: Policy Leadership from the OECD to the G20*, 5 NW. J.L. & PUB. POL'Y 19, 25–28 (2010).

221. For such a manual in the trade area, see Gregory Shaffer, *The Challenges of WTO Law: Strategies for Developing Country Adaptation*, 5 WORLD TRADE REV. 177 (2006).

222. *See, e.g.*, *Country by Country Reporting*, *Task Force on Financial Integrity*, http://www.financialtaskforce.org/issues/country-by-country-reporting/ ("Country-by-country reporting (CCR) would provide information to a wide range of stakeholder groups which will strengthen efforts to monitor corrupt practices, corporate governance and responsibility, tax payments, and world trade flows.").

disputes might provide some of the necessary factual basis for empirical study, as might more aggregated disclosure about these processes and outcomes. Other means of disseminating more information while protecting other important policy and political goals, such as through more detailed corporate accounting disclosure rules, could also assist in the inquiry. To date, concerns about protecting the confidentiality of taxpayers (and perhaps indeed that of the administration of international tax law as well) have led countries to preclude such access, substituting in its place a filtered version in the form of informal guidance.

The turn to soft law constitutes acquiescence to an informal institutional structure for working out the sharing of money and power among nations. Soft law effectively aggregates the preferences of powerful nations but provides no accountability to society beyond what the institutions themselves choose to provide. This structure may be advanced to further a practical compromise between the need for taxpayer confidentiality and the need for a coherent rule of law, but it fails to deliver sufficient information for empirical analysis about how nations share in the gains from global wealth through the mechanism of taxation. Important political goals are undoubtedly served by this paradigm, and therefore change is likely to be met with strong resistance from its current beneficiaries.

The trade-off is manufactured ignorance about the costs and benefits of participation in the global economic order. We can presume but not conclude that the countries that currently dominate the soft tax law institutions are those that currently benefit from this status quo; likewise, we can presume but not conclude that countries not participating in the global tax order will suffer in equal measure. At stake is the future international division of revenues, but also, more fundamentally, the ability of citizens around the world to understand and assess their own nations' tax systems from the perspectives of economic efficiency, fairness, or any other tax policy goals. At a time when national economic and political fortunes are experiencing uncertainty and volatility, it seems prudent to revisit the goals and assumptions that led to the acceptance of obscurity in such an important aspect of national participation in economic globalization as international taxation.