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# A New View of Global Tax

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# [ FACULTY ]

NEWS & RESEARCH



SCHOLAR'S FORUM

## A New View of Global Tax

by Professor Diane Ring

Nations have always been especially protective of their right to levy taxes and collect revenue. Not surprisingly, tax conflicts erupt between nations and failure to resolve these disagreements can be costly to states and to taxpayers. However, recent research focusing on why taxing powers are important *and*

what factors enable states to manage their conflicts offers valuable insights for new tax cooperation.

Governments rely heavily on taxes to fund their operations. If business transactions subject to tax are entirely domestic, a country wields considerable power to implement a tax system and collect the designated taxes. But, if the transactions cross national borders, who taxes them? And, perhaps most important, what happens when countries disagree? The international tax literature has devoted tremendous resources to considering *substantive* issues in international taxation. Little attention, however, has been directed to *how conflict is handled*—essentially the “relations” aspect of international tax.

Yet resolution of tax conflict is crucial to the growth of international commerce. Consider what would happen if Corporation A from Country A set up a sales office in Country B and sold widgets, earning \$1 million in profit; both countries would likely tax the \$1 million. Unless the two countries establish a mechanism for prioritizing which country gets to tax the \$1 million, the

result could be double taxation. If both countries had a 50 percent tax rate, double taxation would not simply discourage cross-border business, it would eliminate the profit because Corporation A would pay half a million in taxes to both Country A and Country B. How might Country A and Country B arrive at a plan to coordinate their taxation? What factors could improve the likelihood of their reaching agreement?

Cross-border conflict is not confined to taxation; virtually all social and commercial behavior can generate international disagreement. The international relations field extensively studies interactions among nations—and regime theory specifically examines how and under what circumstances agreement (i.e., a regime) can be reached internationally. Although the analyses in international relations rarely use taxation as a case study, we can bridge that gap from the tax side by exploring the application of regime theory to case studies from international tax.

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ed Arcelor the running room it needed to elude acquisition. The Mittal legal team's "pocket" decree arrangement acted like a surgical bypass, allowing the life's blood of the deal to flow unabated.

This cross-continental and cross-cultural variance in required tactics is a high hurdle in the globalization of antitrust law.

"A major challenge in transactions like this, especially hostile ones, is understanding the strategic business motivations of the affected parties, the markets you're dealing with, the procedural and substantive antitrust issues in multiple jurisdictions, and, of course, all the relevant takeover rules," says Leddy. "Then, you must craft a coherent strategy and find creative solutions to very difficult, multi-dimensional problems. It requires sustained intensity."

Back on the Continent, Arcelor fought back. The company called a meeting to secure shareholder permission to buy back 20 percent of its stock. The end game? A deal with investor Alexey Mordashov, an 89-percent shareholder in Russia's OAO Severstal steel company, who would exchange \$16.6 billion in cash and assets for a 38-percent stake in Arcelor, if the stockholder buyback succeeded. The merger would have created a steelmaker with a market valuation of \$40 billion, more than twice the size of Mittal.

At that moment, attorneys on both sides of the transaction—folks practically living in their offices across the globe for months—surely cranked into overdrive.

As Arcelor zigged, Mittal zagged, raising its original offer by 20 percent, to just under \$26 billion, including a sweeter pot for Arcelor shareholders. Once the Severstal deal was officially proposed, Mittal leveraged a wavering Arcelor shareholder base by persuading 20 percent of shareholders to sign a letter opposing the buyback and the accompanying minority-investor scenario, with Mordashov serving as the white squire. Gutted from the inside, Arcelor canceled the shareholder vote and, eight days later, capitulated by signing a memorandum of understanding with Mittal.

But after 149 days in play, the deal was far from done.

In August 2006, Mittal closed its tender offer for Arcelor; the final per-share price was nearly double Arcelor's pre-bid peak. Even with ArcelorMittal's European Union-mandated divestiture of steel mills in Germany, Italy, and Poland, the deal created a steelmaking behemoth with a production rate three times that of its clos-

est rival. Meanwhile, Mittal's legal team argued vigorously, but ultimately unsuccessfully, that the post-transaction US market was sufficiently competitive without divestiture. The last thorns of the deal's North American component were still plenty sharp. The DOJ filed a complaint in federal court that same month to enforce Mittal's May agreement to divest Dofasco.

Both the DOJ and TK, the German corporation that had been promised Dofasco, its long-lost target, urged Mittal to try to dissolve the Stichting trust. In October, Mittal formally sought the trust's dissolution, but Stichting's independent board refused. In December, TK sued Mittal in The Netherlands to enforce its contract to buy Dofasco. "In a way, they did us a favor," notes Leddy. The cause of action provided Mittal a means to resolve the issue of whether the Stichting trust could be dissolved. The court ruled for Mittal in January 2007, agreeing that Mittal had exhausted all reasonable avenues to fulfill its eleven-month-old contractual promise to sell Dofasco to TK. In effect, this meant the DOJ's regulatory remedy resided behind Door No. 2.

In February of 2007, the DOJ selected Maryland's Sparrows Point steel plant for divestiture as an alternative to Dofasco (at press time, the Stichting trust still controlled Dofasco's shares) to resolve US market antitrust implications of the ArcelorMittal merger. A May hearing in US District Court in Washington cleared the way for Mittal's sale of Sparrows Point. In August, Mittal agreed to divert Sparrows Point to an international consortium of three companies led by Esmark, a Chicago-based US steel distributor, but the deal collapsed in December when the companies failed to secure financing. Ironically, after another auction process, an agreement was reached to divest Sparrows Point to none other than Severstal, the Russian steel company that Arcelor shareholders had rebuffed in June. That deal closed at the end of March 2008.

Finally, two years, one month and twenty-four days after Mittal's surprise bid for Arcelor, the case was officially closed. Though it's somewhat counterintuitive, Leddy confides that the euphoria of closing a deal—even an acquisition like ArcelorMittal—is powerful, but not as satisfying as watching the byproduct thrive.

"What's rewarding is when you talk to the client months later and they report that

the transaction is a success and that integration went smoothly," says Leddy. "When they tell you that the deal was worth all of the effort, that is what's truly satisfying."

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*Chad Konecky is a freelance writer and a program manager for ESPN. His last article for BC Law Magazine was "Defending Moussaoui," in the Fall/Winter 2006 issue.*

## Scholar's Forum

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Current regime theory literature falls into four rough categories: (1) neorealist-based regime theories (power is the dominant factor in regime formation because states exert power to design and use a regime to achieve their own goals); (2) neoliberalist-based regime theories (regimes form because there is a market failure that prevents states from reaching a Pareto-optimal outcome and the regime reduces transactions costs and facilitates a Pareto-optimal result); (3) cognitivist-based regime theories (a state's "interests and goals" are not a given but instead are shaped by outside forces and actors, including experts); and (4) a synthesis approach to regime theory (the regime theories are not exclusive and competitive but rather reflect the fact that regimes may develop for different reasons depending on whether power, market failure, or expert communities play a more influential role in a particular subset of cases).

What do the perspectives and insights of regime theory add to our understanding of the most widely known example of international tax negotiations: the development of a system to relieve double taxation (experienced by Corporation A in the hypothetical)? This system of relief, embodied in the network of bilateral and model tax treaties established over the past eighty years, clearly constitutes a regime: the *principle* is that international double taxation of income is harmful and should be avoided; the *norm* is that residence countries should yield primary tax jurisdiction to the source country; and the *rules* include the details coordinating the intersection of two countries' tax laws. Accepting the assertion that there is indeed a regime governing double taxation, and that the regime comprises the bilateral tax treaties, the model tax treaties, and the related efforts to avoid double taxation of income, is it possible to understand how it

formed and to contemplate when international tax regimes will be successful?

The first step is to discern whether the double tax regime is driven by power (neorealist tradition) or whether it represents a case of market failure (neoliberal tradition), that is, whether the resulting regime is a product of the exercise of power by one state, or a product of several states overcoming informational barriers to reach mutually desirable outcomes.

Using a series of models involving developed and developing countries, several conclusions emerge. Of the two dominant models of regime formation, the neoliberalist more accurately reflects the experience of the double taxation regime. Although the neorealist focus on power (including economic power) may be useful in explaining some elements of treaty negotiations, the neoliberalist model (which looks beyond power to the impact of game theory, issue type, and related factors) offers a more comprehensive understanding of the regime formation process. For example, it helps explain why countries negotiate treaties despite the availability of a unilateral solution, and why some countries pursue treaties and other do not. The game theory aspect of neoliberalism identifies the double taxation regime as a coordination game where the primary challenge concerns the distributive effects. The greater the distributional component, the more difficult it is to reach consensus. Thus, where two negotiating countries are both developed countries with similar investment flows, fewer distributional issues should arise. If one country is developed and the other is developing, then the selection of regime rules will carry distributional consequences that will impede agreement.

Following the initial step of determining which regime model captures the double taxation example, research should also explore: (1) whether market failure (i.e., neoliberalist regime theory) generally characterizes regime formation in tax; (2) how game theory can refine our assessment of market failure in tax; (3) how the regime participants' relative positions of economic power and resources affect tax regimes; and (4) the role of expert communities in structuring and facilitating the creation of tax regimes.

At the end of the day, the value of regime theory to international tax resides not in a precise predictive power, but rather in creating a framework that shapes critical thinking about international tax questions. Despite the complicated and

unresolved nature of regime theory, the coherence and organization it brings to international tax will discipline our investigations into international agreements and will encourage tax scholars to appreciate international tax relations as part of a broader system of international relations.

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*This column is based on the article "International Tax Relations: Theory and Implications," which was published in 60 Tax L. Rev. 83 (2007).*

## Academic Vitae

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Association (ABA) Firm Counsel Project roundtable at the Boston office of Mintz, Levin, Cohn, Ferris, Glosky & Popeo PC in Jan. His article of the same title was the focus of ABA Firm Counsel Project roundtable events across the country in Jan. and Feb. "Public Health Legal Services," symposium entitled "The First Wealth Is Health: The Nexus of Health, Poverty, and the Law" sponsored by the *Georgetown Journal on Poverty Law and Policy* and the O'Neill Institute for Global and National Health Law, Georgetown University Law Center, Washington, DC, in March. "Casuistry," conference entitled "Ethics, Theory and Lawyer Practice: A Conversation," University of Denver Sturm College of Law, Denver, CO, in April.

### DAVID A. WIRTH

*Professor and Director of International Programs*

**Works in Progress:** "The International Organization for Standardization: Private Voluntary Standards as Swords and Shields." *Boston College Environmental Affairs Law Review* (forthcoming 2008). Contributions on international trade law to a green paper entitled "Climate Change and Intergenerational Justice," a forthcoming publication of the Climate Legacy Initiative.

**Presentations:** "ISO 14001's Green Corporate Leveraging," Boston College Environmental Affairs Law Review 2007 Symposium: "The Greening of the Corporation," Newton, MA, in Oct.

**Activities:** Panel discussant, "Activism and Change—In Personal and Institutional Behavior," conference entitled "The Death and Rebirth of Environmentalism," Harvard University Center for the Environment, Cambridge, MA, in Nov. Invited discussant, "America, Europe, and the World Roundtable Series: Why Transatlantic Conflict on Climate Change Will Persist," Council on Foreign Relations, Washington, DC, in March. BC Law representative, International Association of Law Schools conference, "Learning from Each Other: Enriching the Law School Curriculum in an Interrelated World," Soochow University, Kenneth Wang School of Law, Suzhou, China, in Oct.

### NORAH M. WYLIE

*Associate Dean and Dean for Students*

**Works in Progress:** With Alexis Anderson, "Beyond the ADA: How Clinics Can Assist Law Students with 'Non-Visible' Disabilities Bridge the Accommodations Gap between Classroom and Practice," *Clinical Law Review* (forthcoming 2008).

**Presentations:** With Alexis J. Anderson, "Beyond the ADA: How Clinics Can Assist Law Students with 'Non-Visible' Disabilities Bridge the Accommodations Gap between Classroom and Practice," New England Clinical Conference, BC Law in Nov.

**Activities:** Panelist, "The Challenge of Inclusion: Avoiding the Us and Them," Religiously Affiliated Law Schools Spring 2008 Conference, BC Law in April.

### ALFRED C. YEN

*Professor*

**Presentations:** "Beneficial Illegality and Copyright," DePaul University College of Law School, Chicago, IL, in Nov. "Beneficial Illegality and Copyright" and "Third Party Copyright Liability," Drexel University College of Law, Philadelphia, PA, in March.

**Activities:** Chair of the Association of American Law Schools Committee on Professional Development for 2008.

## In Closing

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Then, by one act of judicial alchemy, nearly 3,000 people of different races, languages, creeds, and social background become one with the People from whom the judiciary derives its power.

After congratulating us, Judge Bowler emphasizes two of our new rights and responsibilities: voting, and jury service. She tells the story of a woman who served on the jury in a case Judge Bowler was trying, although it meant working nights and considerable personal inconvenience. She would willingly have excused the woman, but the Haitian-born juror explained that Judge Bowler had presided over the ceremony that had made her an American citizen, and that she wanted to show that she took her responsibilities seriously.

We too intend to take our new duties seriously, and to do what we can to safeguard the luminous protections and freedoms set out in *Pass the US Citizenship Exam*, even while the actions of an arrogant administration and pliable Congress daily threaten their eclipse in this nation where we have made our home.

But first we need lunch.

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*Jane Whitehead is a frequent contributor to BC Law Magazine.*