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PROSPECTS FOR A MULTILATERAL TAX TREATY

*Diane M. Ring**

I. INTRODUCTION

Victor Thuronyi's paper critically examines the potential structure and prospects for a multilateral tax treaty. The subject is of pressing importance as many nations grapple with an expanding network of trading partners and an array of serious cross border tax questions that require more than bilateral attention. The possibility of a multilateral treaty has been raised before, but ultimately languished, primarily from concerns of feasibility.¹ Mr. Thuronyi seeks to confront those challenges of design and implementation directly, and to conceive of a process that can facilitate the increased multilateral engagement of nations and eventually produce a treaty. I too share the sense that a strategically designed process can lead nations to a level of interaction and substantive discourse that might be impossible to achieve at the outset. That is, process

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1. See Victor Thuronyi, *International Tax Cooperation and a Multilateral Treaty*, 26 BROOK. J. INT'L L. 1641 (2001). See also Rodler, *Austria Proposes Multilateral Tax Treaty*, 97 TNI 183-2 (1997) (the Austrian Ministry of Finance advocating pursuit of a multilateral tax treaty for the European Union, but noting that prior efforts at a comprehensive multilateral tax treaty in the European context failed); Daniel Berman, *Part II: Departing U.S. Treasury Staffer Discusses Treaties*, 15 TAX NOTES INT'L 949, 951 (1997) [hereinafter Berman] (quoting departing Deputy International Tax Counsel Daniel Berman, "It has not proven practical to have a multilateral tax treaty . . . because the tax systems in each country have a lot of differences that you have to reflect in a bilateral negotiation."); Larry Pressler, *Comments on International Tax Treaties*, 92 TNI 57-16 (1992) [hereinafter Pressler] (Senator Larry Pressler's Senate floor statement noting concerns in the tax context that "countries find it much more difficult to reach agreement on a common goal The interests of each nation result in unique approaches to the determination of revenue requirements, the ability to raise taxes and indeed, to the kinds of taxes upon which its system will depend.").

can shape behavior and expectations, and can build skills, networks, and ideas.

A plan for multilateral tax treaties and the ensuing interactions among countries raises two distinct issues: (1) the substantive desirability of varying degrees of "cooperation," and (2) practical problems and barriers to overcome in designing a process leading to multilateral tax agreements. Mr. Thuronyi's paper focuses almost exclusively on the second issue in an effort to respond to the traditional complaints about feasibility. The end result is a procedural framework which, in the short term, provides: A universal template for bilateral tax treaties; common language, terminology, and interpretations; persuasive influence through a single document; and mini-multilateral agreements. The longer term goals include: Developing sufficient comfort with a multilateral structure such that there will be a shift away from bilateral treaties toward wider participation in a multilateral treaty; expanding the subject matter coverage of treaties to include those issues not addressed currently in treaties; and possibly increasing the uniformity of countries' domestic rules and definitions.

II. FOCUS ON THE PROCEDURAL MECHANISM

The decision to tackle procedural issues independent of the substantive treaty tax questions charts a reasonable path. Different countries, scholars, and taxpayers may have divergent views about the appropriate responses to tax questions² and about which questions hold the most promise for multilateral agreement. However, irrespective of the particular answers to substantive questions, we must establish a framework for approaching such issues in a manner conducive to productive and continuing interaction. Another reason to focus on the procedural side of multilateral cooperation is the recognition that a frontal assault on the central substantive questions regarding the ultimate scope of a multilateral endeavor easily

2. See, e.g., Pressler, *supra* note 1; Joel Slemrod, *Tax Principles in an International Economy*, in *WORLD TAX REFORM: CASE STUDIES OF DEVELOPED AND DEVELOPING COUNTRIES* 11, 21 (Michael J. Boskin & Charles E. McLure, Jr. eds., 1990) ("In the case of tax policy, countries differ enormously in their revenue requirements, capacity to raise taxes, and their predisposition toward alternative tax systems, including the perceived need to use tax policy to affect economic activity.").

could derail progress. In contrast, an agreement to establish a process and structure for more modest, circumscribed purposes might be acceptable and yet lead to more comprehensive accords.

Despite the logic and compelling practicality of divorcing the substance from the process, the separation is not entirely possible. We should be aware of the intersection of the two when trying to anticipate objections and accurately assess the nature of potential resistance to Mr. Thuronyi's proposal. Evidence of the intersection first comes from the justifications for a multilateral approach, such as the existing substantive tax problems that require resolution on more than an individual or bilateral basis.³ Even if Mr. Thuronyi's short term agenda described above does not encompass some of these problems, they nonetheless motivate the argument for increased multilateral interaction.⁴ Implicit in the push for multilateral treaties

3. Such income tax issues include cross border tax competition, apportionment of the income of multi-nationals, treaty overlap, and electronic commerce. See, e.g., Adrian J. Sawyer, *Electronic Commerce: International Policy Implications for Revenue Authorities and Governments*, 19 VA. TAX REV. 73, 96 (1999) (examining Australia's efforts in taxation of electronic commerce and observing that "[i]nternational cooperation is paramount given the lack of constraint on transactions posed by geographical boundaries . . . [t]his situation highlights the need for international cooperation through a multilateral agreement or treaty."); Joseph Guttentag, Deputy Assistant Treasury Secretary for International Tax Affairs, "Statement at Finance Committee Hearing on Internet," 137 DTR L-1 (July 17, 1998) ("Close cooperation and mutual assistance are necessary between the United States and all of our trading partners to ensure that international policies regarding the Internet and electronic commerce are consistent and do not lead to multiple or discriminatory taxation of electronic commerce or the Internet."); Arthur J. Cockfield, *Balancing National Interests in the Taxation of Electronic Commerce Business Profits*, 74 TUL. L. REV. 133, 165 (1999) (asserting that "[s]ignificant international cooperation will be required to confront the challenges posed by the taxation of e-commerce" but lamenting the lack of an international entity like the World Trade Organization (WTO) for tax given the Organisation for Economic Cooperation and Development's (OECD) general restrictions on working only with members); *IFA Panel Sketches Solutions to Triangular Tax Treaty Problems*, 98 TNI 196-2 (1998) (during International Fiscal Association panel, Joseph Schuch of the Department of Austrian and International Tax Law observed that, "[t]hese triangular treaty problems emphasize the importance of moving to multilateral tax treaties."); Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1575, 1675 (2000) ("[a] multilateral solution [to the issue of tax competition] . . . is therefore essential if the fundamental goals of taxation are to be preserved.").

4. The other major justification outlined in the paper leans more toward the "purely" process side—the practical difficulty of updating many treaties on a regular basis.

and expanded treaty coverage is an expectation regarding the substantive scope of these agreements, even if the particular details remain entirely open. Thus, we cannot escape the existence of powerful substantive convictions driving the multilateral campaign by devoting our exclusive attention to process.

The second problem with attempting to focus exclusively on the process side emerges from the harmonization that the paper anticipates from the pursuit of a multilateral treaty process.⁵ The quest for a new or expanded process for multilateral agreement presumably is premised on the view that a significant amount of coordination and harmonization will follow—otherwise the effort would not be worthwhile. Mr. Thuronyi clearly articulates this goal but refrains from outlining the content of the harmonization.⁶ Unfortunately, such restraint cannot eliminate sufficiently the concerns of countries uncertain about the degree of harmonization they seek. However, the existence of harmonization concerns does not indicate a failing in the procedural design; it simply reflects the fact that countries do understand the general direction in which a multilateral effort would lead and that the direction inherently involves more coordination than currently exists. Moreover, the acknowledgment of these concerns does not diminish the importance of a carefully designed process for harnessing countries' attention and energies for resolution of tax issues. Even though the substantive issues underlying multilateral treaties cannot be separated thoroughly from the procedural framework, a well designed process which is attentive to countries' reservations and which is introduced with limited nascent goals (but prospects for more ambitious ones) remains critical.

Finally, the procedural/substantive line blurs in the decisions that will be necessary regarding power and voting rules of the entity ultimately selected to oversee the multilateral treaty.⁷ The power and voting structure will dictate, to an extent, what kinds of agreements are possible or likely, and

5. To some degree this observation just amplifies the first point—even without defining the specific substance of a multilateral treaty, the ultimate object remains agreement and thus some level of harmonization.

6. See Thuronyi, *supra* note 1, at 1641.

7. This point holds for whatever organization—existing, new, or modified—that is selected to serve the function of coordinating the multilateral tax treaty.

whether countries will be sufficiently comfortable to participate. These observations on the prospects of encouraging a multilateral treaty through the thoughtful crafting of a process with incremental goals merely highlight the fact that even such modest efforts must confront and incorporate substantive tax concerns of target nations.

III. THE DETAILS OF THE PROPOSED PLAN

Once we decide to encourage the development of multilateral tax treaties, the particulars of the procedural structure assume a serious role. Mr. Thuronyi offers a somewhat flexible picture of the organization and process that could support this mission.⁸ In an effort to identify potential sources of difficulty that might be avoided or at least anticipated, I would like to offer a few comments on the voting structure and power of the selected organization. First, although changing or updating one multilateral treaty generally might be easier than updating many bilateral treaties,⁹ the process of changing the multilateral treaty might move more slowly depending on the type of action or vote necessary to achieve change in the multilateral forum. For example, a new provision such as "treaty shopping"¹⁰ might be easier to introduce initially in a few treaties, and once established and proven desirable could become widely adopted. In contrast, if *ex ante* the agreement of a large group of nations were necessary to introduce the new provision, then adoption could take a long time, especially without a trial version to observe.

A general example of this phenomenon occurred with the Advance Pricing Agreement (APA) program. When the United States introduced this program in the early 1990s to cope with the allocation of income from cross border transactions ("transfer pricing"), many countries were quite suspicious of the Unit-

8. The flexibility derives from the desire to distance the framework from the potentially contentious substantive questions.

9. See, e.g., Berman, *supra* note 1, at 952 (departing Deputy International Tax Counsel Daniel Berman commenting, "The principal problem in using a [bilateral] treaty to combat abuse is the time element. It just takes too long to negotiate a treaty, to get a treaty into force . . . [and] it's very unusual to go back in and fix up that treaty in the near term.").

10. See, e.g., Tax Convention with the Netherlands, Dec. 18, 1992, U.S.-Neth., S. TREATY DOC. NO. 103-6 (1992).

ed States' motives and of the likely results of such agreements.¹¹ Nevertheless, the United States initiated the process and pursued agreements involving one or two other countries. Over time, many more countries began participating in the APA process and developed programs of their own.¹² If the United States had needed to obtain the up-front support of a large number of countries before starting the APA process, it seems unlikely that such support could have been garnered as quickly as it was under the more incremental country by country method that emerged.¹³ The prospect of delay in securing agreement from many nations would not be a problem for the preliminary treaty framework Mr. Thuronyi proposes. At the outset, the "multilateral" treaty merely serves as a template which countries freely can modify in their actual, binding, bilateral treaties. However, the reservations about the ease of treaty modification cannot be dismissed completely. A chief benefit of the template treaty derives from its role as a precursor to true multilateral treaties for which this question of innovation and flexibility is quite salient.

My second comment reflects the concern that the voting structure either will inhibit innovation or raise sovereignty concerns. If the voting structure of the multilateral organization developing the template, and ultimately promoting the

11. See Diane M. Ring, *On the Frontier of Procedural Innovation: Advance Pricing Agreements and the Struggle to Allocate Income For Cross Border Taxation*, 21 MICH. J. INT'L L. 143, n.130-131 (2000).

12. *Id.* at n.127.

13. It is possible that some countries perceived their participation in the APA process to be less than voluntary—that is, if some type of pricing agreement is underway (especially if it involves two other countries) then failure to become involved may put you at a disadvantage despite the existence of domestic transfer pricing rules that always can be enforced. Comparable versions of this problem initially arose in the design of the basic transfer pricing regimes. Other countries perceived the United States' move toward more serious penalties and documentation requirements for transfer pricing as putting extra pressure on taxpayers not to understate their U.S. taxable income. See Ring, *supra* note 11, at 143, 157-58. Thus, to the extent tax burdens in two countries were relatively comparable, taxpayers had an incentive to price the transactions more favorable toward the United States (*i.e.*, more profit appearing in the U.S. side of the related party transaction) so as to reduce or eliminate the likelihood that the United States would pursue a transfer pricing claim on audit. In response to the effects of this U.S. pressure, other countries implemented their own transfer pricing penalties in order to discourage taxpayers from placing too much income in the United States simply to reduce audit and penalty. Now taxpayers would face comparable enforcement "risk" in both countries.

multilateral treaty, requires less than consensus (perhaps in an effort to increase the likelihood of bold innovations being pursued), then countries may be wary of the loss of control over fiscal affairs.¹⁴ Whether a non-consensus rule (such as majoritarian vote) applied only for establishing and revising the treaty or also applied in dispute resolution, countries may question the risks of surrendering these issues to majoritarian international vote. Alternatively, if the organization adopted a consensus voting model¹⁵ to reduce countries' concern over fiscal control, the real risk becomes not one of undesirable action, but of utter non-action because of the difficulty in persuading a larger group as described above. No ideal voting structure exists. Yet, we have managed to craft functional multilateral agreements and bodies in a variety of fields. Thus, the inability to develop a voting structure that fully guarantees fiscal autonomy and fully promotes innovation should not signal impossibility for multilateral tax treaties. It does, however, demonstrate the significance of the voting structure in both meeting the goals of multilateral cooperation and addressing the worries of potential participants. Perhaps the staggered approach Mr. Thuronyi outlines (first the template, and eventually multilateral treaties) will be an adequate compromise. Little autonomy is sacrificed initially, and as more serious

14. In the context of the European Union, the United Kingdom has expressed its commitment to retaining "its veto over tax matters, which it believes reflects national values and the choices made at a national level." Joann M. Weiner, *EU Leaders Debate Qualified Majority Voting at Nice Summit*, 21 TAX NOTES INT'L 2647 (2000).

15. International organizations use a variety of methods, and continue to experiment. For example, GATT traditionally functioned on a consensus basis. Thus, a panel to adjudicate a complaint could be established only with the support of all members, including the defendant country. The Uruguay Round of GATT negotiations, however, established procedures which require a panel to be designated upon receipt of a complaint unless there is a consensus not to do so (i.e., only if the complaining party agrees not to move forward). See Robert A. Green, *Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes*, 23 YALE J. INT'L L. 79, 83-84 & n.13 (1998). In the context of the European Union, tax policy decisions require a unanimous vote, making it difficult to effect change. See *EU Tax Commissioner Supports Proposed E-Commerce VAT Amendment*, 2000 WTD 183-12 (Sept. 20, 2000) (EU Tax Commissioner Frits Bolkestein identifying the voting difficulties in the European Union for tax, and thus explaining the Commission's proposal that a "Qualified Majority Voting" should be approved for certain tax matters—while keeping "key decisions under the unanimity rule in a effort to prevent any eroding of national sovereignty.").

steps toward a single treaty are taken, time remains to reevaluate whatever voting structure has been implemented. In addition, incrementalism gives the organization an opportunity to grow and develop its own patterns, norms, and historical practices which might raise countries' comfort level with assigning increased power to the group.

The third issue regards the organization selected as the locus of power and deliberation for the multilateral treaty project. Mr. Thuronyi offers several possibilities including the Organisation for Economic Cooperation and Development (OECD), the World Trade Organization (WTO), or offshoots of either. In keeping with his desire to focus on the core design questions and the developmental path multi-national interaction can take, he leaves the final selection of organization to the political choice of nations.¹⁶ Of course, countries and organizations are not clean slates. For example, to the extent that countries are wary of a WTO type authority for tax matters,¹⁷ a WTO based organization might be less acceptable even if the details of power and decision making in this forum differ from standard WTO practice. Forum preferences poses an empirical question about nations' perceptions of existing organizations.

Ultimately, the hardest problem may be pitching the proposed treaty reform as neither too revolutionary nor too incremental. The project could be viewed as too ambitious because it truly constitutes a call for a multilateral treaty and harmonization (both harmonization of treaty terms made available to different countries, and harmonization of the different countries' domestic tax systems)—thereby fueling substantive and political objections to the prospect. Alternatively, the proposal could be viewed as too little change (as Mr. Thuronyi suggests, the OECD basically accomplishes the initial stage of this work—the template function—now)¹⁸ and hence not worth

16. An organization with a global scope would be central. *See, e.g.,* Avi-Yonah, *supra* note 3, at 1675 (a multilateral approach to tax competition requires an organization "with an equally global reach [that] can regulate or tax private market activity"); Cockfield, *supra* note 3, at 165 (noting desirability of a WTO like organization for resolution of electronic commerce issues, given the OECD's limited membership).

17. *See, e.g.,* Berman, *supra* note 1, at 951 (quoting departing Deputy International Tax Counsel Daniel Berman, "The tax authorities of the world have not accepted the World Trade Organization as a player in the area of tax policy or tax administration. It's just a trade organization.")

18. Thuronyi, *supra* note 1, at 1641. *See also* Chang Hee Lee, *Impact of E-*

the effort or the political capital. That is, the very reason the proposal might be considered acceptable is that in theory it demands little from countries. Thus, the challenge for those promoting reform is to persuasively walk the line between these two characterizations.

IV. CONCLUSION: FINAL THOUGHTS

The proposal for multilateral cooperation starts with treaty reform (templates followed by multilateral treaties) and considers focused topical agreements as a subsequent possibility once the procedural framework and treaty reforms are in place. However, it might be possible, and perhaps preferable, to reverse the order. To the extent that part of the serious impetus for treaty reform comes from the substantive areas where solutions demand multilateral attention, perhaps we should start with multilateral agreements limited to these prominent topics. If significant political will proves necessary to initiate a multilateral treaty process, then it may make sense to direct that energy and attention not to the general operation, maintenance, and development of the treaty network, but instead to the specific questions and problems most likely to undermine the international tax system in the near future.¹⁹ The recent efforts of the OECD regarding tax competition indicate the plausibility of an issue-focused approach.²⁰

Regardless of whether we pursue an issue specific agreement or the general treaty regime first, serious attention must

Commerce on Allocation of Tax Revenue Between Developed and Developing Countries, 18 TAX NOTES INT'L 2569 (1999) (noting most tax treaties have followed the OECD model and have been negotiated bilaterally, although "the treaty network over the world virtually has resulted in a global multilateral treaty with a very complex set of reservations by each participant.").

19. Of course, the sensitivity of these topics (for which countries might perceive the benefits of multilateral engagement, but nonetheless find agreement elusive) could reduce the likelihood of immediate success. In that case, the treaty template could be the better option—pitched as a streamlining first step. The advisability of initially targeting either the treaty process or the topical agreements turns on political and empirical information.

20. Depending on one's perspective, the recent OECD work in tax competition represents an example of countries recognizing a shared issue and jointly working toward a resolution that demands extensive multilateral cooperation, or highlights the difficulty and careful incremental work necessary to move so many countries in the same direction. See OECD, HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE (1998).

be given to the primary reservation voiced about multilateral tax treaties—sovereignty.²¹ Similar questions about sovereignty arose with the OECD work on tax competition.²² Countries value their ability to make individual negotiations and draft domestic tax policy suitable to their needs. Grants of tax power to an international organization threaten such sovereignty. Careful consideration of these concerns can offer insights into how to make this political move successful. Unlike trade issues, where national and international interests are thought to coincide more regularly,²³ tax matters are less determinate. Although we should not overstate the likely differences between national and international goals (for example, the commonality of the existing treaty network demonstrates a notable degree of convergence of goals and methods), two special aspects of tax deserve comment. First, though trade policy is central to a national government, the tax system *funds* the government as well as provides a policy mechanism. Second, the historical and cultural views about the role of taxation (especially in the United States) and the exercise of the taxing power must be acknowledged.

As Mr. Thuronyi describes at the outset, the question reduces to a political one; how to achieve increased cooperation. A variety of choices emerge from the different levels of the proposed plan. First, an entity for this activity must be designated—it could be an existing organization, a spin off, or an entirely new body. Second, a voting structure for the organization must be selected, recognizing that it directly will influence the organization's appeal and plausible actions. Third, different voting rules could apply for different steps or acts such as initial enactment, revision, and enforcement. Finally, the initial step taken by this organized multilateral effort could be reform of the treaty network as proposed by Mr.

21. See, e.g., Pressler, *supra* note 1; Slemrod, *supra* note 2, at 21 ("ceding tax policy-making authority to an international agreement would compromise national sovereignty too greatly" for it to be a realistic option). See also *supra* note 13.

22. See, e.g., Daniel Mitchell, *An OECD Proposal to Eliminate Tax Competition Would Mean Higher Taxes and Less Privacy*, 21 TAX NOTES INT'L 1799 (2000) (arguing that the OECD's recommended action for tax competition "contradicts international norms and threatens the ability of sovereign countries to determine their own fiscal affairs.").

23. See, e.g., Slemrod, *supra* note 2, at 21 ("a clear benchmark goal of zero tariffs" exists in the trade context).

Thuronyi, or, alternatively, could be the pursuit of targeted topical reform. All of these choices, when taken together, either will enable proponents of a multilateral system to successfully navigate political and policy pitfalls, or will force the otherwise inevitable foundering of such an enterprise on the rocky shores of national self-interest and bilateral suspicion. While Victor Thuronyi's mission is a bold one, the simple saying still applies. Here, in tax, as elsewhere, the devil is in the details. Ironically, it may be that our sometimes frustrating experience with bilateral regimes will provide us with some keys to multilateral success.