Copenhagen Business School Law Research Paper Series
No. 23-05

Breaking the Double Tax Paradigm

Jeroen Lammers & Tarcísio Diniz Magalhães

Breaking the Double Tax Paradigm

Jeroen Lammers & Tarcísio Diniz Magalhães *

Abstract

The success story of economic globalization is often linked to increased freedom of capital movement between countries, facilitated by the existence of more than three thousand bilateral tax treaties whose primary purpose is to prevent double taxation. Even the most outspoken critics of the international tax regime subscribe to the notion that double taxation is detrimental to global growth and development, yet they argue, all things considered, tax treaties might not be worth signing. Based on an extensive review of the available tax policy and economics literature, this Article shows that there is not enough normative or empirical basis for thinking that double taxation will necessarily restrict trade and capital flows, provided that the combined effective tax burden is kept at a reasonable level. At the same time, treaties provide investors with legal certainty that is key to cross-border business activity. This Article thus posits that relaxing the double tax paradigm could help improve tax treaties, with a view to preserving their role in fostering international commerce and investment. We propose a simplified tax treaty model that, by allowing a limited overlap between home- and host-state taxes, would diminish overall implementation costs, thus benefiting both taxpayers and tax administrations. The Article further demonstrates that this approach is superior to the current Pillar One proposal and other popular systemic reform suggestions in the literature, specifically the destination-based cashflow tax (DBCFT) and global formulary apportionment.

* Dr. Jeroen Lammers, Assistant Professor of International Tax Law, Copenhagen Business School; Dr. Tarcísio Diniz Magalhães, Assistant Professor of International Tax Law, University of Antwerp.

INTRODUCTION

When double taxation first arose as a common concern among states about one hundred years ago, the League of Nations framed the issue in explicit moral-laden terms, by asking a group of four economists to study whether international agreements could "remove the evil consequences of double taxation . . . ."[1] The language of unfairness embedded in the narrative was confounded with an instinctive conviction that double taxation is economically inefficient in global welfare terms, because it can be an obstacle to international capital mobility.[2] As a result, an intricate global network of over three thousand bilateral tax treaties was built over the last century, with the primary purpose of guaranteeing that income earned in a jurisdiction

---

[1] Econ. Fin. Comm'n, *Report on Double Taxation Submitted to the Financial Committee by Professor Bruins, Einaudi, Seligman and Sir Jonah Stamp*, League of Nations, at 3 (1923) [hereinafter LN Report]. *See also id.* 9–10, 51.

[2] The first question the four economists were asked to answer was: "What are the economic consequences of double taxation from the point of view: (1) of the equitable distribution of burdens; (2) of interference with economic intercourse and with the free flow of capital?" *Id.* at 5.

(interchangeably if imperfectly called source, host, debtor, or capital-importing state) by an investor of another jurisdiction (interchangeably if imperfectly called residence, home, creditor, or capital-exporting state) is taxed no more than once.[3] To date, this double tax paradigm is largely taken for granted, to the point that questioning it may border academic heresy.[4]

Yet remarkably, past decades have seen a rise in criticism of tax treaties, including from organizations such as the International Monetary Fund (IMF) and World Bank that long advised countries (especially developing and low-income ones) to enter into such agreements.[5] A common thread in this critique is that existing double tax conventions disproportionately favor the revenue needs of relatively wealthier states, as the residence jurisdictions of most investors, with no concrete assurances that increased levels of cross-border investments will follow.[6] With the ongoing structural transition from a brick-and-mortar economy to one based on digitalized business models, the frustration with the existing tax treaty network has exponentially grown because many multinational enterprises now derive significant profits from multiple states through all manner of virtual means that leave no taxable footprint at source.[7]

How to improve tax treaties in a way that satisfies source states has, therefore, become a constant theme in recent scholarship as well as policy-based work carried out at a multilateral level.[8] But nearly all proposals advanced by scholars and experts take the double tax paradigm as a given, and thus proceed to suggest rule-based reforms to allocate income more equitably by way of transferring taxing rights from a certain group of countries to another.[9] The approach, however, has proven to be elusive in effectuating meaningful change, not least because of sturdy opposition by countries that currently enjoy greater taxing rights in sharing some of these rights.

---

[3] *Cf.* ICTD, World Bank & G-24, Tax Treaties Explorer: Online Datasets (Mar. 5, 2021), https://www.treaties.tax/en/.

[4] *E.g.,* OECD, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL, at 9 (Nov. 21, 2017) [hereinafter OECD MTC] (stating that "harmful effects on the exchange of goods and services and movements of capital, technology and persons are so well known that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries."); U.N. DEP'T OF INT'L ECON. & SOC. AFFAIRS, U.N. MODEL DOUBLE TAX CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES, at 10–16, U.N. Doc. ST/ESA/378, U.S. Sales No. E.21.XVI.1, at iv (2021) [hereinafter UN MTC] (stating that "the effects of [double taxation] are harmful to the exchange of goods and services and to the movement of capital and persons . . . .").

[5] Lee A. Sheppard, *The IMF Debunks Tax Competition*, TAX NOTES (2014) ("The IMF recommends that developing countries not sign tax treaties that cede tax jurisdiction over income earned within their borders."); Mindy Herzfeld, *The Backlash Against Tax Treaties and Free Trade*, 84 Tax Notes Int'l 438 (2016) ("Some in academia and the nonprofit world (as well as organizations like the IMF and the World Bank) are urging developing countries to reconsider the value of entering into bilateral tax agreements, arguing that they give away more than they get when they enter into a tax treaty with a developed country."); Amanda Athanasiou, *Developing Countries Rethinking Tax Treaties*, 76 TAX NOTES INT'L 395 (2014) (reporting on Uganda's decision to renegotiate existing treaties or suspend new negotiations and Mongolia's decision to cancel treaties with Luxembourg and the Netherlands). *See also* Part I.C *infra.*

[6] Parts I.A–B, II.B and II.C *infra*.

[7] *See generally* CRAIG ELLIFFE, TAXING THE DIGITAL ECONOMY: THEORY, POLICY AND PRACTICE (2021).

[8] Parts I.C and III.A *infra*.

[9] *Id*.

The purpose of this Article is to challenge the self-evidently held notion that curbing double taxation should be an invariable element in any proposal for the reform of the international tax system. By breaking with a longstanding intellectual tradition that assumes that improving the tax position of some countries necessarily comes at the expense of other countries, we propose a simplified structure for a new tax treaty model that would explicitly allow a limited level of double taxation of cross-border business profits, with the ultimate goal of raising revenues for both contracting states while increasing legal certainty and lowering overall administrative and compliance costs.

Part I sets the stage for the discussion that follows by exposing the main issues with bilateral tax agreements in force today that justify alternative approaches. Part II conducts an extensive review of the literature surrounding tax treaties, corporate taxation, and international double taxation that shows that there is (perhaps surprisingly) very little empirical or normative support to the double tax paradigm. Part III calls for a shift of attention away from double taxation and towards simplification, and then explains how tax treaties could be recast as a mechanism that fixes a percentage of global profits that may be taxed by both treaty partners at once, without necessarily restricting the flow of capital between them. Even if our proposal is not fully embraced, this Article's analysis contributes to the ongoing discourse on how to properly redesign international tax rules by dispelling core misconceptions about double taxation.

I. WHAT'S WRONG WITH DOUBLE TAX TREATIES?

For the greater part of the existence of the treaty-based international tax law order, the focus was on relieving interjurisdictional double taxation.[10] In broad strokes, this form of double taxation occurs when two states levy (personal and/or corporate) income taxes over the same cross-border transaction.[11] Three are the typical double-tax scenarios: two states claiming to be the residence of a taxpayer (residence-residence jurisdictional overlap); two states claiming to be the source of a taxpayer's income (source-source jurisdictional overlap); or a residence state and a source state exercising their taxing authority over the same income item (residence-source jurisdictional overlap).[12] The third is the main target of existing tax treaties, especially when double taxation involves the same income and taxpayer at the same time—what legal doctrine traditionally calls juridical, as opposed to economic, double taxation.[13]

From the 1990s onward, world leaders came to realize that, in seeking to avoid that income is double taxed, tax treaty rules often allow income to go untaxed.[14] Following the 2008 global

---

[10] Steven A. Dean & Rebecca M. Kysar, *Reconsidering the Tax Treaty*, 41 BROOK. J. INT'L L. 967, 967 (2016).

[11] *See generally* EDWIN R.A. SELIGMAN, DOUBLE TAXATION AND INTERNATIONAL FISCAL COORDINATION (1928).

[12] KEVIN HOLMES, INTERNATIONAL TAX POLICY AND DOUBLE TAX TREATIES: AN INTRODUCTION TO PRINCIPLES AND APPLICATION 23 (2nd ed. 2014).

[13] In contrast, international economic double taxation is "characterized by a lack of identity regarding the taxpayer" as "when the same economic transaction or asset is taxed in two states in the same period under different tax laws." Roland Ismer & Julia Ruß, *What is International Double Taxation?*, 48 INTERTAX 555, 555 n.4 (2020).

[14] OECD, Rep. of the Comm. Fiscal Aff., Harmful Tax Competition: An Emerging Issue, at 33 (1998) ("The OECD has encouraged countries to extend their treaty networks since an extensive network of treaties helps eliminate double taxation

financial crisis, the Organisation for Economic Co-operation and Development (OECD) initiated a multi-year, multi-country initiative called the Base Erosion and Profit Shifting (BEPS) project,[15] which proposed a series of changes to the international tax regime to respond to a phenomenon that was dubbed "double nontaxation".[16] Since 2018, the BEPS project entered a second phase (colloquially referred to as "BEPS 2.0") that is characterized by a two-pillar approach to address the tax challenges of the digital economy and remove some of the remaining pressure for countries to engage in tax competition via a coordinated global minimum tax.[17]

To understand how tax treaties function and what problems they might entail, the following Sections critically examine their rule-based structure by reference to the OECD, United Nations (UN), and U.S. model conventions as well as the main critiques found in the literature. By bringing these issues to the fore, this Part sheds light on the motivations behind the ongoing global reform initiative and alternative approaches, including our proposed model presented in Part 3 *infra*.

A. Anachronistic structure

In the simplest of terms, a bilateral tax treaty establishes voluntary and mutually agreed international law limits on the contracting states' sovereign power to tax all income that arises

---

and encourages co-operation between tax authorities. Yet an extensive treaty network may open up the benefits of harmful preferential tax regimes offered by the treaty country to a broader array of countries than would otherwise be the case."). *See also* Thomas Rixen, *From Double Tax Avoidance to Tax Competition: Explaining the Institutional Trajectory of International Tax Governance*, 18 REV. INT'L POL. ECON. 197, 220 (2011) ("As an unintended consequence of its institutional setup, the tax regime, which originally only dealt with double tax avoidance, endogenously creates under-taxation."); Philipp Genschel & Thomas Rixen, *Settling and Unsettling the Transnational Legal Order of International Taxation*, *in* TRANSNATIONAL LEGAL ORDERS 154, 154–56 (Terence C. Halliday & Gregory Shaffer eds., 2015) (arguing that transnational legal orders can be problem-solvers and problem-creators, as exemplified by the way double tax treaties have enabled tax competition, avoidance, and evasion); Ruth Mason, *The Transformation of International Tax*, 114 AM. J. INT'L L. 353, 401 (2020) ("Throughout the twentieth century, states oversatisfied the norm against double taxation, accommodating significant nontaxation of corporate income.").

[15] *See generally* OECD, ADDRESSING BASE EROSION AND PROFIT SHIFTING (2013); OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING (2013).

[16] *See* Luc De Broe, Editorial, *At Last, Some Output on the Fight against Double Non-Taxation*, 6 EC TAX REV. 310, 310 (2014) (stating that double nontaxation arose "[i]n the aftermath of the crisis and the resulting budgetary impact . . . ."); Anne Van de Vijver, *International Double (Non-)Taxation: Comparative Guidance from European Legal Principles*, 5 EC TAX REV. 240, 242–44 (2015) (investigating the relation between double nontaxation and fairness); Allison Christians, *BEPS and the New International Tax Order*, 2016 BYU L. REV. 1603, 1621–39 (2016) (explaining BEPS' four minimum standards); Rifat Azam, *Ruling the World: Generating International Tax Norms in the Era of Globalization and BEPS*, 50 SUFFOLK U. L. REV. 517, 531–54, 563–84 (2017) (using international relations theory to explain the evolution of the international tax regime since its inception until the BEPS project); Félix Daniel Martínez Laguna, *Abuse and Aggressive Tax Planning: Between OECD and EU Initiatives – The Dividing Line between Intended and Unintended Double Non-Taxation*, 9 WORLD TAX J. 189, 206–43 (2017) (investigating the meaning of unintended double nontaxation and OECD and EU measures to counter it); Porus F. Kaka, *From the Avoidance of Double Taxation to the Avoidance of Double Non-Taxation: The Changing Objectives of Tax Treaties*, 75 BULL. INT'L TAX'N 613, 616–17 (2021) (discussing BEPS Action 6 modification of tax treaty objectives to explicitly counter double nontaxation).

[17] For previous analyses of these pillars, see Allison Christians & Tarcísio Diniz Magalhães, *A New Global Tax Deal for the Digital Age*, 67 CAN. TAX J. 1153, 1168–71 (2019); Tarcísio Diniz Magalhães & Allison Christians, *Rethinking Tax for the Digital Economy After COVID-19*, 11 HARV. BUS. L. REV. 1, 18–25 (2021); Allison Christians & Tarcísio Diniz Magalhães, *Why Data Giants Don't Pay Enough Tax*, HARV. L. & POL'Y REV. (forthcoming 2023); JEROEN LAMMERS, THE SPIRIT OF INTERNATIONAL TAX LAW: FROM FISCAL VIRTUE TO MISSION-ORIENTED MOON-SHOT, PhD Thesis (University of Amsterdam 2023).

in connection with their territories or residents.[18] By definition, income that is produced across borders fundamentally depends on the regulatory and economic interactions of two or more states. Without these states' combined efforts to liberalize capital flows and the exchange of goods and services, no cross-border profit would be possible to begin with. Given these premises, all states involved by a taxpayer's international activities presumably have a legitimate claim to tax the corresponding income. But if they all decide to do so, multiple taxation can occur. To coordinate the avoidance of such an outcome, it has become a common practice for states to enter bilateral treaties—and, more rarely, regional multilateral agreements[19]—whose primary aim is to define when and how much each contracting state will tax income flows between them.

The text of most tax treaties in force around the world is inspired by model conventions designed—and periodically updated—by the OECD and United Nations,[20] or country-specific models such as in the United States.[21] In commonality, these models adopt what is referred to in doctrine as a "schedular structure".[22] At a national level, a schedular income tax system is one that relies on income categories to determine a designated tax treatment for each type of earning, including whether the earning is taxable or exempt.[23] Similarly, tax treaties contain various rules that categorize cross-border income streams, but the reason is that each category must be assigned between treaty partners in a way that avoids a double tax effect. In this vein,

---

[18] Jérôme Monsenego, *Nexus for Transfer Pricing Purposes Before and After BEPS 2.0: From Form to Substance and Back to Form?*, *in* TAX NEXUS AND JURISDICTION IN INTERNATIONAL AND EU LAW (ebook) (Edoardo Traversa ed., 2022) ("Under public international law, nothing seems to prevent a state from exercising tax jurisdiction in situations in which there would be no sufficient nexus, unless a state accepts limiting its own sovereignty, for example, by concluding a tax treaty or becoming a member of an international organization of which membership affects national sovereignty, such as the European Union."); Allison Christians, *Who Should Tax Multinationals?*, 39 SOC. PHIL. & POL'Y 208, 211–15, 218–24 (2023) (examining the legal and philosophical literature on the right to tax, and finding no clear hard limitations on asserted tax jurisdiction).

[19] *E.g.,* SICE Foreign Trade Information System, Decision 40: Approval of the Agreement among Member Countries to Avoid Double Taxation and of the Standard Agreement for Executing Agreements on Double Taxation between Member Countries and Other States Outside the Subregion, http://www.sice.oas.org/trade/junac/decisiones/dec040e.asp (between Andean Community member states, namely Bolivia, Colombia, Ecuador, and Peru); CARICOM, 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, https://caricom.org/wp-content/uploads/Agreement-Among-The-Member-States-of-The-CARICOM-for-the-Avoidance-of-Double-Taxation-and-the-Prevention-of-Fiscal-Evasion-........pdf (between some Caribbean Community member states, namely Antigua and Barbuda, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago); Nordic eTax, Nordic Tax Treaty, https://www.nordisketax.net/pages/en-GB/nordic-tax-treaty (between Norway, Denmark, Iceland, Sweden, and Finaland).

[20] OECD MTC, *supra* note 4; UN MTC, *supra* note 4. *See also* Elliot Ash & Omri Marian, *The Making of International Tax Law: Empirical Evidence from Tax Treaties Text*, 24 FLA. TAX REV. 151, 167–87 (2020) (empirically testing the influence of these two models on real-life treaties through natural language processing).

[21] The first U.S. tax treaty model was published in 1996, then updated in 2006 and again in 2016. IRS, United States Model – Tax Treaty Documents, https://www.irs.gov/businesses/international-businesses/united-states-model-tax-treaty-documents.

[22] Klaus Vogel, *The Schedular Structure of Tax Treaties*, 56 BULL. INT'L FISC. DOC. 260, 260 (2002); H. David Rosenbloom, *Comments on the Schedular Structure of Tax Treaties*, 56 BULL. INT'L FISC. DOC. 262, 262 (2002).

[23] Examples of countries that tax income in a schedular way include France, Germany, Italy, Spain, the United Kingdom, and many others. In contrast, comprehensive or global income tax systems, for instance in the United States and Brazil, tend to subject all forms of gains deriving from any source to taxation. REUVEN AVI-YONAH, NICOLA SARTORI & OMRI MARIAN, GLOBAL PERSPECTIVES ON INCOME TAX LAW 17–22 (2011). *See generally* VICTOR THURONYI, KIM BROOKS & BORBALA KOLOZS, COMPARATIVE TAX LAW (2nd ed. 2016); HUGH J. AULT, BRIAN J. ARNOLD & GRAEME S. COOPER, COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS (4th ed. 2019).

tax treaties' rule-based structure allocates each predefined income item to either the residence or source state ("exclusive jurisdiction"),[24] or to both at the same time ("concurrent or shared jurisdiction").[25] In the latter case, the residence state is usually required to alleviate double taxation through either the credit or exemption methods (Article 23).

The two broadest categories of income recognized by the international tax regime are "active" and "passive" income (or "business" and "investment" income, respectively).[26] From this classification, tax treaties subdivide income (active and passive) according to whether it is earned by natural/physical persons (i.e., individuals or human beings) or legal/juridical persons (i.e., companies and other abstract entities).[27]

Types of individuals' active income include earnings related to independent personal services (Article 7, OECD/U.S., applied to "business profits"; but a specific Article 14 under the UN model); employment or dependent personal services (Article 15, OECD/UN models; Article 14, U.S. model); director's fees and remuneration of top-level managerial officials (Article 16, OECD/UN models; Article 15, U.S. model); entertainers, artistes, and sportspersons (Article 17, OECD/UN models; Article 16, U.S. model); pensions and social security payments (Article 19, OECD/UN models; but in the U.S. model Article 17, including annuities, alimony, and child support, and Article 18 for pension funds);[28] government service (Article 19, OECD/UN/U.S. models); and students and trainees (Article 20, OECD/UN/U.S. models). Entities' active income include business profits (Article 7, OECD/UN/U.S. models) and profits from international shipping and air transport (Article 8, OECD/UN/U.S. models).

---

[24] This is typically the case of provisions that use the expression "shall be taxable only" with reference to one of the contracting states. OECD MTC, *supra* note 4, arts. 7(1), 8(1), 12(1), 13(3) and (5), 15(1), (2) and (3), 18, 19(1) and (2), 21(1), and 22(3) and (4) (regarding business profits, international shipping and air transport, royalties, capital gains, income from employment, pensions, government services, other income, and capital); UN MTC, *supra* note 4, arts. 7(1), 8A(1) and 8B(1) and (2), 13(3) and (8), 14(1) 15(1), (2) and (3), 18A(1) and (2) and 18B(3), 19(1) and (2), 21(1), and 22(3) and (4) (regarding business profits, international shipping and air transport, capital gains, independent personal services, dependent personal services, pensions and social security payments, government services, other income, and capital); UNITED STATES MODEL INCOME TAX CONVENTION (U.S. DEP'T OF TREAS. 2016), https://home.treasury.gov/system/files/131/Treaty-US-Model-2016_1.pdf [https://perma.cc/2MFE-NJ87] [hereinafter US MTC], arts. 7(1), 8(1), 11(1), 12(1), 13(4), (5) and (6), 14(1), (2) and (3), 17(1), (4), and (5), 19(1) and (2), and 21(1) (regarding business profits, shipping and air transport, interest, royalties, gains, pensions, social security, annuities, alimony, and child support, government service, and other income).

[25] This is typically the case of provisions in which the expression "may be taxed" appears. OECD MTC, *supra* note 4, arts. 6(1), 7(1), 10(1), 11(1), 13(1), (2) and (4), 15(1), 16, 17(1), and 22(1) and (2) (regarding income from immovable property, business profits, dividends, interest, capital gains, income from employment, directors' fees, entertainers and sportsperson, and capital); UN MTC, *supra* note 4, arts. 6(1), 7(1), 8B(2), 10(1), 11(1), 12(1), 12A(1), 12B(1), 13(1), (2), (4), (5), (6) and (7), 14(1), 15(1), 16(1) and (2), 17(1), 18B(1), and 22(1) and (2) (regarding income from immovable property, business profits, international shipping and air transport, dividends, interest, royalties, fees for technical services, income from automated digital services, capital gains, independent personal services, dependent personal services, directors' fees and remuneration of top-level managerial officials, artistes and sportspersons, pensions and social security payments, and capital); US MTC, *supra* note 24, arts. 6(1), 7(1), 10(1), (5), (6), and (10), 11(2) and (3), 12(2), 13(1) and (3), 14(1), 15, and 16(1) and (2) (regarding income from real property (immovable property), business profits, dividends, interest, royalties, gains, income from employment, directors' fees, and entertainers and sportsmen).

[26] *See generally* Reuven S. Avi-Yonah, INTERNATIONAL TAX AS INTERNATIONAL LAW: AN ANALYSIS OF THE INTERNATIONAL TAX REGIME (2007) (deriving a principle from the benefits theory of taxation according to which passive or investment income should be taxed at residence while active or business income should be taxed at source).

[27] *See generally* 1 ROY ROHATGI ON INTERNATIONAL TAXATION: PRINCIPLES (Ola Ostaszewska & Belema Obuoforibo eds., 2018) (various contributions explaining the structure of tax treaties and distributive rules for individual and company income, among other topics).

[28] *But see* HOLMES, *supra* note 12, at 94 (classifying pensions as passive income).

Regarding passive income of natural or juridical persons, the main types are earnings from immovable/real property, also known as "rental income" (Article 6, OECD/UN/U.S. models); dividends (Article 10, OECD/UN/U.S. models); interest (Article 11, OECD/UN/U.S. models); and royalties (Article 12, OECD/UN/U.S. models). There are also specific rules for capital gains (Article 13, OECD/UN/U.S. models) as well as for all other unspecified income streams that fall under the umbrella term "other income" (Article 21, OECD/UN/U.S. models). In addition, the latest version of the UN model proposes specific articles for income from two types of services, namely technical services (Article 12A) and automated digital services (Article 12B).

The origin of these income classes can be traced to customs and practices among various states, but the current structure and content of tax treaties is largely attributed to a century-old political compromise achieved at the birth of the League of Nations.[29] In the 1920s and 1930s, many League of Nations members had schedular national income tax systems in place, but some key members like the United States, Germany, and the Netherlands deviated from this pattern.[30] To this date, fully comprehensive income tax systems are still a minority around the world, even though the specialized literature depicts them as the optimal approach.[31] The main reason is that drawing clear dividing lines between different types of income always involves a challenging and costly exercise for both governments and taxpayers. A global/comprehensive income tax system is supposed to prevent, in particular, arbitrage between income from labor and income from capital.[32]

From another angle, fully comprehensive income tax systems have the disadvantage of potentially undermining certain policy goals a state might find appropriate. For instance, treating all forms of income the same way for tax purposes can create economic disincentives for activities that are considered socially valuable, such as saving and investing.[33] This explains why many countries prefer a dual model, applying a progressive rate for labor income and a lower flat rate for capital.[34] Since the work of the League of Nations, there has been an observable trend away from purely schedular domestic income tax systems towards models

[29] *Cf.* Steven A. Dean, *A Constitutional Moment in Cross-Border Taxation*, 1 J. FIN. DEV. 1, 1–2 (2021) (comparing the structure of tax treaties to a "Classification and Assignment Constitution" and claiming that recent global reform projects imply a new "constitutional moment").

[30] LN Report, *supra* note 1, at 26.

[31] Lee Bruns & Richard Kreever, *Individual Income Tax*, *in* 2 TAX LAW DESIGN AND DRAFTING 495, 496–98 (Victor Thuronyi ed., 1996).

[32] Ruud de Mooij & Alexander Klemm, *Why and How to Tax Corporate Income*, *in* CORPORATE INCOME TAXES UNDER PRESSURE: WHY REFORM IS NEEDED AND HOW IT COULD BE DESIGNED 11, 12 (Ruud de Mooij, Alexander Klemm & Victoria Perry eds., 2021).

[33] *Id. See also* John A. Kay, *Tax Policy: A Survey*, 100 ECON. J. 18, 67 (1990) (arguing that a comprehensive income tax encounters political obstacles, imposes administrative burdens for taxpayers and tax authorities, and leads to avoidance and distortions).

[34] de Mooij & Klemm, *supra* note 32, at 16.

that do not rely on different income classes and that tax business income in a more comprehensive way.[35]

This reality stands in stark contrast with how tax treaties demarcate the right to tax. Concerning corporate profits in particular, treaties prescribe a general treatment for all non-investment/active income (called "business profits" by Article 7), which are often subject to net-basis taxation, and then specific treatments for investment/passive income such as dividends (Article 10), interest (Article 11), and royalties (Article 12), which are often subject to gross-basis withholding taxes at source. The distributional implication of this structure is the object of the next Section, but it is worth noticing that those categories have always been prone to overlap, such that authors have long debated whether distributive treaty provisions are overinclusive or underinclusive.[36]

It is true that, when overlapping occurs, a hierarchical ordering rule built into Article 7 determines that special income provisions should take precedence over Article 7.[37] In this sense, if business profits include other income items such as dividends, interest, and royalties, then Articles 10, 11, or 12 must apply. But each of these provisions refers back to Article 7 when the special income item is connected to a permanent establishment in the source state.[38] This apparently in-built circularity reveals that the same income streams can be concomitantly depicted as business profits and a subcategory of such profits. This issue was raised in a famous Australia-India tax treaty dispute decided in 2015 and 2016. In *Tech Mahindra Limited v. Commissioner of Taxation*, Judge Perry of the Federal Court of Australia took the view that "Article 12(4) does not pick up Article 7(7) so as to create a circularity."[39] Upon appeal, however, Judges Robertson, Davies, and Wigney of the Full Court arrived at the opposite conclusion, stating that "there is circularity: the application of the business profits rule in Art 7(1) is subject to Art 7(7); where business profits include "royalties", Art 7(7) is subject to Art 12(4) which has the effect that Art 7, not Art 12, will be applicable."[40]

---

[35] *Cf.* SUNITA JOGARAJAN, DOUBLE TAXATION AND THE LEAGUE OF NATIONS 22 (2018) ("The 1925 Report notes that the officials recognised the reality that source countries would not give up the imposition of schedular taxes, and that the imposition of the general income tax (GIT) based on residence was growing.").

[36] *Compare* Vogel, *supra* note 22, at 261 (arguing that business profits could be further specified according to special source rules and thresholds with different allocation outcomes, such as (i) business income from the sales, production, and leasing of tangible goods; (ii) business income from the sales, production, and leasing of intangible assets; (iii) business income from services; and (iv) business income from financial transactions) *with* Kees van Raad, *International Coordination of Tax Treaty Interpretation and Application*, 29 INTERTAX 212, 213–14 (2001) (claiming that income types in treaties might appear clear but they in fact are easily prone to overlap, leading to divergence in interpretation and application by courts in various countries) *and* Rosenbloom, *supra* note 22, at 262 (arguing that a system with more types of income would likely lead to continuing disagreement among treaty partners).

[37] OECD MTC, *supra* note 4, art. 7(4); UN MTC, *supra* note 4, art. 7(6); US MTC, *supra* note 24, art. 7(4).

[38] OECD MTC, *supra* note 4, art. 10(4), 11(4), and 12(3); UN MTC, *supra* note 4, art. 10(4), 11(4), and 12(4). *See also* US MTC, *supra* note 24, art. 7(5) ("In applying this Article, paragraph 8 of Article 10 (Dividends), paragraph 5 of Article 11 (Interest), paragraph 5 of Article 12 (Royalties), paragraph 3 of Article 13 (Gains) and paragraph 3 of Article 21 (Other Income), any income, profit or gain attributable to a permanent establishment during its existence is taxable in the Contracting State where such permanent establishment is situated even if the payments are deferred until such permanent establishment has ceased to exist.").

[39] Federal Court of Australia, Tech Mahindra Limited v. Commissioner of Taxation, 1082 FCA 1, 21 (2015).

[40] Federal Court of Australia, Tech Mahindra Limited v. Commissioner of Taxation, 130 FCAFC 1, 8 (2016).

If distinguishing active from passive income is an inherently challenging exercise, doing so in today's much more complex global economic reality is compounded by the existence of varied business models involving digital, nondigital, and hybrid forms of profit-making activities that do not neatly fit a single income category.[41] In the last Section, we return to this issue in analyzing the recent ongoing global project to address the tax challenges of digitalization.

B. Pro-residence bias

To allocate taxing rights between residence and source, tax treaties adopt so-called "distributive rules" for each previously specified income category within the treaty's structure. A key example is Article 7, which prescribes a general rule for "business profits", a concept that is meant to encompass most forms of active/non-investment income. For passive/investment income, specific distributive rules allocate the right to tax on either a shared basis (often with tax rate limitations imposed on source states in respect to withholding taxes) or exclusive basis (in favor of the residence state). In following either the OECD, UN, or U.S. models, the wording of general and specific distributive rules in most tax treaties looks very much alike, but there are some relevant differences that are worth mentioning.

With the goal of preventing double taxation of business profits, Article 7(1)'s first sentence starts by assigning the right to tax to the residence state alone. The expression "shall be taxable only" contained in that sentence signals that, prima facie, the residence state has an exclusive entitlement over all business profits earned by its residents, even when the income arises from activities in another state.[42] But the same provision also conditions the exercise of this right in full to the nonexistence of a permanent establishment in the source state, as defined by Article 5.[43] Examples include a local place of management, branch, office, factory, and workshop, among others, but their mere existence is not enough for characterizing a permanent establishment for tax treaty purposes.

First, Article 5(1) ordinarily requires a factual and legal analysis that demonstrates that the foreign taxpayer's presence in the source state meets six minimum elements: (1) a "place of business" that is "fixed" (2) temporally and (3) geographically, (4) "through which" the

---

[41] João Francisco Bianco & Ramon Tomazela Santos, *A Change of Paradigm in International Tax Law: Article 7 of Tax Treaties and the Need to Resolve the Source versus Residence Dichotomy*, 70 BULL. INT'L TAX'N 1, 1 (2016) (arguing that the conflict residence-source in respect to the classification of certain income streams and whether tax should be withheld at source predates the digital economy, but developed countries only grew interested in this conflict after many of them, especially in Europe, became source jurisdictions for digital services provided by U.S. multinationals); Elena Vėgėlytė, *Deconstructing User Participation: Why in the Digital Era Advertising Income is Different from Other Business Income*, 27 INT'L TRANSFER PRICING J. 1, 1 (2020) (arguing that network effects lead to high user participation and low business participation, making the advertising income obtained by some digital companies a type of income that resembles pay-as-you-go fees).

[42] OECD MTC, *supra* note 4, comm. art. 7, para. 11 ("The first principle underlying paragraph 1 . . . has a long history and reflects the international consensus that, as a general rule, until an enterprise has a permanent establishment in another State, it should not properly be regarded as participating in the economic life of that other State to such an extent that the other State should have taxing rights on its profits.").

[43] Jacques Sasseville, *Article 7: Business Profits*, *in* GLOBAL TAX TREATY COMMENTARIES (Pasquale Pistone et al. eds., 2019) (ebook) ("Article 7(1) of both the OECD Model and the UN Model confers exclusive taxing rights on the residence state over the profits of an enterprise in the absence of a PE in the other state.").

business is (5) "wholly or partially carried", and that is (6) effectively "at the disposal of the enterprise".[44] Second, even if all these elements are present, a permanent establishment will usually not be characterized if the taxpayer falls into one of the exceptions listed in Article 5(4), provided that the performed activities are "of a preparatory or auxiliary character". All these requirements have been the subject of much debate in scholarship and court cases world-over, but one thing seems certain: only when the source state is capable of fully demonstrating the existence of a local permanent establishment is there an entitlement to tax. When this happens, the residence state is no longer permitted to tax business profits in their entirety, yet the residence state still preserves a nonexclusive right to tax.[45] In stating that in the presence of a permanent establishment profits "may be taxed" by the source state, Article 7(1) grants shared or concurrent taxing rights to both contracting states.

Additionally, Article 7(1)'s second sentence introduces another rule that works in favor of residence states. The rule consists of limiting how much profits can be attributed to the permanent establishment and then taxed at source. Depending on whether the treaty follows the UN or the OECD/U.S. models, the allocation of income can be more or less restrictive. The UN model's Article 7(1) uses a more expansive wording that denotes what is known in the literature as "force of attraction".[46] The expression conveys the idea that in some cases the source state might "attract" income in addition to what the permanent establishment strictly produces. In theory, force of attraction admits a limited and full interpretation, but both are rejected by the OECD/U.S. models. The UN model, on the other hand, accepts a limited force of attraction when Article 7(1) states that certain profits from sales and other business activities that are similar to the activities performed through the permanent establishment are also taxable at source.

Whatever the model, the residence state can tax profits derived from the source state in basically three situations: (1) income items that do not qualify as "business profits" and that are allocated on an exclusive or shared basis to the residence state per other provisions, such as dividends, interest, and royalties (further explained below); (2) income items that qualify as "business profits" but are not strictly attributable to a permanent establishment (nor, per the UN model, to certain similar activities); and (3) permanent establishment profits that are taxed by the source state at a rate lower than the residence states' rate, in case the treaty adopts the credit method (Article 23B) instead of the exemption method (Article 23A) for double tax

---

[44] *See generally* Brian A. Arnold & Geoffrey Loomer, *Article 5: Permanent Establishment*, *in* GLOBAL TAX TREATY COMMENTARIES (2019) (ebook). Note that the temporal and geographical dimensions of the "fixed" element and the "at the disposal" element are not expressly stated in Article 5(1), but they appear throughout commentaries to the article. OECD MTC, *supra* note 4, at 117–27, para. 6–44; UN, *supra* note 4, at 179–96, para. 3–44.

[45] Sasseville, *supra* note 43 (ebook) ("Read literally, article 7(1) of the OECD Model does not provide that the residence state may also tax the profits if there is a PE [permanent establishment] in the other state, but this is clearly implicit, and certainly the language does not prevent the residence state from taxing.").

[46] *See* Amar Mehta, *The Limited Force of Attraction Rule*, 21 ASIA-PACIFIC TAX BULL. 1, 1–3 (2015); Suhas Sagar, *How "Limited" is the Limited Force of Attraction? An Analysis of the Relevant Case Law and the Potential Implications of the OECD/G20 BEPS Initiative*, 71 BULL. INT'L TAX'N 180, 182–91 (2017).

relief.[47] The last situation arises from the general treaty obligation imposed on residence states to account for source-paid income taxes in order to eliminate double taxation. While the exemption method determines that taxes paid at source are final, the credit method leaves room for residual taxation by the residence state when the amount of foreign taxes that is eligible for credits in the residence state does not fully eliminate residence-based taxation.[48]

It is easy to see that this structure favors residence jurisdictions, which are often developed countries functioning as the world's largest capital exporters. Especially when the treaty follows the OECD model as it is often the case,[49] Article 7 is ostensibly more restrictive towards source jurisdictions. There are scenarios where business profits will be entirely allocated to the residence state in absolute disregard for the contributions that the source state makes to income generation. For example, when the foreign taxpayer performs business activities in the source state that do not require a local physical presence—a reality that is increasingly common in today's digital economy—or even if the taxpayer is physically present in the source state but this presence does not fulfill all the formal requirements necessary to constitute a permanent establishment, as specified in Article 5, or little income is attributed to permanent establishment activities.

Whether treaties are pro-residence or pro-source matters in particular when one of the contracting states is at a lower level of economic development.[50] This is because investments flow asymmetrically between developed and developing countries,[51] in that the former are often capital exporters with "residence interests" while the later are often capital importers with "source interests".[52] But in the digital economy, many developed countries, foremost in Europe, function as source states to the largest digital multinationals, which are largely U.S.-based.

Under a pro-residence tax treaty, source states that wish to tax profits derived from their territories by a nonresident face a double onus: first, they must demonstrate that the taxpayer

---

[47] Sasseville, *supra* note 43 (ebook) ("[I]f a tax treaty adopts the exemption method of the kind in article 23 A, the residence state exempts the profits of the PE [permanent establishment] from tax as a way of relieving residence-source double taxation.").

[48] *Id.* ("[A] reference to article 23 A and 23 B of the OECD Model, which deals with the elimination of double taxation by the residence state . . ., clarifies that the determination of the profits attributable to a PE [permanent establishment] is relevant not only for the purposes of taxation of these profits by the PE state but also for the determination of the amount of exemption or credit that the residence state must grant in accordance with article 23 A and 23 B.").

[49] Rebecca M. Kysar, *Interpreting Tax Treaties*, 101 IOWA L.R. 1387, 1417 (2016).

[50] Honey Lynn Goldberg, *Conventions for the Elimination of International Double Taxation: Toward a Developing Country Model*, 15 LAW & POL'Y INT'L BUS. 833, 846–47 (1983) ("A treaty can then be characterized as having an overall source bias, an overall residence bias, or no overall bias.").

[51] Peter D. Byrne, *Developing Countries, Tax Treaties and the United Nations Model Tax Convention*, 2 ILSA J. INT'L & COMP. L. 695, 701 (1996) ("When you have international economic activity between a developed and a developing country, the direction of the flow of investment is almost always from Country R (being the developed country) into Country S (the developing country), whether you are talking about a business activity or a passive investment such as shares of stock or a debt instrument."); Thomas Rixen, *A Politico-Economic Perspective on International Double Taxation*, 49 TAX NOTES INT'L 599, 600 (2008) ("The distribution of tax revenues depends on the symmetry or asymmetry of investment flows between treaty partners.").

[52] Charles I. Kingson, *The Coherence of International Taxation*, 81 COLUM. L. REV. 1151, 1158 (1981).

has a local permanent establishment with all its constitutive elements;[53] and second, they must present persuasive arguments about how much of the taxpayer's total profits belong (legally and economically) to that permanent establishment. Alternatively, source states can try to argue that the profit comprises a specific passive income item (dividend, interest, or royalties, for example) if the treaty allows gross-basis withholding.[54]

Here again, there are obvious practical challenges in building a case for stripping certain income items out of business profits and, depending on the treaty, the strategy might not work for any type of passive income. Per the OECD and U.S. models, royalties and other income are generally allocated to the residence state on an exclusive basis, and the same applies to interest with respect to the U.S. model.[55] Interest under the OECD model may be subject to withholding taxation at source at a maximum 10% rate, while the maximum withholding tax rates for dividends under the OECD and U.S. models are 5% or 15% depending on the case.[56] But in many real-life treaties between developed and developing countries, the percentage of withholding on passive income is set at zero, effectively eliminating source taxation of given income items altogether.[57]

---

[53] *See* Doris Canen, *Permanent Establishment: The Latest Trends from the Brazilian Tax Authorities—A Case Law Update*, 70 BULL. INT'L TAX'N 1, 1 (2016) (discussing the business impact of jurisprudential changes in Brazil that "held that there are PEs [permanent establishments] where they were previously not considered to exist.").

[54] Latin American countries are known for adopting such an approach, even if often challenged in courts by taxpayers. *See* Vanessa Arruda Ferreira, *Service Income under Brazilian Tax Treaties: The Possible End of Article 7 v. Article 21 Battle, but the Start of a New Old One?*, 42 INTERTAX 427, 429–32 (2014); Vanessa Arruda Ferreira, *The New Brazilian Position on Services Income under Tax Treaties: If You Can't Beat'em, Join'em*, 43 INTERTAX 255, 257–62 (2015); Leonardo Freitas de Moraes e Castro & Alexandre Luiz Moraes do Rêgo Monteiro, *Qualification of Services under Double Tax Treaties in Brazil: Open Issues After* Iberdrola *Case*, 45 INTERTAX 54, 58–61 (2017); M.F. Furtado, H. Verboom & C. Lütter, *No Brazilian Withholding Tax on Payments for Technical Services?*, 69 BULL. INT'L TAX'N 558, 558–59 (2018); Leonardo Thomaz Pignatari, *The Qualification of Technical Services in Brazilian Double Tax Treaties and the Possible Impacts of the Adoption of Article 12B, UN Model Convention*, 49 INTERTAX 674, 674–76 (2021). For an example of a developed country adopting an expansive royalties provision, see William Hoke, *Royalties are Taxable in Australia under Australia-India Treaty*, TAX NOTES (Oct. 22, 2018), https://www.taxnotes.com/featured-news/royalties-are-taxable-australia-under-australia-india-treaty/2018/10/19/28jbf.

[55] OECD, *supra* note 4, art. 12(1) and 21(1); US MTC, *supra* note 24, art. 11(1), 12(1) and 21(1). For a critique and counterproposal, see Kim Brooks, *Tax Treaty Treatment of Royalty Payments from Low-Income Countries: A Comparison of Canada and Australia's Policies*, 5 EJ. TAX RES. 168, 169 (2007) (calling the OECD model's royalties provision "one of the most extreme examples of high-income countries unfairly confiscating revenues that appropriately belong to their low-income treaty partners."). *See also* Annet Wanyana Oguttu, *A Critique of International Tax Measures and the OECD BEPS Project in Addressing Fair Treaty Allocation of Taxing Rights between Residence and Source Countries: The Case of Tax Base Eroding Interets, Royalties and Service Fees from an African Perspective*, 29 STELLENBOSCH L. REV. 314, 314–46 (2018); Eric C.C.M. Kemmeren, *Legitimacy of Tax Claims of Developing Countries on Interest and Royalties of MNEs*, *in* PRACTICAL PROBLEMS IN EUROPEAN AND INTERNATIONAL TAX LAW: ESSAYS IN HONOR OF MANFRED MÖSSNER 163, 163–86 (Heike Jochum et al. eds., 2017). The UN model leaves the percentage of withholding tax rates to be negotiated bilaterally, including with respect to royalties. UN MTC, *supra* note 4, art. 12(2). *See generally* Anna Binder & Selina Siller, *Passive Income*, *in* THE UN MODEL CONVENTION AND ITS RELEVANCE FOR THE GLOBAL TAX TREATY NETWORK 117 (Michael Lang et al. eds., 2017).

[56] OECD, *supra* note 4, art. 12(1) and 21(1); US MTC, *supra* note 24, art. 12(1) and 21(1).

[57] *Cf.* Patricia A. Brown, *How Hard Can This Be? The Dearth of U.S. Tax Treaties with Latin America*, 74 U. MIAMI L. REV. 359, 380 f.122, 382–84 (2020); Ministerie van Financiën, 2020 Memorandum on Tax Treaty Policy, at 16–18, (2020).

C. Critiques in the literature

Notwithstanding the exponential growth in the number of tax treaties in the course of the last century,[58] a host of critics emerged in the scholarship over the years. For example, in the 1970s Charles Irish noticed the imbalance between residence (mostly developed) and source (mostly developing) states when he declared that "the present system of tax agreements creates the anomaly of aid in reverse—from poor to rich countries."[59] A few decades later, Tsilly Dagan made a similar claim in the sense that tax treaties "serve much less heroic goals, such as easing bureaucratic hassles and coordinating tax terms between contracting countries, and much more cynical goals, particularly redistributing tax revenues from the poorer to the richer signatory countries."[60] As another scholar put it differently, "the [treaty] regime that developed was a default of source taxation with a mechanism for countries to shift to a more residence-based taxation on a case-by-case basis."[61]

Many others have endorsed some version of the view that, at least for a large number of developing countries and most certainly for low-income ones, double tax treaties might hurt more than help.[62] Even institutions such as the IMF and the World Bank that in previous decades advised multiple countries to enter into tax treaty relationships in order to attract investments have recently adjusted their position on the matter. For example, a 2014 IMF

---

[58] *See* Lyne Latulippe, *The Expansion of the Bilateral Tax Treaty Network in the 1990s: The OECD's Role in International Tax Coordination*, 27 AUSTL. TAX F. 851, 853 f.1, 854, t.1 (2012).

[59] Charles R. Irish, *International Double Taxation Agreements and Income Taxation at Source*, 23 INT'L & COMP. L. QUART. 292, 292 (1974). *See also* Stanley S. Surrey, *United Nations Group of Experts and the Guidelines for Tax Treaties between Developed and Developing Countries*, 19 HARV. INT'L L.J. 1, 8–10 (1978) (discussing the residence-source conflict in respect to developed and developing countries in the design of the UN model convention).

[60] Tsilly Dagan, *The Tax Treaties Myth*, 32 INT'L L. & POL. 939, 939 (2000).

[61] Adam H. Rosenzweig, *Thinking Outside the (Tax) Treaty*, 2012 WIS. L. REV. 717, 742 (2012). *See also* Adam H. Rosenzweig, *Thinking Outside the (Tax) Treaty Revisited*, 41 BROOK. J. INT'L L. 1229, 1231 (2016) ("[A] bilateral tax treaty is intended to permit countries to shift, on a bilateral basis, from a primarily source-based system to a primarily residence-based system.").

[62] *See* Allison Christians, *Tax Treaties for Investment and Aid to Sub-Saharan Africa: A Case Study*, 15 BROOK. L. REV. 639 (1999), *reprinted in* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS 563 (Karl P. Sauvant & Lisa E. Sachs eds., 2009); Lee A. Sheppard, *Revenge of the Source Countries?*, TAX NOTES (2005); Lee A. Sheppard, *Revenge of the Source Countries, Part 2: Royalties*, TAX NOTES (2005); Lee A. Sheppard, *Revenge of the Source Countries, Part III: Source as Fiction*, TAX NOTES (2005); Lee A. Sheppard, *Revenge of the Source Countries, Part 4: Who Gets the Bill?*, TAX NOTES (2005); Lee A. Sheppard, *Revenge of the Source Countries, Part 5: Throwing BRICs*, TAX NOTES (2006); Lee A. Sheppard, *Revenge of the Source Countries, Part 6: Subsidiary as PE*, TAX NOTES (2006); Kim Brooks, *Canada's Evolving Tax Treaty Policy toward Low-Income Countries*, *in* GLOBALIZATION AND ITS TAX DISCONTENTS: TAX POLICY AND INTERNATIONAL INVESTMENTS—ESSAYS IN HONOUR OF ALEX EASSON (Arthur J. Cockfield ed., 2010); Bret Wells & Cym H. Lowell, *Income Tax Treaty Policy in the 21st Century: Residence vs. Source*, 5 COLUM. J. TAX L. 1 (2013); VERONIKA DAURER, TAX TREATIES AND DEVELOPING COUNTRIES (2013); Alberto Vega, *Tax Treaties between Developed and Developing Countries: The Role of the OECD and UN Models*, in TAX JUSTICE AND THE POLITICAL ECONOMY OF GLOBAL CAPITALISM, 1945 TO THE PRESENT (Jeremy Leaman & Attiya Waris eds., 2013); Lee A. Sheppart, *How Can Developing Countries Cope with Tax Avoidance?*, TAX NOTES (2013); Kim Brooks & Richard Krever, *The Troubling Role of Tax Treaties*, *in* TAX DESIGN ISSUES WORLDWIDE (Geerten M.M. Michielse & Victor Thuronyi eds., 2015); Victor Thuronyi, *Tax Treaties and Developing Countries*, *in* TAX TREATIES: BUILDING BRIDGES BETWEEN LAW AND ECONOMICS (Michael Lang et al. eds., 2016); Dimitri Paolini et al., *Tax Treaties with Developing Countries and the Allocation of Taxing Rights*, 42 EUR. J.L. & ECON. 383 (2016); Petr Janský & Marek Šedivý, *Estimating the Revenue Costs of Tax Treaties in Developing Countries*, 42 WORLD ECON. 1828 (2018); Eric M. Zolt, *Tax Treaties and Developing Countries*, 72 TAX L. REV. 111 (2018); Oladiwura Ayeyemi Eyitayo-Oyesode, *Source-Based Taxing Rights from the OECD to the UN Model Conventions: Unavailing Efforts and an Argument for Reform*, 13 L. & DEV. REV. 193 (2020); MARTIN HEARSON: IMPOSING STANDARDS: THE NORTH-SOUTH DIMENSION OF GLOBAL TAX POLITICS (2021).

Policy Paper raised various issues with bilateral tax agreements concluding that "treaties systematically favor developed countries over developing countries."[63] In another Policy Paper from 2019, the IMF restated that "[d]ouble tax agreements (DTAs) continue to impose revenue risks for developing countries."[64] Finally, a recent study published by economists Sebastian Beer (from the IMF) and Jan Loeprick (from the World Bank) on tax treaties between Sub-Saharan African countries and so-called "investment hubs" provided evidence that "treaties tend to come with non-negligible revenue losses" that, all in all, might not be worthwhile.[65]

When states negotiate tax treaties, there is always an implicit normative question to be answered that concerns which of their a priori equally valid claims over a common pool of resources should prevail. When the states involved are at different levels of wealth, the question is complicated further because tax treaties bring into sharp focus global distributive justice issues.[66] In public discourse and news media outlets, it has become commonplace to talk about a "fair share of taxes",[67] but in more technical terms the normative question implied by tax treaties concerns what in public finance is known as "inter-nation equity". This concept was originally coined by economist Peggy Musgrave in the 1960s,[68] and it was later popularized by an influential essay with Richard Musgrave.[69]

In the Musgraves' original formulation, inter-nation equity was not exclusively about sharing tax revenues. The Musgraves adopted a broader definition that included all gains (and losses) that states obtain by economically engaging with one another.[70] From a national welfare perspective, states might gain or lose from international economic cooperation depending on the observed levels of employment, consumption, and capital returns after they start cooperating. They also gain (or lose) in respect to public revenues that might come from any type of tax they are willing to levy, including payroll taxes, consumption taxes, personal income taxes and, of course, corporate (profit-based) taxes. In formulating a wide concept, the Musgraves drew attention to all possible financial advantages and disadvantages that individual

---

[63] IMF, *Spillovers in International Corporate Taxation*, Policy Paper, at 45 (May 9, 2014).

[64] IMF, *Corporate Taxation in the Global Economy*, Policy Paper n. 2019/007, at 59 (2019).

[65] Sebastian Beer & Jan Loeprick, *Too High a Price? Tax Treaties with Investment Hubs in Sub-Saharan Africa*, 28 INT'L TAX & PUB. FIN. 113, 113 (2021).

[66] *See* Nancy H. Kaufman, *Fairness and the Taxation of International Income*, 29 L. & POL'Y IN INT'L BUS. 145 (1998); Alexander W. Cappelen, *National and International Distributive Justice in Bilateral Tax Treaties*, 56 FINANZARCHIV/PUB. FIN. ANALYSIS 424 (1999); Nancy H. Kaufman, Commentary, *Equity Considerations in International Taxation*, 26 BROOK. J. INT'L L. 1465 (2001); Arthur Cockfield, *Purism and Contextualism within International Tax Law Analysis: How Traditional Analysis Fails Developing Countries*, 5 EJ. TAX RES. 199 (2007); Miranda Stewart, *Redistribution between Rich and Poor Countries*, 72 BULL. INT'L TAX'N 297 (2018).

[67] *See* Allison Christians, *Measuring a Fair Share*, 68 TAX NOTES INT'L 95 (2012); Adam H. Rosenzweig, *Defining a Country's "Fair Share of Taxes"*, 42 FLA. ST. U. L. REV. 373 (2015); MAARTEN FLORIS DE WILDE, SHARING THE PIE: TAXING MULTINATIONALS IN A GLOBAL MARKET (2017); BUSINESS, CIVIL SOCIETY AND THE 'NEW' POLITICS OF CORPORATE TAX JUSTICE: PAYING A FAIR SHARE? (Richard Eccleston & Ainsley Elbra eds., 2018).

[68] *See generally* PEGGY B. MUSGRAVE, TAXATION OF FOREIGN INVESTMENT INCOME: AN ECONOMIC ANALYSIS (1963); PEGGY B. MUSGRAVE, UNITED STATES TAXATION OF FOREIGN INVESTMENT INCOME: ISSUES AND ARGUMENTS (1969).

[69] Richard A. Musgrave & Peggy B. Musgrave, *Inter-Nation Equity*, *in* MODERN FISCAL ISSUES: ESSAYS IN HONOUR OF CARL S. SHOUP 63, 71 (Richard M. Bird & John G. Head eds., 1972).

[70] Allison Christians, *Digital Services Taxes and Internation Equity: A Tribute to Peggy Musgrave*, TAX NOTES INT'L 589, 589–90 (2019).

states might experience when they open themselves up to cross-border business activity. But the Musgraves were also interested in the more fundamental normative question of what a just allocation of those gains and losses, especially between richer and poorer nations, would look like.

Since that seminal contribution to the literature, inter-nation equity has been routinely incorporated in works by other scholars concerned with improving fairness in interjurisdictional tax relations.[71] As a common starting point, these scholars tend to emphasize that the current global taxation system is biased towards residence (relatively wealthier) countries and that structural reform is needed in order to allow source (less affluent) countries to regain some of the taxing rights they have surrendered by entering tax treaty relationships. Though inter-nation equity may not provide a definitive answer as to the precise size of source countries' legitimate claim over the global tax base, the concept paves the way for rethinking the structure of international taxation and how taxing rights should be allocated between all states involved.

For Peggy and Richard Musgrave, the best approach would be to design a system that taxes income on a global basis, subsequently allocating the proceeds among all participating countries through some apportionment mechanism that takes into account their levels of development.[72] Others have considered alternative metrics. Ilan Benshalom, for example, starts with a claim that duties of global distributive justice to alleviate poverty and inequality must be linked to the actual economic interactions between states.[73] The upshot is that only those states directly engaged in a specific cross-border transaction can demand a fairer division of the wealth produced by such a transaction. Benshalom then argues that such "relational-distributive duties" are stronger when wealthy nations exploit trade advantages over economically disadvantaged nations, in which case tax allocation arrangements should be used as a corrective.

Allison Christians and Laurens van Apeldoorn differently argue that international trade and commerce give rise to synergy effects that would not exist in the absence of widespread regulatory cooperation between most of the world's states. But since it is not possible to isolate how much each of their cooperative efforts contributes to global wealth production, Christians and van Apeldoorn argue the net benefits of cooperation should be shared equally between all

---

[71] *See* Kim Brooks, *Inter-Nation Equity: The Development of an Important but Underappreciated International Tax Policy Objective*, *in* TAX REFORM IN THE 21ST CENTURY: A VOLUME IN MEMORY OF RICHARD MUSGRAVE (John H. Head & Richard Krever eds., 2009); Jinyan Li, *Improving Inter-Nation Equity through Territorial Taxation and Tax Sparing*, in GLOBALIZATION AND ITS DISCONTENTS: TAX POLICY AND INTERNATIONAL INVESTMENTS—ESSAYS IN HONOUR OF ALEX EASSON (Arthur J. Cockfield ed., 2010); Anthony C. Infanti, *Internation Equity and Human Development*, *in* TAX, LAW AND DEVELOPMENT (Yariv Brauner & Miranda Stewart eds., 2013); Ivan Ozai, *Inter-Nation Equity Revisited*, 12 COLUM. J. TAX L. 58 (2020); Adam H. Rosenzweig, *International Vertical Equity*, 52 LOY. U. CHI. L.J. 471 (2021); Arief Hakim P. Lubis & Ning Rahayu, *Emphasizing Inter-Nation Equity in the New Digital Economy's Taxing Rights Allocation Scheme*, 11 INT'L J. SCI. & RES. PUB. 7 (2021).

[72] Musgrave & Musgrave, *supra* note 69, at 85.

[73] Ilan Benshalom, *The New Poor at Our Gates: Global Justice Implications for International Trade and Tax Law*, 85 NYU L. REV. 1, 31–37, 81 (2010).

participating states.[74] Beyond allocating most taxing rights to residence states, another problem Christians and van Apeldoorn notice is that tax treaties do not explicitly consider which part of multinationals' profits is connected to the synergy effects of cross-border activities. They contend that source states have an equally justifiable right to tax international income, most especially because it is hard to attribute with precision an income item to a specific geographic source.[75] If gains that rely on two parties cooperating should not belong exclusively to either one of them, the fairest way to distribute those gains, they claim, is to allow each jurisdiction to tax an equal share, irrespective of their economic size or strength.[76] Because their model seeks distributive justice without double taxation,[77] the conclusion is that residence states ought to relinquish taxing rights corresponding to net benefits of cooperation in favor of source states.[78]

In a series of papers, Ivan Ozai urges incorporating the principle of common but differentiated responsibility into international tax law as a means to achieve global justice.[79] That principle derives from other areas of international law, such as international labor law, law of the sea, international trade law, international climate law, and international patent law.[80] Given the massive disparities of resources and capabilities between developed and developing nations,[81] Ozai claims that the former bear an international legal obligation to cede taxing rights

---

[74] ALLISON CHRISTIANS & LAURENS VAN APELDOORN, TAX COOPERATION IN AN UNJUST WORLD 4, 11–13, 28 (2021). We return to this idea in Part III.A.3 *infra.*

[75] Mitchell Kane and Adam Kern classify Christians and van Apeldoorn's theory as "need-based", in contrast to contributory theories of international taxation. Kane and Kern then argue that contributory theories give rise to a "thorny problem" that they call "the measurement problem". Mitchell Kane & Adam Kern, *The Use and Abuse of Location-Specific Rent*, 76 TAX L. REV. (forthcoming 2023) ("The contributory theory asserts that the value of each country's rights to tax a business's profit should be proportionate to each country's degree of contribution to that business's profit. Thus, in order to apply this theory, we need to measure each country's contribution to each business's profit. But that is very hard to do when a business's operations span national borders and multiple countries contribute to a single stream of profit."). This description, however, overlooks that the measurement problem is regarded by many authors as inherent to any international tax allocation scheme and, precisely for this reason, approaches that do not depend on sorting out states' individual contributions to cross-border profit-making are necessary. *See* note 79–82, *infra*, and accompanying texts.

[76] *Id.* at 12, 119.

[77] *Id.* at 4 ("Central to the analysis of the problems identified as publicly unacceptable, and the solutions in the OECD-led initiatives in response, is the persistent normative question about which states are entitled to tax what, and the related question of which should prevail if more than one is entitled to tax.").

[78] *Id.* at 166–69.

[79] Ivan O. Ozai, *Tax Competition and the Ethics of Burden Sharing*, 42 FORDHAM INT'L L.J. 61, 81 (2018) [hereinafter *Burden Sharing*] (explaining that the principle is grounded on wealthier nations' historical responsibility as well as their higher ability to pay); Ivan Ozai, *Institutional and Structural Legitimacy Deficits in the International Tax Regime*, 12 WORLD TAX J. 53, 75 (2020) ("The normative foundations for differential treatment in international law lies on the notion that formal equal treatment can only secure equality among parties at an identical or similar level of economic and political power, and that an unequal treatment is needed to correct underlying inequalities among different parties."); Ivan Ozai, *Two Accounts of International Tax Justice*, 33 CAN. J.L. & JURISPRUDENCE 317, 338 (2020) ("[J]ustice requires not only improving inclusivity of less affluent countries in the current tax policy decision-making (political justice) but also establishing a normative framework that provides them with differentiated taxing rights based on their different levels of development (distributive justice)."). *See also* Ivan Ozai, *Designing an Equitable Border Carbon Adjustment Mechanism*, 70 CAN. TAX J. 1, 1–33 (2022) (applying the same principle to carbon taxation).

[80] Ivan Ozai, *Origin and Differentiation in International Income Allocation*, 44 DALHOUSIE L.J. 129, 138–39 (2021).

[81] Ivan Ozai, *Between Legitimacy and Justice in International Tax Policy*, *in* TAX JUSTICE AND TAX LAW: UNDERSTANDING UNFAIRNESS IN TAX SYSTEMS 187, 200 (Dominic de Cogan & Peter Harris eds., 2020) ("[P]olitical equality does not ensure substantive equity, and an inclusive decision-making process might still lead to an unfair allocation of taxing rights due to existing inequalities and differences in bargaining position among countries.").

to the latter, and that this obligation becomes stronger in the face of hard-to-source income streams. Moreover, Ozai asserts that countries with the lowest levels of national income should experience the most substantial increase in access to taxing rights.[82]

Other authors advocate more radical solutions. Sérgio André Rocha, for example, advises developing countries not to include Article 7 in their tax treaties at all. Rocha argues that it makes no sense for developing (source) states to adhere to a highly complex regime that conditions their sovereign right to tax income derived from their territorial jurisdictions to the ability to demonstrate, first, that a local permanent establishment exists and, second, how much of a foreign taxpayer's profits is attributable to that permanent establishment.[83] From the perspective of the United States, Rebecca Kysar recommends scaling down U.S. tax treaties, by way of abandoning provisions that have a clear distributional impact in revenue terms, most clearly Article 7.[84] Kysar's claim is that in the past years the United States has transitioned from a capital-exporting to a capital-importing economy, thus becoming vulnerable to revenue losses arising from pro-residence provisions that are often found in U.S.-signed tax treaties.[85]

While refraining from entering tax treaty relationships or excluding certain treaty provisions would allow capital-importing states to retain their full right to tax business income generated within their jurisdictional boundaries, these solutions appear suboptimal because they would likely entail greater legal uncertainty for investors, which can in turn harm cross-border business activities.

Proposals for the reform of the international tax system should take a holistic view that considers possible impacts not only on the level of tax revenues allocated to host and home countries but also incentives for cross-border investing. This is a key lesson that can be extracted from the Musgraves' broader focus on national gains and losses arising from international economic cooperation. Accordingly, the next Part examines the impact of cross-border taxation on investor decision and firm location and the role of treaties in providing capital owners with investment-promoting legal certainty, while the final Part returns to the concept of inter-nation equity as one of the justifications for a new tax treaty model.

II. ASSESSING THE DOUBLE TAX PARADIGM

In designing a system to divide taxing rights between residence and source, ensuring that cumulative tax claims do not obtain is an omnipresent concern among experts, analysts, and commentators. This Part investigates why this is so by searching the existing literature for normative and empirical support for the double tax paradigm. The first two Sections thus provide a comprehensive summary of available theoretical and evidence-based research on the relationship between taxation and principles of political morality, on the one hand, and foreign direct investment (FDI) determinants, on the other. Finding no sufficient grounds to oppose

---

[82] Ozai, *Burden Sharing*, supra note 79, at 77–80.

[83] Sérgio André Rocha, *Should Developing Countries Include Article 7 in Their Tax Treaties?*, 71 BULL. INT'L TAX'N, 345 355–56 (2017).

[84] Rebecca M. Kysar, *Unraveling the Tax Treaty*, 104 MINN. L. REV. 1755, 1824–32 (2020).

[85] *Id.* at 1800–06.

unqualified overlapping taxation, the last Section examines what role tax treaties should play today.

A. Normative theories

For many people in many places, double (or duplicative) taxation instinctively sparks a deep-rooted sense of unfairness. At face value, it seems objectionable that a person would be subject to the payment of taxes more than one time in respect to the same asset or activity. Upon closer inspection, however, it is not the number of times a tax is imposed that raises normative challenges. This is clearly seen when we consider that most of the time people already pay taxes on assets that have been previously taxed. For example, personal income taxes are charged on income that is earned by employing one's capital, labor, or a combination of both in productive processes. When the income is later privately spent with the acquisition of goods and services for personal consumption, other taxes apply, including general consumption-based taxes (such as the value-added tax, the goods and services tax, or retail sales taxes) as well as excise taxes of all kinds levied on specific products and activities and special property taxes levied on the ownership of real estate. Not to mention the possibility of gifts and inheritance or estate taxes applying over the already multiple-taxed income, when it is voluntarily transferred to someone else either during the life of the original owner or after their death, and wealth taxes on accumulated income above a certain threshold.[86]

Already in 1895, Edwin Seligman—one of the four economists who later coauthored the League of Nations 1923 Report on Double Taxation—noted that there is "much misconception" surrounding double taxation.[87] According to Seligman, double taxation "is not always wrong", the real problem being "unjust" or "unequal" taxation that arises when different tax treatments are accorded to individuals or groups of individuals that are equally situated in an economic sense.[88] In expressing these ideas, Seligman was not alone among his peers at the time. One of them was Thomas Adams, who is said to have single handedly architected the U.S. foreign tax credit in 1918. Despite his many disagreements with Seligman, Adams also believed, according to Michael Graetz and Michael O'Hear, that "what is wrong in double taxation is *discrimination*: the person who chooses to live in one country and earn money in another is singled out for a double dose of taxes."[89] If equal people are equally taxed two, three,

---

[86] LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP: TAXES AND JUSTICE 143 (2002) ("That issue cannot be the number of times an asset is taxed, however. It is hard to be sure whether the objection is mere demagoguery or actual confusion. Taxes are not like punishments, which cannot be imposed twice for the same crime. . . . Multiple distinct taxes often tax people's assets "twice," as when a sales tax is imposed on the expenditure of someone's after-tax income, or a property tax is collected on an asset that was bought with income subject to tax.").

[87] Edwin R. A. Seligman, *Double Taxation*, *in* ESSAYS IN TAXATION 95, 98 (1895).

[88] *Id.* (stating that double taxation "is unjust only when one taxpayer is assessed twice while another in substantially the same class is assessed but once" and that "[i]t is the inequality of taxation that instinctively shocks us.").

[89] Michael J. Graetz & Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 DUKE L.J. 1021, 1047 n.108 (1997), *reprinted in* MICHAEL J. GRAETZ, FOLLOW THE MONEY: ESSAYS IN INTERNATIONAL TAXATION 2 (2016). *See also* Seligman, *supra* note 87, at 98 ("[I]f all persons within the class are equally subjected to the burden, there can be no just complaint. It may be objected that people are not treated alike when they pay different taxes on the same income. Our opinion must depend, however, entirely on the attitude we take toward what is called "differentiation" of taxation. If we maintain that all incomes should be taxed alike, irrespective of source, the objection would be valid. But modern theory has

or more times, no particular fairness issue is deemed to arise from this fact alone, except in the extreme circumstance where the juxtaposition of various taxes becomes excessive and even confiscatory.[90] Outside these more extreme and limited cases, the problem is not precisely with double or multiple taxation, but with tax laws that unjustifiably violate some notion of horizontal equity.[91]

Nevertheless, public discourse still perceives the compounded imposition of taxes on something or someone as deserving of condemnation. A longtime controversy concerns the taxation of income generated by conducting business activities (through the corporate form, for instance) that is again taxed when the income is allocated to business owners (such as in the form of distributed dividends).[92] This form of double taxation in respect to the same income in the hands of a corporation and its shareholders has produced in the past decades a sizable literature on how to integrate corporate and personal income taxes into a unified, one-time taxing system that would avoid that perceived unwelcome result.[93] However, as Herwig Schlunk has convincingly argued, "double taxation" of income at an entity- and individual-level is not objectionable once the benefits theory of taxation is taken into account.[94] Schlunk

formulated the demand for a distinction between earned and unearned incomes, or between incomes from labor and incomes from property.").

[90] Seligman, *supra* note 87, at 97–98 ("[I]f all are put upon the same plane, the simultaneous taxation of property and of income works no injustice. If all the members of the class are treated alike, it makes no difference whether there is one single high tax on property, or a low tax on property and another low tax on the profits of the property. In fact, the government would be perfectly justified in taxing the property, the income of the property and also the expenses or any other attribute of the property. All such duplicate or triplicate taxes are perfectly reasonable so long as they fall equally on all. Taken together, they amount simply to a high rate for a single tax on the property."); MURPHY & NAGEL, *supra* note 84, at 143 ("Any issue of fairness in such cases would have to be about the cumulative effect of multiple taxes, not about double taxation per se. Looking at the issue in the traditional terms of the distribution of tax burdens, then, what matters is the total burden a person (not an asset) faces, compared with others.").

[91] On this concept, see generally David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 YALE L. & POL'Y REV. (2006); James Repetti & Diane Ring, *Horizontal Equity Revisited*, 13 FLA. TAX REV. 3 (2012), *reprinted in* THE PROPER TAX BASE: STRUCTURAL FAIRNESS FROM AN INTERNATIONAL AND COMPARATIVE PERSPECTIVE—ESSAYS IN HONOR OF PAUL MCDANEIL 121 (Yariv Brauner & Martin James McMahon Jr. eds., 2012); Ira K. Lindsay, *Tax Fairness by Convention: A Defense of Horizontal Equity*, 19 FLA. TAX REV. 79 (2016).

[92] *See generally* CHARLES E. MCLURE, MUST CORPORATE INCOME BE TAXED TWICE? (1979); Jasper L. Cummings Jr., *'Taxing Business Income Once': Where's the Beef? A Review and Critique of the Treasury Integration Study*, 54 TAX NOTES FED. 1391 (1992).

[93] *See* George F. Break, *Integrating Corporate and Personal Income Taxes: The Carter Commission Proposals*, 34 L. & CONTEMP. PROB. 4 (1969); Charles E. McLure Jr., *Integration of the Personal and Corporate Income Taxes: The Missing Element in Recent Tax Reform Proposals*, 88 HARV. L. REV. 532 (1975); Alvin Warren, *The Relation and Integration of Individual and Corporate Income Taxes*, 94 HARV. L. REV. 717 (1981); Reuven S. Avi-Yonah, *The Treatment of Corporate Preference Items under an Integrated Tax System: A Comparative Analysis*, 44 TAX LAWYER 1 (1990); Scott A. Taylor, *Corporate Integration in the Federal Income Tax: Lessons from the Past and a Proposal for the Future*, 10 VA. TAX REV. 2 (1990); Emil. M. Sunley, *Corporate Integration: An Economic Perspective*, 47 Tax L. Rev. (1992); George K. Yin, *Corporate Tax Integration and the Search for the Pragmatic Ideal*, 47 TAX L. REV. (1992); R. Glenn Hubbard, *Corporate Tax Integration: A View from the Treasury Department*, 7 J. ECON. PERSP. 1 (1993); Joseph A. Snoe, *The Entity Tax and Corporate Integration: An Agency Cost Analysis and a Call for a Deferred Distributions Tax*, 48 U. MIAMI L. REV. 1 (1993); Micheal J. Graetz & Alvin C. Warren Jr., *Integration of Corporate and Individual Income Taxes: An Introduction*, TAX NOTES (1999); Yariv Brauner, *Integration in an Integrating World*, 2 NYU J.L. & BUS. 51 (2005); Michael J. Graetz & Alvin C. Warren Jr., *Integration of Corporate and Shareholder Taxes*, 69 NAT'L TAX J. 3 (2016); Nir Fishbien, *The Case for Tax Integration and Current-Base Taxation*, 11 COLUM. J. TAX L. 2 (2020).

[94] Herwig J. Schlunk, *How I Learned to Stop Worrying and Love Double Taxation*, 79 NOTRE DAME L. REV. 127, 142–71 (2003).

further claims that the conclusion would be the same whether the taxpayer conducts activities within a single state or across borders.[95]

In a cross-border context, taxation by both the state where an investor resides and the state where the income is earned has long been viewed as justifiable on the basis of the benefits principle.[96] The explanation is that both states provide the income earner with tax-funded public benefits. But Schlunk argues that this logic equally vindicates "double taxation" in a purely domestic context. When a state taxes a local entity's profit (call it business income) and then the money the entity distributes to a resident shareholder for personal consumption (call it individual income), the rationale might be that the state regards each of those levies (the corporate income tax and the personal income tax) as payments for different packages of public benefits that are directly or indirectly provided to a person. A similar line of reasoning was employed by Peter Harris in the mid-1990s when he proposed a so-called "composite income tax",[97] even though Harris did not acknowledge that, technically speaking, his proposal implies double taxation.[98]

According to what Harris called "production services" provided by the state,[99] the corporate (entity-level) tax could be seen as funding public benefits that enable shareholders to efficiently conduct business activities under the corporate form. These are costs a state incurs with respect to infrastructure and other public goods that are necessary to secure a stable market environment, which in turn reduces the costs of doing business and enables profits to be generated in an efficient manner. Examples of such public benefits are highways and railways to transport raw materials and manufactured goods; schools and universities to build an educated workforce; police force and courts to protect a company's property rights, including intellectual property, etc. Conversely, the personal income tax funds public benefits that allow

---

95 *Id.* at 128–42.

96 *See generally* EVA ESCRIBANO: JURISDICTION TO TAX INCOME PURSUANT TO THE PRESUMPTIVE BENEFIT PRINCIPLE: A CRITICAL ANALYSIS OF STRUCTURAL PARADIGMS UNDERLYING CORPORATE INCOME TAXATION AND PROPOSALS FOR REFORM (2019). A few authors, chief among them Reuven Avi-Yonah, have defended the existence of a single tax principle that "states that cross-border income should be taxed once at the rate determined by the benefits principle . . .", but this position remains a minority in the literature. *Compare* Reuven S. Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of U.S. Treaty Policy*, 59 N.Y. L. SCH. L. REV. 305 (2014-2015); Reuven S. Avi-Yonah, *Full Circle? The Single Tax Principle, BEPS, and the New US Model*, 1 GLOB. TAX'N 1 (2016); Gianluca Mazzoni, *Present at the Creation: Archival Research and Evidence of the Origins of the Single Tax Principle*, 47 INTERTAX 10 (2019); Reuven Avi-Yonah & Gianluca Mazzoni, *Stanley Surrey, the 1981 US Model, and the Single Tax Principle*, 49 INTERTAX 8/9 (2021) *with* Daniel Shaviro, *The Two Faces of the Single Tax Principle*, 41 BROOK. J. INT'L L. 3 (2016); SINGLE TAXATION? (Joanna Wheeler ed., 2018); Elizabeth Gil García, *The Single Tax Principle or Reality in a Non-Comprehensive International Tax Regime?* 11 WORLD TAX J. 3 (2019); Leopoldo Parada, *Full Taxation: The Single Tax Emperor's New Clothes*, 24 FLA. TAX REV. 729 (2021).

97 PETER ANDREW HARRIS, CORPORATE/SHAREHOLDER INCOME TAXATION: AND ALLOCATING TAXING RIGHTS BETWEEN COUNTRIES—A COMPARISON OF IMPUTATION SYSTEMS (1996). *See also* C. John Taylor, *Twilight of the Neanderthals, or Are Bilateral Double Taxation Treaty Networks Sustainable?*, 34 MELB. U. L. REV. 268, 306–11 (2010) (considering the implementation of Harris' proposal via unilateral measures or a multilateral tax treaty within trading blocs).

98 Herwig J. Schlunk, *Double Taxation: The Unappreciated Ideal*, TAX NOTES 895 f.4 (2004) ("Although two taxes are imposed on the same income, Harris fails to acknowledge that his result is "double taxation." The reason, I think, is that his book concerns itself largely with imputation mechanisms. As such, his composite income tax finds itself positioned in a world of generally integrated income tax regimes. Thus, Harris is able to convince himself that his composite income tax is nothing more than a way to allocate taxing authority between countries, which allocation implies that the ultimate tax imposition is a single, rather than a double, tax. Whatever the linguistic manipulation, however, the composite income tax is a double tax: The same income is taxed twice.").

99 HARRIS, *supra* note 96, at 470.

the individual to enjoyably consume personal income by engaging in non-business activities—what Harris called "consumption services".[100] These include all costs a state incurs in supplying a social safety net with systems of healthcare, childcare, retirement pension, and education available to the individual and their family members; roads and bridges that allow them to travel and move around; police force and courts that protect lives, individual rights, and personal belongings, etc.

If this theoretical explanation makes sense, it is much easier to justify the simultaneous taxation of cross-border transactions by residence and source states, since the arising income, by definition, can only be generated when a person or firm engages with and benefits from both states' apparatuses.[101] This point was recently stressed by Julie Roin who wrote that "many multijurisdictional taxpayers will derive more in the way of governmental benefits than they would have enjoyed had they operated solely within any single jurisdiction"—what she calls a form of double-dipping.[102] Roin posits that "it may well be both fair and "efficient" (in terms of reducing tax-related distortions by taxpayers or states) for multijurisdictional taxpayers to pay some additional tax, in total, than taxpayers operating in only one state . . . ."[103] Accordingly, to completely eliminate cross-border double taxation might lead to a free-riding situation where some taxpayers obtain a "tax bonus" corresponding to the use of public goods provided by different states while contributing in only one of them.

B. Empirical studies

If double taxation does not, on its own, raise moral issues, it might still be the case that capital owners will feel disinclined to invest in other jurisdictions if they know they are going to be subject to income taxes in both places. The idea that economic distortion is an inevitable consequence of jurisdictional overlapping taxation might carry a rhetorical appeal of simplicity, but it is ultimately flawed or misguided.

One reason lies with the assumption that investments will be subject to a lower effective tax rate if only one jurisdiction exercises its tax authority.[104] This might be true in a hypothetical world of two states with similar corporate tax rates and profit measurement approaches. In such a homogenous two-state world, the imposition of taxes over the same income by both states would logically imply that the final burden is higher than if the income were taxed by only one of them. But this is obviously not the world we live in. Against the backdrop of various national

---

[100] *Id.*

[101] The same applies to interstate double taxation within federal states like the United States. SELIGMAN, *supra* note 10, at 40 ("As it has been laid down repeatedly by both state and federal courts, duplicate taxation as a result of being taxed by different states is not within the prohibition of double taxation for the reason that a tax in another state is not considered a tax for the purpose of the state to whose tax objection is taken.").

[102] Julie Roin, *Duplicative Taxation Among the States: A Problem Not Worth Solving?*, 25 FLA. TAX REV. 607, 669 (2022).

[103] *Id.* at 670–71.

[104] This assumption dates back to the League of Nations' work. LN Report, *supra* note 1, at 23 (mentioning that all income should be taxed "once, and once only"). *See also* Reuven Avi-Yonah, *Nothing New Under the Sun? The Medieval Origins of the Benefits Principle*, 51 INTERTAX 2, 2 (2023) (describing the 1923 Report on Double Taxation's conclusions that "double taxation impacts existing cross-border investments and deters new cross-border investment, and therefore should be avoided as much as possible.").

tax systems each with their own set of rules, that assumption breaks down. Even putting aside tax avoidance and tax competition, cross-border investments do not have to follow a single route. Especially when they are carried out by multinational enterprises that operate in multiple countries at once, several investment routes may be available, each with distinct tax (and non-tax) implications and considerations. Under these circumstances, the fact that one investment route is not double taxed does not mean that the ultimate tax burden will be lower than other investment routes where the taxpayer faces double taxation.[105]

To illuminate the extent to which double taxation might affect investment decisions, we summarize the economic literature below, examining three groups of empirical studies.

1. *Tax treaties*

One way scholars have tried to empirically measure double taxation's influence on cross-border investment decisions is by comparing FDI stocks before and after countries enter into bilateral tax agreements. Yet, after decades of research and debate, economists are still unsure about whether such a correlation can be substantiated. A large number of studies in fact suggests that many existing tax treaties have had either a zero or even a (significant) negative effect on FDI levels.[106]

A 2015 paper focusing on the United States presented some nuanced results.[107] According to this study, new and renegotiated U.S. tax treaties appear to have negatively affected the total of FDI outflows to host countries. But the authors' conclusion is that considering the total

[105] Maarten van 't Riet & Arjan Lejour, *Optimal Tax Routing: Network Analysis of FDI Diversion*, 25 INT'L TAX & PUB. FIN. 1321, 1337 (2018) ("[M]ultinationals may prefer routes with slightly higher costs than the strictly optimal route because of non-tax characteristics of the conduit countries.").

[106] Ronald B. Davies, *Tax Treaties, Renegotiations, and Foreign Direct Investment*, 33 ECON. ANAL. & POL'Y 251, 252 (2003) ("[D]ata suggests that treaties have either a zero or even a negative effect on FDI."); Ronald B. Davies, *Tax Treaties and Foreign Direct Investment: Potential versus Performance*, 11 INT'L TAX & PUB. FIN. 775, 776 (2004) [hereinafter *Potential v. Performance*] ("The empirical literature . . . finds little support for [the] expectation [that treaties encourage FDI]."); Bruce A. Blonigen & Ronald B. Davies, *The Effects of Bilateral Tax Treaties on U.S. FDI Activity*, 11 INT'L TAX & PUB. FIN. 601, (2004), *reprinted in* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS 485 (Karl P. Sauvant & Lisa E. Sachs eds., 2009); Bruce A. Blonigen & Ronald B. Davies, *Do Bilateral Tax Treaties Promote Foreign Direct Investment?*, *in* 2 HANDBOOK OF INTERNATIONAL TRADE: ECONOMIC AND LEGAL ANALYSIS OF TRADE POLICY AND INSTITUTIONS 526–46 (2004), *reprinted in* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS 461 (Karl P. Sauvant & Lisa E. Sachs eds., 2009); Peter Egger et al., *The Impact of Endogenous Tax Treaties on Foreign Direct Investment: Theory and Evidence*, 39 CAN. J. ECON. 3 (2006), *reprinted in* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS 513–40 (Karl P. Sauvant & Lisa E. Sachs eds., 2009); Tom Coupé, Irina Orlova & Alexandre Skiba, *The Effect of Tax and Investment Treaties on Bilateral FDI Flows to Transition Economies*, *in* THE IMPACT OF RICH COUNTRIES' POLICIES ON POVERTY AND POOR COUNTRIES (Bob Lucas, T.N. Srinivasan & Lyn Squire eds., 2008), *reprinted in* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS 687–712 (Karl P. Sauvant & Lisa E. Sachs eds. 2009); Peter Egger et al., *Bilateral Effective Tax Rates and Foreign Direct Investment*, 16 INT'L TAX & PUB. FIN. (2009) [hereinafter *Bilateral Rates*]; Ronald B. Davies, Pehr-Johan Norbäck & Ayça Tekin-Koru, *The Effect of Tax Treaties on Multinational Firms: New Evidence from Microdata*, WORLD ECON. 108 (2009) ("[F]or the most part tax treaties seem to have little effect on the level of FDI activity, measured in levels or as shares of affiliate sales."); Bruce A. Blonigen, Lindsay Oldenski & Nicholas Sly, *The Differential Effects of Bilateral Tax Treaties*, 6 AM. ECON. J. 17 (2014), at 17 ("[T]here is no robust evidence of an average positive effect of BTTs [bilateral tax treaties] on foreign affiliate activity and FDI [foreign direct investment] if one does account for the use of differentiated inputs . . . .").

[107] Joseph P. Daniels, Patrick O'Brien & Marc B. von der Ruhr, *Bilateral Tax Treaties and US Foreign Direct Investment*, 22 INT'L TAX & PUB. FIN. 999, 1022–25 (2015).

number of treaties host countries have in place, an overall positive impact is most likely to be ascertained.

Other analyses have yielded positive results with respect to most countries, but low-income countries are largely excluded from the sample. This strand of empirical work reveals an increase in FDI activity between high-income states and between these and middle-income ones once treaties entered into force.[108] Similarly, a study on Austrian tax treaties suggested that, although developing countries generally lose in revenue terms by signing a tax treaty, FDI inflow is expected to rise yet solely for middle-income countries.[109] In a new study by economists Kunka Petkova, Andrzej Stasio and Martin Zagler, the authors criticize previous analyses for disregarding two essential points.[110] First, tax treaties need to be examined as part of an integrated network, and not as a mere collection of isolated bilateral agreements. Second, numerous treaties within the network do very little to stimulate FDI because they ultimately fail to reduce effective marginal tax rates.[111] When these two points are accounted for, and after controlling for treaty shopping, Petkova, Stasio, and Zagler claim that a positive pattern emerges: tax treaties typically have a lowering effect on combined effective tax rates that in turn leads to an FDI increase by eighteen percent.

Be that as it may, the abundance of mixed studies and incompatible conclusions in the literature casts doubt on the value of existing double tax treaties to effectively promote international investment flows.[112] As further discussed in greater detail in Part II.B.3 *infra*, one reason could be that most residence countries already provide double tax relief via either foreign tax credits or exemption.[113] On the one hand, cross-border investors might still care

---

[108] Julian di Giovanni, *What Drives Capital Flows? The Case of Cross-Border M&A Activity and Financing Deepening*, 65 J. INT'L ECON. 127 (2005); Eric Neumayer, *Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries?*, 43 J. DEV. STUD. 1501 (2007), *reprinted in* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS 659–84 (Karl P. Sauvant & Lisa E. Sachs eds., 2009); Fabian Barthel et al., *The Relationship between Double Taxation Treaties and Foreign Direct Investment*, in TAX TREATIES: BUILDING BRIDGES BETWEEN LAW AND ECONOMICS (Michael Lang ed., 2010); Fabian Barthel, Matthias Busse & Eric Neumayer, *The Impact of Double Taxation Treaties on Foreign Direct Investment: Evidence from Large Dyadic Panel Data*, 28 CONTEMP. ECON. POL'Y 3 (2009); Fabian Barthel & Eric Neumayer, *Competing for Scarce Foreign Capital: Spatial Dependence in the Diffusion of Double Taxation Treaties*, 56 INT'L STUD. QUART. 645 (2012).

[109] Julia Braun & Daniel Fuents, *The Effects of Double Tax Treaties for Developing Countries: A Study of Austria's Double Tax Treaty Network*, 16 PUB. FIN. & MGMT. 383, 413 (2016).

[110] Kunka Petkova, Andrzej Stasio & Martin Zagler, *On the Relevance of Tax Treaties*, 27 INT'L TAX & PUB. FIN. 575, 578 (2020).

[111] *Id.* at 586, 603.

[112] Literature on bilateral investment treaties (BITs) and FDI is equally inconclusive. *See* Andrew Kerner, *What Can We Really Know About BITs and FDI?* 33 ICSID REV. 1 (2018); Jason Webb Yackke, *Are BITs Such a Bright Idea? Exploring the Ideational Basis of Investment Treaty Enthusiasm*, 12 U. C. DAVIS J. INT'L & POL'Y 195 (2005); Jason Webb Yackke, *Bilateral Investment Treaties, Credible Commitment, and the Rule of (International) Law: Do BITs Promote Foreign Direct Investment?*, 42 L. & SOC. REV. 805 (2008); Jason Webb Yackke, *Conceptual Difficulties in the Empirical Study of Bilateral Investment Treaties*, 33 BROOK. J. INT'L L. 405 (2008); Jason Webb Yackke, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*, 31 VA. J. INT'L L. 397 (2011); Sonia E. Rolland & David M. Trubek, *Legal Innovation in Investment Law: Rhetoric and Practice in Emerging Countries*, 39 U. PA. J. INT'L 355 (2017).

[113] Dagan, *supra* note 60, at 72–119; Paul L. Baker, *An Analysis of Double Taxation Treaties and Their Effect on Foreign Direct Investment*, 21 INT'L J. ECON. BUS. 3, 3 (2014). *See generally* CLAUDIO M. RADAELLI, THE POLITICS OF CORPORATE TAXATION IN THE EUROPEAN UNION: KNOWLEDGE AND INTERNATIONAL POLICY AGENDAS (1997) (arguing that tax treaties do not serve to reduce double taxation); Mindy Herzfeld, *The Purpose of Treaties: Not Always Double Taxation*, 81 TAX NOTES INT'L (2016).

about international double taxation, yet since its occurrence is largely reduced by residence-based unilateral measures, tax treaties become irrelevant to attract foreign capital. On the other hand, it could be that, as some economists have recently pointed out, "[i]nconclusive empirical findings on the importance of tax treaties for FDI are likely partly a result of the subordinated role of taxation in investor decision making and of the complexity of FDI decision making in multinational enterprises . . . ."[114]

Single, low or no taxation might not be the most relevant FDI determinant because an advantageous tax treatment can be easily offset by multiple other factors, including weak markets and poor infrastructure, or simply a lack of effective legal protection conferred by the host country to incoming investors. Consider, for instance, countries that, despite having a low tax rate or adopting measures to relieve double taxation, enforce property rights regimes that more easily allow investments to be expropriated, impose higher thresholds of patentability or restrict intellectual property rights through compulsory or open-source licensing, embrace protectionist policies that restrict trade and commerce, impose legal requirements and other regulatory burdens that reduce returns, so on and so forth.

2. *Corporate taxation*

For many decades, economists have employed a variety of theories and empirical approaches to identify the main factors that might increase or decrease FDI volumes, but such studies remain inconclusive.[115] Regarding tax-related FDI determinants in particular, an extensive body of work has focused on the role of tax incentives, corporate tax cuts, and the overall effect of corporate taxation, especially in respect to host-country taxes, on firm location and investment decisions.[116] However, a recent analysis by economists Sebastian Gechert and

---

[114] Beer & Loeprick, *supra* note 65, at 116.

[115] *E.g.,* Ali Abbas, *What Robustly Determines FDI in Emerging Markets and Developing Countries? A Sensitivity Analysis*, 32 J. INT'L TRADE & ECON. DEV. 410 (2023); Imad A. Moosa, *Theories of Foreign Direct Investment: Diversity and Implications for Empirical Testing*, 7 TRANT'L CORP. REV. 3 (2015); Isabel Faeth, *Determinants of Foreign Direct Investment – A Tale of Nine Theoretical Models*, 23 J. ECON. SURV. 165 (2009); Bruce A. Blonigen, *A Review of the Empirical Literature on FDI Determinants*, 33 ATL. ECON. J. 383 (2005).

[116] Marina Beljić, Olgica Glavaški & Jovica Pejčić, *The Impact of Corporate Income Tax on FDI Inflow in Emerging EU Economies*, 20 ECON. & ORG. 39–52 (2023) (showing a negative link between corporate tax rates and FDI influx in Czech Republic, Hungary, Lithuania, Latvia, Poland, Slovakia, and Slovenia during 2010-2019); Adamu Braimah Abille & Sulemana Mumuni, *Tax Incentives, Ease of Doing Business and Inflows of FDI in Africa: Does Governance Matter?*, 11 COGENT ECON. & FIN. (2023) (recommending that African tax administrations "shift from corporate-tax focused revenue generation to other sources of revenue generation to boost foreign investment" by improving institutional and governance indicators such as corruption, political stability, regulatory quality, rule of law, and government effectiveness); Seydou Coulibaly & Abdramane Camara, *The End of Tax Incentives in Mining? Tax Policy and MIning Foreign Direct Investment in Africa*, AFR. DEV. REV. (2022) (suggesting that "instead of granting corporate tax incentives, governments may consider improving the quality of socio-economic infrastructure, the availability of geological information and promoting political and economic stability for attracting mining investments."); James F. Albertus, Brent Glover & Oliver Levine, *Foreign Investment of US Multinationals: The Effect of Tax Policy and Agency Conflicts*, 144 J. FIN. ECON. 289–327 (2022) (estimating that the 2017 U.S. Tax Cuts and Jobs Act reduced foreign investment by 15.6% on average); Thomas von Brasch, Ivan Frankovic & Eero Tölö, *Corporate Taxes and Investment When Firms are Internationally Mobile*, INT'L TAX & PUB. FIN. (2022) (observing that FDI-export spillovers compensate corporate tax cuts "only if other countries do not follow suit and lower their corporate tax rates."); Ronald B. Davies, Iulia Siedschlag & Zuzanna Studnicka, *The Impact of Taxes on the Existence and Intensive Margins of FDI*, 28 INT'L TAX & PUB. FIN. 434–64 (2021) (finding evidence that host country taxes affect the decision of whether to invest or not (the "where" question) but not the size of the investment (the "how much" question)); Mahmoud M. Abdellatif, Ashraf G. Eid & Abdel-Salam G. Abdel-Salam, *The Relevance of Supply Side Taxation for Attracting Foreign Direct Investment to Developing Countries: Evidence from Egypt*, 19 EJ. TAX. RES. 1–16 (2021) (arguing that Egyptian supply-side tax policies that lowered rates and broadened the base were more effective than

Philipp Heimberger concluded that "[t]he literature on corporate taxes and growth has been biased towards over-reporting results according to which corporate tax cuts boost growth rates."[117]

Lately, the OECD sponsored a study to examine the particular effects of corporate taxation on multinationals' investment decisions.[118] This study points out that because neoclassical investment theory tends to assume that corporate taxes increase the cost of capital, these taxes are then assumed to negatively affect cashflows thereby reducing investments.[119] In 1992, for example, the Commission of the European Communities produced the "Ruding Report" noticing that tax-increased capital costs are likely to affect investment decisions and competitiveness, especially in marginal projects whose returns are entirely consumed in paying costs (taxes included).[120] But in distinguishing between marginal investments and other projects on the one hand, and multinational enterprises and small and medium-sized enterprises

---

tax holidays, since "tax incentives have an insignificant effect on FDI"); Michael Ade, *The Effect of Tax Harmonization in the Southern African Development Community on Foreign Direct Investment*, 55 J. DEV. AREAS 1 (2021) (identifying a significant positive relationship between regional tax harmonization and enhanced FDI flows in Southern Africa); Amadou Boly, Sydou Coulibaly & Eric N. Kéré, *Tax Policy, Foreign Direct Investment and Spillover Effects in Africa*, 29 J. AFR. ECON. 306–31 (2020) (finding that corporate tax cuts "increase FDI net inflows in the host country and in the neighbouring countries in the short and long run."); Leonardo Baccini, Quan Li & Irina Mirkina, *Corporate Tax Cuts and Foreign Direct Investment*, 33 J. POL'Y ANALYSIS & MGMT. 977–1006 (2014) (using Russia as a case study to make the case that "on average, relative to the absence of tax cuts, nondiscriminatory tax cuts on direct investment profit increase FDI, but discriminatory tax cuts on selected government-sanctioned investment projects do not."); Johannes Becker, Clemens Fuest & Nadine Riedel, *Corporate Tax Effects on the Quality and Quantity of FDI*, 56 EUR. ECON. REV. 1495–1511 (2012) (claiming that "taxes do not only affect the quantity of FDI but also the extent to which FDI contributes to corporate tax revenue and labour income, i.e. the quality of FDI."); Simeon Djankov et al., *The Effect of Corporate Taxes on Investment and Entrepreneurship*, 2 AM. ECON. J. 31–64 (2010) (presenting "cross-country evidence that effective corporate tax rates have a large and significant adverse effect on corporate investment and entrepreneurship.") Christian Bellak & Markus Leibrecht, *Do Low Corporate Income Tax Rates Attract FDI? Evidence from Central- and East European Countries*, 41 APP. ECON. 2691–703 (2009) (providing evidence that strategies of lowering corporate taxes impact foreign firms' location decisions); Christian Bellak, Markus Leibrecht & Jože P. Damijan, *Infrastructure Endowment and Corporate Income Taxes as Determinants of Foreign Direct Investment in Central and European Countries*, WORLD ECON. (2009) (arguing that, since infrastructure is a key FDI-location factor that creates rents for firms, countries with "an above-average infrastructure endowment can—at least in part—afford to finance their infrastructure by taxing corporations."); Michael P. Devereux & Rachel Griffith, *The Impact of Corporate Taxation on the Location of Capital: A Review*, 9 SWED. ECON. POL'Y 79–102 (2002) (reviewing the economic literature and concluding that "there is some evidence that taxes affect firms' location and investment decisions, although we do not have a very good idea about the size of this effect."); Roger H. Gordon & James R. Hines Jr., *International Taxation*, *in* 4 HANDBOOK OF PUBLIC ECONOMICS 1965 (Alan J. Auerbach & Martin Feldstein eds., 2002) ("Tax policies are obviously capable of affecting the volume and location of FDI, since, all other considerations equal, and in the absence of countervailing effects, higher tax rates reduce after-tax returns, thereby reducing incentives to commit investment funds."); James R. Hines Jr., *Lessons from Behavioral Responses to International Taxation*, 52 NAT'L TAX J. 2 (1999) (discussing evidence that "taxation significantly influences the location of foreign direct investment, corporate borrowing, transfer pricing, dividend and royalty payments, and R&D [research & development] performance."); Michael P. Devereux & Harold Freeman, *The Impact of Tax on Foreign Direct Investment: Empirical Evidence and the Implications for Tax Integration Schemes*, 2 INT'L TAX & PUB. FIN. 85–106 (1995) (finding a significant impact of taxation on the location of outward FDI but not the choice between domestic investment and total outward FDI).

[117] Sebastian Gechert & Philipp Heimberger, *Do Corporate Tax Cuts Boost Economic Growth?*, 147 EUR. ECON. REV. 1, 13 (2022).

[118] Tibor Hanappi & David Whyman, *Tax and Investment by Multinational Enterprises: An Empirical Analysis of Tax Sensitivities Within and Across Jurisdictions*, Tax'n Working Papers n. 64, at 2 (2023). (stating that OECD Working Papers do not represent the official views of the OECD or of its member countries, but rather describe preliminary results or research in progress by the author(s), which are published to stimulate discussion on a broad range of issues on which the OECD works).

[119] *Id.* at 8.

[120] Commission of the European Communities, *Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation*, Luxembourg: Office for Official Publications of the European Communities, at 22 (1992) [hereinafter Ruding Report].

on the other, the Ruding Report noted particularities to multinationals' investment responses, notably that corporate taxation seems to affect the legal and financial structure of the group more than the underlying investments.[121]

The new OECD study suggests that multinationals present a special case for corporate taxation because their investments are less sensitive to changes in effective marginal tax rates.[122] Within the organizational structure of the group, investment decisions can be optimized across a multitude of jurisdictions with different tax rates and tax treatments.[123] By setting up foreign branches or subsidiaries, financing investments locally or via the parent entity, and routing income through intermediate holding entities outside the parent jurisdiction, a multinational can influence the effective tax rate on its entire investments.[124] As such, general assumptions about the inefficiency of corporate taxation do not seem to easily translate to the context of multinational firms.

3. Double taxation

Taking double taxation as an autonomous phenomenon to be studied, a smaller fraction of economic papers has been produced trying to measure impacts on cross-border economic activity. Most of these studies, however, have been conducted on an ad hoc basis by focusing on specific countries or transactions, and their conclusions or recommendations are either questionable or inadequate to inform general policy decisions. For example, a 2009 paper stated that high levels of international double taxation reduce countries' attractiveness as the chosen location for multinationals' parent companies. This is a reasonable assertion, yet the authors strangely recommend in response the removal of both residence and source taxes.[125] Instead of providing an argument against double taxation, this paper appears to endorse double *non*taxation.

Another study from 2012 proposed replacing worldwide taxation with territorial taxation (which is equivalent to exempting all foreign-source income) due to an observed high sensitivity of foreign subsidiaries to additional taxes imposed at the parent company level, even when foreign tax credits or deferral are available.[126] But the result is not associated with double taxation per se. Rather, the authors explain their findings as possibly stemming from a

[121] *Id.* at 177.

[122] Hanappi & Whyman, *supra* note 118, at 18. *See also id.*, at para. 27 ("While domestic firms exhibit a 1.4 percentage-point decrease in investment for a 10 percentage-point increase in host jurisdiction EMTR [effective marginal tax rate], MNE [multinational enterprise] entities only exhibit a 0.9% decrease in investment . . . .").

[123] *Id.* at 23.

[124] Hanappi & Whyman, *supra* note 118, para. 70 ("[T]ax increases in a given host jurisdiction are associated with investment increases in other jurisdictions where the MNE group has a presence."). *See also* LAMMERS, *supra* note 17.

[125] Harry P. Huizinga & Johannes Voget, *International Taxation and the Direction and Volume of Cross-Border M&As*, 64 J. FIN. 1217, 1244 (2009) ("International double taxation comes in the form of nonresident dividend withholding taxes and parent country corporate income taxation of repatriated dividends. To reduce the potential for international double taxation to distort organizational structures, both forms of international double taxation should be lowered or eliminated.").

[126] Salvador Barrios et al., *International Taxation and Multinational Firm Location Decisions*, 96 J. PUB. ECON. 946–58 (2012).

discriminatory effect in that parent country taxation "only applies to parent firms residing in the parent country."[127]

A 2014 paper argued that international double taxation affects the volume and pricing of cross-border banking activities, thereby reducing financial-sector FDI.[128] To reach this conclusion, the authors compared domestic banks that must pay only the local corporate income tax with foreign-owned banks that must pay the same tax in respect to repatriated dividends plus a withholding tax in the subsidiary country.[129] As such, the analysis in fact involved high versus low effective tax burdens, which is not the same as arguing that income taxes simultaneously imposed by residence and source countries are necessarily FDI-inhibiting. To build an efficiency-based case against double taxation requires a holistic analysis that takes into account the combined effective tax rate and the composition of the tax base,[130] but most importantly building such a case involves asking the question "compared to what?"—what can be generally referred to as "the baseline problem" in efficiency analyses in general.[131]

In the beginning of the 1990s, economist Joel Slemrod analyzed the tax sensitivity of FDI flows into the United States, comparing the different impact of home countries' double tax relief measures whether exemption or foreign tax credit.[132] Finding no clear pattern of investor responsiveness to either of those two methods led him to conclude that "because of deferral and the availability of sophisticated financial strategies, the home country tax rate and its system of alleviating international double taxation is not an important determinant of FDI."[133] Other economists who have similarly examined those methods concluded that their impact on FDI ultimately depends on "corporate tax differentials".[134] Another study published in 2016

---

[127] *Id.* at 957.

[128] Harry Huizinga, Johannes Voget & Wolf Wagner, *International Taxation and Cross-Border Banking*, 6 AM. ECON. J. 94–125 (2014).

[129] *Id.* at 115 ("Foreign-owned banks may face higher corporate income taxation than domestic banks in the same banking market on account of international double taxation.").

[130] Egger et al., *Bilateral Rates*, *supra* note 106, at 822 (finding that "outbound FDI is positively related to the parent and host country tax burden and negatively associated with bilateral effective tax rates."); Alena Andrejovska & Jozef Glova, *An Effective Average Tax Rate as the Deciding Factor in Tax Competitiveness in the Context of Foreign Investment Influx*, 14 J. COMP. 3, 5–23 (2022) (contending that "[a] higher tax burden in individual countries need not always deter investors from investing profitably" because what matters is the effective average tax rate or "real tax burden"); Michael P. Devereux & Rachel Griffith, *Taxes and the Location of Production: Evidence from a Panel of US Multinationals*, 68 J. PUB. ECON. 335–67 (1998) (arguing that the effective average tax rate is more significant than marginal tax rates for location decisions); Michael P. Devereux & Rache Griffith, *Evaluating Tax Policy for Location Decisions*, 10 INT'L TAX & PUB. FIN. 107–26 (2003) (restating that location choices depend on the effective average tax rate and proposing how to measure it). *But see* Thiess Buettner & Martin Ruf, *Tax Incentives and the Location of FDI: Evidence from a Panel of German Multinationals*, 14 INT'L TAX & PUB. FIN. 151–64 (2007) (confirming Devereux and Griffith's findings but suggesting that statutory tax rates might be even more significant).

[131] *Cf.* Neil H. Buchanan & Michael C. Dorf, *A Tale of Two Formalisms: How Law and Economics Mirrors Originalism and Textualism*, 106 CORNELL L. REV. 591, 603–04 (2021) (arguing that "there is nothing hard-headed about efficiency analysis until one makes contestable and ultimately normative baseline assumptions that necessarily predetermine where the supposedly objective analysis will lead.").

[132] Joel Slemrod, *Tax Effects on Foreign Direct Investment in the United States: Evidence from a Cross-Country Comparison*, *in* TAXATION IN THE GLOBAL ECONOMY 79, 103–12 (Assaf Razin & Joel Slemrod eds., 1992).

[133] *Id.* at 112.

[134] Agnès Bénassy-Quéré, Lionel Fontagné & Amina Lahrèche-Révil, *How Does FDI React to Corporate Taxation?*, 12 INT'L TAX & PUB. FIN. 583–603 (2005) (noting that, while "FDI should be more sensitive to tax incentives when repatriated

stressed that other policy strategies adopted by host states, such as entering regional trade agreements, can enhance FDI volumes even in an environment with double taxation.[135]

As economists Michael Keen and Peter Mullins have noted, "[w]hile the rhetoric commonly abhors 'double taxation,' what investors presumably care about (compliance costs aside) is not how many times they are taxed but how much."[136] Corroborating this statement, Daniel Shaviro illustrates with a very simple example: "most of us would rather be taxed twenty times at 1 percent than once at 35 percent."[137] Shaviro embraces a unilateral welfare perspective to challenge the widespread idea that states should refund their resident taxpayers for income taxes paid to other governments via the credit mechanism.[138] On this more narrow normative view, a country's optimal international tax approach would be to allow deductions for foreign-paid income taxes, which essentially means that a limited level of double taxation is maintained in the end.[139]

A similar point is made by Wei Cui who contends that unilateral double tax relief (in the form of either foreign tax credits or exemption of foreign-source income) poses a policy puzzle for self-interested states that are predominantly concerned with advancing the wellbeing of their own citizens and residents. Cui bases this assertion on the observation that "taxes paid to foreign governments represent a genuine cost" and "[g]overments should not want their taxpayers to be indifferent to such costs."[140]

However, neither Cui nor Shaviro explain why states should see immediate self-serving tax policy as necessarily conducive of national interests. Such accounts also fail to explain why states continue to engage in multilateral coordinative initiatives in spite of what the rational choice theories espoused by those authors predict.[141] Even from a purely national welfare

---

profits are exempted from taxation", "because parent firms are not refunded for taxes paid abroad in excess of their home country bill, higher taxes abroad should discourage FDI flowing from credit countries too.").

[135] Charles Braymen, Yang-Ming Chang & Zijun Luo, *Tax Policies, Regional Trade Agreements and Foreign Direct Investment: A Welfare Analysis*, 21 PACIFIC ECON. REV. 2 (2016).

[136] Michael Keen & Peter Mullins, *International Corporate Taxation and the Extractive Industries: Principles, Policies, Problems*, *in* INTERNATIONAL TAXATION AND THE EXTRACTIVE INDUSTRIES 11, 36 (Philip Daniel et al. eds., 2017).

[137] DANIEL N. SHAVIRO, FIXING U.S. INTERNATIONAL TAXATION 7 (2014).

[138] Daniel Shaviro, *The Case Against Foreign Tax Credits*, 3 J. LEGAL ANALYSIS 1 (2011); Daniel N. Shaviro, *Rethinking Foreign Tax Creditability*, 63 NAT'L TAX J. 709 (2010). *See also* Ronald B. Davies, *The OECD Model Tax Treaty: Tax Competition and Two-Way Capital Flows*, 44 INT'L ECON. REV. 2 (2003).

[139] Under a deduction system, foreign-source income is, at first, fully taxed by the source state at its regular corporate tax rate, and then taxed again by the residence state but with a reduced base that excludes the source tax amount. In technical terms, the outcome is double taxation of a portion of the same tax base. *See generally* Thomas Dickescheid, *Exemption vs. Credit Method in International Double Taxation Treaties*, 11 INT'L TAX & PUB. FIN. 721 (2004); EXEMPTION AND CREDIT METHOD: THE APPLICATION OF ARTICLE 23 OF THE OECD MODEL (Georg Kofler et al. eds., 2022).

[140] Wei Cui, *New Puzzles in International Tax Agreements*, 75 TAX L. REV. 201, 243 (2022). *See also* John Whalley, *Puzzles over International Taxation of Cross-Border Flows of Capital Income*, *in* 2 INTERNATIONAL HANDBOOK ON THE ECONOMICS OF INTEGRATION: COMPETITION, SPATIAL LOCATION OF ECONOMIC ANALYSIS AND FINANCIAL ISSUES (Miroslav N. Jovanović ed., 2011).

[141] For a critique of international tax policy discourse based on economic rational actor theories, see Steven A. Dean, *Philosopher Kings and International Tax: A New Approach to Tax Havens, Tax Flight, and International Tax Cooperation*, 58 HASTINGS L.J. 911, 965 (2007) (recommending Oona Hathaway's integrated theory of international law, which "acknowledges and attempts to make sense of the array of political and economic pressures that drive a nation's decision-making process.").

perspective, taking into account the revenue needs of other countries could be seen as furthering the interests of domestic investors and homegrown firms, whose expansion beyond borders relies on a stable and prosperous global business environment.[142]

In any case, based on the extensive literature review above, it appears safe to conclude that the available empirical work on FDI determinants, including studies with a particular focus on taxation, has not provided sufficient evidence of a clear negative impact arising from the mere fact that two or more states impose tax on the same cross-border income item. This conclusion holds true to the extent that the double-tax scenario does not imply a significantly higher effective tax burden (in comparison with a single-tax scenario), or even when that is the case, the higher burden is not offset by other advantages provided to investors by the host state (in comparison with other host states). In what follows, we examine theories that explain why states continue to conclude tax agreements, and then argue that doing so is valuable not for purposes of reducing double taxation, but to offer legal certainty to cross-border investors.

C. The value of treaties

Of all rationales and policy reasons for concluding a tax treaty, the prevention of international double taxation is generally perceived as the most prominent goal.[143] However, there are many other context-specific factors that help explain why certain states or groups of similar states choose to enter tax treaty relationships. For example, an econometric analysis on the motivations for developing countries to sign tax treaties with other developing countries or with developed countries underscored the importance of geography, size as measured by gross domestic product (GDP), economic openness, colonial status, political similarity, and development aid.[144] A quantitative study on tax treaty negotiations found that a stronger reliance on corporate income taxes increases the likelihood of a developing country signing a tax treaty with a developed country.[145] This study also revealed a "significant and consistent learning effect" in the sense that "the more treaties a country has signed, the better negotiated outcomes it obtains . . . ."[146]

[142] *Cf.* DAVID HULME, SHOULD RICH NATIONS HELP THE POOR? (2016) (arguing that rich nations should go beyond aid in helping poorer nations, such as by reforming international regimes in trade, migration, climate change, and finance, because doing so is not only the morally right thing to do but would also advance self-interested goals of improving the welfare of nationals); SARAH BLODGETT BERMEO, TARGETED DEVELOPMENT: INDUSTRIALIZED COUNTRY STRATEGY IN A GLOBALIZING WORLD 1 (2018) ("Wealthy states are increasingly unable to insulate themselves from the effects of events in developing countries. While rhetoric may not have shifted much, reality is catching up to the rhetoric: the key to prosperity and peace in wealthy states increasingly depends on conditions in poorer areas."). *See also* Terecent Wood & Christopher Hoy, *Helping Us or Helping Them? What Makes Foreign Aid Popular with Donor Publics?*, 70 ECON. DEVELOP. CUL. & CHANGE 567, 567 (2002) (investigating the effectiveness of framing foreign aid in terms of advancing national interests).

[143] Beer & Loeprick, *supra* note 64, at 115 ("Double tax treaties (DTTs) are intended to facilitate cross-border trade and investment by demarcating taxing rights of countries. . . . While DTTs [double tax treaties] serve more purposes and often also come with a range of complementary political objectives, the avoidance of double taxation is at their core.").

[144] Julia Braun & Martin Zagler, *An Economic Perspective on Double Tax Treaties with(in) Developing Countries*, 2014 WORLD TAX J. 242–81 (2014).

[145] Martin Hearson, *When Do Developing Countries Negotiate Away Their Corporate Tax Base?*, 30 J. INT'L DEV. 233–55 (2018).

[146] *Id.* at 251.

Viewed as an instrument of foreign economic policy, tax treaties are often justified on efficiency-based notions of neutrality in cross-border investments, the application of which is expected to enhance economic welfare between treaty partners.[147] Over the years, scholars have developed an array of neutrality concepts for international taxation, such as capital export neutrality (CEN), capital import neutrality (CIN), national neutrality (NN), capital ownership neutrality (CON), national ownership neutrality (NON), and global portfolio neutrality (GPN).[148] These concepts have proven to be irreconcilable, in that they cannot be realized at the same time without violating one another. In practice, jurisdictions actively choose the neutrality concept that best fits their domestic economy and broader policy objectives.[149]

Irrespective of the meaning and import of various neutrality concepts, the unifying assumption is that international tax policy should not be crafted in a manner that leads taxpayers to make business decisions regarding whether and how much to invest in another jurisdiction solely based on the prospect of facing taxation once, multiple times, or not at all. Especially if states embrace a global welfare perspective,[150] double taxation, double nontaxation, and mismatches between tax systems are all regarded as nonneutral and, thus, economically distortive, because they affect taxpayers' behaviors and potentially lead to a suboptimal allocation of productive factors.[151]

Furthermore, even if mitigating double taxation is seen as a worthy goal, it is not at all clear that existing bilateral tax agreements are the best or most appropriate instrument for such purposes. For example, in 1999 John Avery Jones cast doubt on the utility of tax treaties for such purposes, by pointing out issues such as treaties' self-perpetuating nature and lock-in effects.[152] On the first, Jones claimed "[t]reaties are a one-way street; they lead only to more treaties."[153] On the second, Jones stressed that an extensive treaty network inhibits future changes at the level of treaties themselves (because they all need to be amended if harmonization is to be preserved) as well as internal law (because treaty provisions usually

---

[147] *See* Fadi Shaheen, *International Tax Neutrality: Reconsiderations*, 27 VA. TAX REV. 203 (2007); Fadi Shaheen, *International Tax Neutrality: Revisited*, 64 TAX L. REV. L. 131 (2011); Michael S. Knoll, *Reconsidering International Tax Neutrality*, 64 TAX L. REV. 99 (2011); David Hansen, *Tax Neutrality and Tax Amenities*, 12 FLA. TAX REV. 57 (2012); David Elkins, *A Critical Reassessment of the Role of Neutrality in International Taxation*, 40 NW. J. INT'L L. & BUS. 1 (2019).

[148] Daniel Shaviro, *The Crossroads Versus the Seesaw: Getting a "Fix" on Recent International Tax Policy Developments*, 69 TAX L. REV. 1, 4, 8, 39 (2015) (criticizing international tax neutrality concepts as an unhelpful "alphabet soup" that leads to a "battle of the acronyms").

[149] Rachel Griffith, James Hines & Peter Birch Sørensen, *International Capital Taxation*, *in* DIMENSIONS IN TAX DESIGN: THE MIRRLESS REVIEW 914, 954 (2010) ("If a country practices worldwide income taxation, its multinationals will tend to earn a lower after-tax return on operations. . . . [while] a policy of exemption will maximize the after-tax profitability of domestic multinationals. A country seeking to maximize the sum of its tax revenue and the after-tax profits of its companies will therefore opt for the exemption system if such a system does not reduce domestic tax revenue raised from domestic economic activity.").

[150] *But see* Daniel Shaviro, *Why Worldwide Welfare as a Normative Standard in U.S. Tax Policy?*, 60 TAX L. REV. 155 (2007).

[151] *Cf.* JAMES MIRRLEES ET AL., TAX BY DESIGN: THE MIRRLEES REVIEW 472 (2011).

[152] John F. Avery Jones, *Are Tax Treaties Necessary?*, 53 TAX L. REV. 1 (1999) [hereinafter *Necessary?*]. For a response to some of the issues raised by Jones, see Lee Burns, *Commentary*, 53 TAX L. REV. 39 (1999) (considering refining bilateral tax treaties, designing a multilateral tax treaty, and designing a model income tax law).

[153] Jones, *Necessary?*, *supra* note 152, at 3.

trump domestic provisions), with the consequence that reform is oftentimes stalled or, in the extreme, leads to treaty override.[154]

A recurrent argument that is not at all new in the literature is that tax treaties might not be so relevant as an instrument to tackle double taxation because domestic unilateral measures, such as granting foreign tax credits or exempting foreign-source income, are as effective for such purposes.[155] Alex Easson, for example, recognizes the dispensability of most treaty clauses addressing double taxation with the exception of Article 9(2).[156] Because this provision in particular requires the competent authorities of the two treaty partners to strive to reach mutual agreements regarding transfer pricing adjustments, Easson argues that the chances of resolving unintended double taxation arising in those cases are significantly increased.

Others are more skeptical of the entire treaty-based framework. Drawing from game theory, Dagan has famously argued that residence states have plenty of reasons and incentives to unilaterally adopt double tax relief measures, which would make tax treaties largely redundant.[157] Dagan adds that, contrary to a treaty, those unilateral measures preserve, rather than restrict, source states' primary—and otherwise unlimited—right to tax all income arising in their territories. Cui finds both traditional bilateral tax treaties and recently proposed international tax agreements puzzling to explain from an economic point of view.[158] Cui thus highlights ambiguities in theory and empirical work regarding what those instruments aim to and can achieve.[159] In support of these claims, economists have shown that, in practice, most residence states do unilaterally offer double tax relief to income taxes paid at source.[160] An economic study of tax treaties taking into account bilateral foreign aid concluded that "in asymmetric situations, where one country is predominantly a capital exporter and the other a capital importer, a DTA [double tax treaty] is mutually beneficial if and only if there is a compensation for the capital importer, that loses tax base, by the capital exporter."[161]

A question that arises here is: if residence states already prevent international double taxation via their domestic laws, what explains the widespread adoption of tax treaties by so many source (developing) states?

Eduardo Baistrocchi offers two possible explanations based on game theory. First, a prisoner's dilemma pushes source-developing states to adhere to a tax treaty network even

---

[154] *Id.* at 4.

[155] *See* Elisabeth A. Owens, *United States Income Tax Treaties: Their Role in Relieving Double Taxation*, 17 RUTGERS L. REV. 428, 430 (1963) (arguing that "U. S. income tax treaties play a very marginal role in relieving double taxation" because the "U.S. has unilaterally provided for the avoidance of double taxation for its own citizens, corporations, and residents through the foreign tax credit provisions of the Internal Revenue Code", which means that "treaties do not need to make—and do not in fact, make—any substantial change in the pattern of U. S. taxation.").

[156] *See* Alex Easson, *Do We Still Need Tax Treaties?*, 54 BULL. TAX TREATY MON. 619 (2000).

[157] Dagan, *supra* note 60, at 52.

[158] Cui, *supra* note 140, at 208–37, 246–48.

[159] *Id.*

[160] *E.g.,* Davies, *Potential v. Performance*, *supra* note 106, at 776; Baker, *supra* note 113, at 400.

[161] Julia Braun & Martin Zagler, *The True Art of the Tax Deal: Evidence on Aid Flows and Bilateral Double Tax Agreements*, 41 WORLD ECON. 1478, 1495 (2018).

when its effects are asymmetric (mostly benefitting residence-developed states) out of a "fear of driving FDI away to competing jurisdictions". Second, tax treaty networks, despite their disadvantages, create some positive externalities for the participating states, such as "the minimisation of communication and enforcement costs" and "reputation advantages over otherwise comparable rivals who do not belong to the tax treaty network."[162] In addition to these strategic and network effects (which include the lock-in effects previously mentioned by Jones), Dagan raises the existence of asymmetric cooperative capabilities and agenda-setting powers as reasons for why developing countries sometimes adhere to tax treaty regimes that are against their better interests.[163] All these effects can, in Dagan's view, be traced to cartelistic behaviors within the international tax game, as powerful states often seek to promote bilateral agreements and global deals that allow them to impose excessive prices on weaker members in order to extract monopolistic rents.[164] Dagan's critique, developed in a series of publications dating back to the end of the 1990s,[165] ultimately suggests that developing countries might be better advised to embrace an exit-based approach towards the existing tax treaty system and other harmonized solutions proposed at the global level.[166]

Reuven Avi-Yonah and Oz Halabi have expressed their accord with Dagan's argument that, given that simultaneous taxation by residence and source states is already largely eliminated by residence-based unilateral measures (i.e., foreign tax credits or exemption), the main outcome of existing tax treaties is to unnecessarily transfer revenues from source to residence states.[167] But Avi-Yonah and Halabi argue that treaties might still be relevant for two other purposes related to preventing double nontaxation of individuals. First, treaties could permit source states to impose withholding taxes every time a cross-border taxpayer does not demonstrate an effective payment of income taxes at home. Second, treaties could require source states to share information on the local income of residents of another state, in order to secure residence-based taxation.

We agree that tax treaties will continue to play an important role in international fiscal and economic relations, even if divorced from the goal of eliminating double taxation. But differently than Avi-Yonah and Halabi, we argue that tax treaties' key function is to provide legal certainty to investors by means of simple rules that allow both contracting states to raise

---

162 Eduardo Baistrocchi, *The Use and Interpretation of Tax Treaties in the Emerging World: Theory and Implications*, 4 BRIT. TAX REV. 352, 355 (2008).

163 TSILLY DAGAN, INTERNATIONAL TAX POLICY: BETWEEN COMPETITION AND COOPERATION 166–80 (2018).

164 *See* Tsilly Dagan, *Tax Treaties as a Network Product*, 41 BROOK. J. INT'L L. 1081 (2016).

165 *See* Tsilly Dagan, *National Interests in the International Tax Game*, 18 VA. TAX REV. 2 (1998); Tsilly Dagan, *The Costs of International Tax Cooperation*, *in* THE WELFARE, GLOBALIZATION, AND INTERNATIONAL LAW (Eyal Benvenisti & Georg Nolte eds., 2004); Tsilly Dagan, *Community Interests in International Taxation*, *in* COMMUNITY INTERESTS ACROSS INTERNATIONAL LAW (Eyal Benvenisti & Georg Nolte eds., 2018); Tsilly Dagan, *GloBE: The Potential Costs of Cooperation*, 51 INTERTAX 10 (2023).

166 Tarcísio Diniz Magalhães, *International Tax Law between Loyalty, Exit, and Voice*, 44 DALHOUSIE L.J. 49, 58–61 (2021).

167 Reuven S. Avi-Yonah & Oz Halabi, *Double or Nothing: A Tax Treaty for the 21st Century*, L. & Econ. Work. Papers, U. Mich. L. Sch. (2012) (unpublished paper). *See also* Lee A. Sheppard, *Why Do We Need Tax Treaties?*, TAX NOTES (2012); Nana Ama Sarof, *Developing Countries and the Tax Treaties Myth*, TAX NOTES (June 12, 2021), https://www.taxnotes.com/featured-analysis/developing-countries-and-tax-treaties-myth/2021/06/18/76mrs.

revenues at lower administrative costs. The next Part explores how a simplified tax treaty model along those lines could be designed.

III. Repurposing Tax Treaties Beyond Double Taxation

Given the many deficiencies of existing tax treaties that are compounded today by challenges brought on by the digital economy, the best approach is to design more comprehensive and streamlined international tax rules that reduce administrative and compliance burdens without depriving source states of the ability to raise revenues. Such an approach should aim to relieve source states of having to demonstrate the existence of a permanent establishment and how much profit should be attributed to it in order to exercise tax jurisdiction. Allowing residence and source states to concurrently tax a mutually agreed-upon portion of a company's entire active income could accomplish simplicity and some level of inter-nation equity, provided that limited double taxation is deemed acceptable.

Accordingly, the next Section proposes a simplified treaty model for the taxation of multinational firms to replace the current approach that involves (1) distinguishing business profits (Article 7) from passive forms of income such as dividends (Article 10), interest (Article 11), and royalties (Article 12), (2) characterizing permanent establishments (Article 5), and (3) pricing transactions in order to accurately allocate income between related parties (Article 9). In contrast to this highly complex structure, our model consists of three basic taxing rights: (1) the right of residence states to tax (on a net basis) resident firms' profits in their entirety; (2) the right of source states to tax (on a net basis) a percentage of in-scope profits from foreign-based firms under a revenue-based nexus; and (3) the right of source states to impose (gross-basis) withholding taxes on out-of-scope payments to foreign sources with full creditability in residence states. In fleshing out this model, we draw from the ongoing Pillar One project as a ready framework, explaining in what ways our simplified approach departs from and improves upon Pillar One.

A. Our proposal

In Pillar One negotiations, five technical design features of a new international tax regime for the digital economy have taken center stage: (1) a scoping rule to determine which companies are covered; (2) a nexus threshold to determine which jurisdictions are entitled to a new tax base; (3) an income apportioning method to split this base between the eligible jurisdictions; (4) mechanisms to guarantee legal certainty for taxpayers; and (5) options of legal instruments for implementation. Each of these five is examined below in constructing our model.

1. Scope

Scoping rules designate enterprises, activities, and profits that are the potential targets of a given tax. In the rollout of Pillar One, various types of scope were explored. Beginning with the 2018 Interim Report, the OECD focused on multinationals that operate at what was described as "scale without mass".[168] The phrase was coined to depict a phenomenon in which certain firms reach hundreds of thousands, millions, or even billions of users and consumers all around the world without physically touching the corresponding market base. According to the OECD, firms achieve scale without mass by combining intangible assets (such as intellectual property rights) with online platforms and other virtual means to engage customers.[169]

Later, a 2019 Policy Note expanded that concept by introducing the ideas of "significant economic presence" (already mentioned in the Action 1 Report) or "significant digital presence".[170] A 2019 Public Consultation Document then outlined three proposals coming from different groups of countries, each with its own preferred range of affected companies and profits.[171]

The "user participation" proposal, put forward by EU member states led by the United Kingdom, targeted a portion of so-called "nonroutine profits" that are earned through social media platforms, search engines, and online marketplaces.[172] The OECD describes nonroutine profits as "profits that remain after routine activities have been allocated an arm's length return . . . ."[173] Because the EU proposal would mostly affect data giants such as Google, Amazon, and Facebook, the United States proposed instead that the targeted portion of nonroutine profits was defined as profits attributable to "marketing intangibles".[174] This expansion of scope meant that the new rules would encompass not only highly digitalized firms that are mostly U.S.-based but also European household brands with the likes of Louis Vuitton, Prada, and Gucci.[175]

The third proposal was advanced by the Group of Twenty-Four (G24), led by India.[176] It consisted of using the idea of a "significant economic presence" in a much more comprehensive

[168] OECD, Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project (2018).

[169] *Id.*

[170] OECD, Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note, As approved by the Inclusive Framework on BEPS on 23 January 2019, OECD/G20 Base Erosion and Profit Shifting Project (2019).

[171] OECD, Addressing the Tax Challenges of the Digitalisation of the Economy, Public Consultation Document 13 February – 6 March 2019, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing (2019).

[172] *Id.* at 9–10.

[173] *Id.* at 10.

[174] The 2019 Public Consultation Document referred to the OECD Transfer Pricing Guidelines for the definition of marketing intangibles. *Id.* at 11 n.4. *See also* OECD, TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS 23 (2022) [hereinafter OECD TPG] ("An intangible . . . that relates to marketing activities, aids in the commercial exploitation of a product or service and/or has an important promotional value for the product concerned. Depending on the context, marketing intangibles may include, for example, trademarks, trade names, customer lists, customer relationships, and proprietary market and customer data that is used or aids in marketing and selling goods or services to customers.").

[175] *Cf.* Giuseppe Abatista, *Luxury Fashion and Transfer Pricing: IP Owners, Distributors, Supply Chain and Digitalization at the Beginning of a New Era*, 29 INT'L TRANSFER PRICING J. 1, 5 (2022).

[176] Reuven S. Avi-Yonah & Ajitesh Kir, *India's New Profit Attribution Proposal and the Arm's-Length Standard*, TAX NOTES INT'L 1183, 1184–85 (2019); Annet Wanyana Oguttu, *A Critique from a Developing Country Perspective of the Proposals to Tax the Digital Economy*, 12 WORLD TAX J. 799, 813, 816, 818 (2020); Melanie Dewi Astuti, *Three Approaches to Taxing Income from the Digital Economy – Which Is the Best for Developing Countries?*, 74 BULL. INT'L TAX'N 721, 723 (2020).

and radical way than contemplated by the OECD. The G24's idea was to fully replace arms'-length transfer pricing with a formulaic approach covering all profits (routine and nonroutine) of any multinational.[177] Probably for this reason, when the OECD Secretariat presented a so-called "unified approach" (a name that would seem to suggest a compromise between the three proposals),[178] commentators were quick to notice the absence of any resemblance with the G24 model.[179]

The Secretariat's unified approach stipulated three amounts by the letters A, B, and C to be reallocated to market jurisdictions.[180] In latest versions of Pillar One, Amount C turned out to be a misnomer as it was meant to establish tax certainty mechanisms,[181] but Amounts A and B kept their nature of allocable sums.[182] Amount B engages profit allocation by way of streamlining arm's-length transfer pricing through a fixed percentage attributed to baseline marketing and distribution activities. Amount A, in turn, proposes a sharp departure from the current system by embracing a fractional apportionment approach to isolate a share of nonroutine profits of in-scope multinationals. At first, Amount A was meant to contemplate two groups of companies, namely those that provide "automated digital services" and operate "consumer-facing businesses".[183] But this classification was perceived as disproportionately impacting U.S. multinationals, much like the EU-proposed user participation model. So, in October 2021, Inclusive Framework members agreed to use more neutral thresholds for determining in-scope companies. While Amount A continues to cover only a portion of nonroutine profits, companies affected are only those with a global turnover above EUR 20 billion (to be reduced to EUR 10 billion after seven years of successful implementation) and profitability above 10%.[184]

To the extent that we want to achieve simplicity and reduce administrative and compliance costs as much as possible, those scoping approaches are inadequate. A simpler alternative is to build a single uniform regime covering all multinationals and any type of cross-border business

---

177 G24 Working Group on Tax Policy and International Tax Cooperation, Proposal for Addressing Tax Challenges Arising from Digitalization (Jan. 17, 2019), www.g24.org/wp-content/uploads/2019/03/G-24_proposal_for_Taxation_of_Digital_Economy_Jan17_Special_Session_2.pdf; Government of India, Ministry of Finance, Department of Revenue, Central Board of Direct Taxes, Public Consultation on the Proposal for Amendment of Rules for Profit Attribution to Permanent Establishment-reg, Doc. No. F. No. 500/33/2017-FTD.I (Apr. 18, 2019).

178 OECD, Secretariat Proposal for a "Unified Approach" under Pillar One, Public Consultation Document, OECD/G20 Base Erosion and Profit Shifting Project (Oct. 9–Nov. 12, 2019) [hereinafter Unified Approach].

179 Vidushi Gupta, *How Unified is the OECD's Unified Approach?*, 96 TAX NOTES INT'L 1143 (2019); Allison Christians, *A Unified Approach to International Tax Consensus*, 96 TAX NOTES INT'L 497 (2019); Jeroen Lammers, *OECD Unified Approach Leaves Market Jurisdictions Out in the Cold*, 97 TAX NOTES INT'L 172 (2020).

180 *See generally* Hartmut Förster, Stefan Greil & Arnim Hilse, *Taxing the Digital Economy – The OECD Secretariat's New Transfer Pricing A-B-C and Alternative Courses of Action*, 27 INT'L TRANSFER PRICING J. 1 (2020).

181 OECD, Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, at 12 (2020) [hereinafter Pillar One Blueprint].

182 OECD, Public Consultation Document, Pillar One – Amount B (Dec. 8, 2022–Jan. 25, 2023); OECD, Progress Report on Amount A of Pillar One, Two-Pillar Solution to the Tax Challenges of the Digitalisation of the Economy, Public Consultation (July 11–Aug. 19, 2022).

183 Pillar One Blueprint, *supra* note 181, at 10.

184 OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, OECD/G20 Base Erosion and Profit Shifting Project, at 1 (Oct. 8, 2021) [hereinafter IF Statement].

profit. To the extent that we also want to achieve inter-nation equity, an approach that does not rely on ring-fencing is also justified, in particular by reference to the entitlement theory of international taxation.[185] As Christians and van Apeldoorn explain, if states are morally entitled to wealth within their territory because they enable its generation, when they facilitate trade and cross-border investment they should be equally entitled to the correlated income streams.[186] For these reasons, our simplified tax treaty model does not singularize industries, sectors, or lines of business, accounts for company size, or restricts allocation to portions or classes of profits.

2. *Nexus*

In introducing the unified approach, the OECD Secretariat declared that "a previously agreed allocation key" based on selected variables that "approximate the appropriate profit due to the new taxing right" would need to be considered.[187] The Secretariat did not clarify the eligibility criteria for market jurisdictions but mentioned sales as a possible variable for the allocation key. Then, in the 2020 Blueprint on Pillar One, the OECD recommended the use of indicators of a "significant and sustained engagement with the market even if there is not a physical presence . . . ."[188] Because the unified approach under consideration at the time was meant to apply only to automated digital services and consumer-facing businesses, the Blueprint noted that nexus indicators could vary according to those two types of activities. For automated digital services, the Blueprint mentioned a "market revenue thresholds" and "temporal requirements".[189] For consumer-facing business, the Blueprint considered those two together with "plus factors" such as a "physical presence test", a "deemed engagement provision", and a "nexus rule for small developing economies".[190] But when a public

---

185 Peggy B. Musgrave, *Sovereignty, Entitlement, and Cooperation in International Taxation*, 26:4 BROOK. J. INT'L L. 1335, 1341 (2001) ("The right of a jurisdiction to tax all income arising within its geographical borders is recognized as a fundamental entitlement. This permits a country to share in the gains of foreign-owned factors of production operating within its borders; gains which are generated in cooperation with its own factors, whether they be natural resources, an educated and/or low-cost work force, or the proximity of a market."); Peggy B. Musgrave, *Fiscal Coordination and Competition in an International Setting*, *in* RETROSPECTIVES ON PUBLIC FINANCE 276, 294 (Lorraine Eden ed., 1991) (supporting the "widely recognized concept of 'territorial entitlement', whereby the jurisdiction of source or location of economic activity giving rise to the income, consumption or property, is assigned the primary right to tax whether the income accrues to its own or foreign residents."); Michael J. Graetz, *Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 TAX L. REV. 261, 298 (2001) ("The claim of source countries to tax income produced within their borders is analogous to a nation's long-recognized claim of sovereignty over natural resources within its boundaries. The idea that the source country has a fair claim to the income produced within its borders is also grounded in the view that foreigners, whose activities reach some minimum threshold, should contribute to the costs of services provided by the host government, including, for example, the costs of roads and other infrastructure, police and fire protection, the system for enforcement of laws, education, and the like."), *reprinted in* 26 BROOK. J. INT'L L. 1357 (2001) *and in* MICHAEL J. GRAETZ, FOLLOW THE MONEY: ESSAYS IN INTERNATIONAL TAXATION 2 (2016).

186 CHRISTIANS & VAN APELDOORN, *supra* note 74, at 5 ("We conclude that the entitlement principle entails that states that host cross-border investment (commonly if imperfectly referred to as source states) are entitled to tax the income from such investment and moreover, given the principle of fair cooperation, they are entitled to an international tax system that enables them to exercise this entitlement.").

187 Unified Approach, *supra* note 178, at 15, para. 60.

188 Pillar One Blueprint, *supra* note 181, at 65, para. 190.

189 *Id.* at 66–67.

190 *Id.* at 67–69.

consultation was opened in 2022, the OECD dropped most of those criteria, requesting input exclusively on market revenue as a nexus threshold.

The quantitative thresholds thereafter agreed by Inclusive Framework members in late 2021 (that is, EUR 20 billion in global revenue and 10% of profit margin) might have seemed like a straightforward and easy-to-apply test, but the OECD later released a series of highly complex revenue sourcing rules.[191] Generally speaking, these rules specify which types of revenue qualify under the new nexus rule, categorize them according to the underlying activity, and then apportion each among the eligible market jurisdictions. According to the OECD, the analysis is to be conducted on a transaction-by-transaction basis, considering transactions in a broad sense to encompass not merely invoices but also items or actions that generate revenues, such as, for instance, clicks on an online advertisement. Where a contract or invoice comprises various items or services and goods sold to different countries, revenue is to be allocated in proportion to the amount of income earned in each consumer market rather than by equal split. In addition, location-specific differences in pricing must be taken into account. Recognizing that there might be cases where assessing revenues is burdensome, the OECD proposed that in-scope multinationals may be allowed to use targeted proxies or allocation keys based on statistical information, aggregated headcount data, or macroeconomic indicators.[192]

The evident high level of complexity of this ruleset is a testament to the difficulties in formulating a simple and common approach to determine taxable presence in a world where national borders and tangible assets are increasingly less relevant.[193] As a proxy for market access, revenue seems like an obvious metric because it embraces a similar logic behind traditional permanent establishments. For example, the Commentary to Article 7 of the OECD Model Convention notices a historical international consensus that "as a general rule, until an enterprise of one State has a permanent establishment in another State, it should not properly be regarded as participating in the economic life of that other State to such an extent that the other State should have taxing rights on its profits."[194] Moreover, if the goal is to choose a threshold that reflects a "significant and sustained engagement with the market", a specified minimum and steady level of revenue is logical. That said, a high threshold applied across the board to all companies would likely exclude many low-income countries with small economies, depriving them of taxing rights that they might currently enjoy in respect to foreign businesses that sell little into their markets or local businesses that export most of their products and

---

[191] OECD, Public Consultation Document, Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing (Feb. 14–18, 2022). *See also* OECD, Explanatory Statement to the Multilateral Convention to Implement Amount A of Pillar One, Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, at 52–82 (2023) [hereinafter Explanatory Statement].

[192] OECD, Progress Report on Amount A of Pillar One, Two-Pillar Solution to the Tax Challenges of the Digitalisation of the Economy, OECD/G20 Base Erosion and Profit Shifting Project, OECD, Paris, 2022, at 64 et seq.

[193] *See* Aitor Navarro, *The Allocation of Taxing Rights under Pillar 1 of the OECD Proposal*, *in* THE OXFORD HANDBOOK OF INTERNATIONAL TAX LAW 10 (Florian Haase & Georg Kofler eds., 2023); Maarten de Wilde, *On the OECD's 'Unified Approach' as Frankenstein's Monster and a Dented Shape Sorter*, 48 INTERTAX 9, 13 (2021).

[194] OECD MC, comm. art. 7, para. 11; Benjamin Hoffart, *Permanent Establishment in the Digital Age: Improving and Stimulating Debate Through an Access to Markets Proxy Approach*, 6 NW. J. TECH. & INTELL. PROP. 106, 117–121 (2007). *See also* Peter Hongler & Pasquale Pistone, *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy*, WU Int'l Tax'n Res. Paper Series 2015–15, at 18–19 (2015) (arguing that modernizing the sourcing theory can also help in establishing a nexus in relation to the business income that is attributable to the source country).

services to other countries. The later situation is most clearly exemplified by the extractive industries,[195] but any other export-oriented sector could be equally considered representative.

A possible compromise would be to use revenue markers as a defining parameter for net-basis taxation versus gross-basis withholding in respect to source states. This would be in line with approaches already adopted by many developing and low-income countries that embrace the concept of permanent establishments in their domestic law. As Brian Arnold observes, "[s]everal developing countries use the PE [permanent establishment] concept, not as a threshold requirement, but to determine whether a non-resident is taxable on a net or gross basis."[196] Withholding taxes are often opposed by taxpayers because, as a charge levied on gross receipts that by definition do not account for expenses, there is an ever-present risk of over-taxation.[197] The solution is to have tax treaties clearly state that withholding taxes imposed on outgoing payments (in cases where the foreign company does not meet the new revenue-based nexus) should be fully recognized as charges "in lieu of" net-basis income taxation. Doing so would ensure that residence states bear the obligation to offset paid amounts through their foreign tax credit systems.[198]

With these considerations, the revenue threshold could work as a proxy for establishing nexus in an effective and relatively simple manner, while also accommodating the interests of lower-income countries to prevent other types of business income from escaping source taxation. Based on the Amount A's proposed thresholds, high- and medium-income countries would then be eligible to tax foreign-based multinationals doing business in their territory when a minimum of EUR 1 million in revenues is derived from local sources. For multinationals with revenues below this amount, source countries could retain the right to impose withholding taxes on outbound transactions that should be fully creditable in the residence state. In addition, the lower threshold of EUR 250,000 adopted by Amount A could also be applied in respect to low-income countries, understood as those with a GDP below EUR 40 billion.

Finally, to ensure a simplified application of these thresholds, revenue sourcing rules should be replaced by a clearer test that assesses any kind of revenue as well as intra-group and third-party income-generating activities on a jurisdictional aggregate basis rather than transaction by transaction. A jurisdictional approach would likely allow more source states to pass the nexus test, but this is justifiable given that, under current rules, many of those states either lack taxing rights or can only exercise them in a very limited way. Such an approach is also more appropriate for low-income countries because it is much easier to apply, thus requiring less resources and administrative capacity that are some of the key challenges these countries face.

---

[195] Independent Commission for the Reform of International Corporate Taxation [ICRICT], A Roadmap To Improve Rules for Taxing Multinationals: A Fairer Future for Global Taxation, at 10 (Feb. 2018).

[196] Brian J. Arnold, *Taxation of Income from Services*, *in* UNITED NATIONS HANDBOOK ON SELECTED ISSUES IN PROTECTING THE TAX BASE OF DEVELOPING COUNTRIES 61, 67 (Alexander Trepelkov, Harry Tonino & Dominika Halka eds., 2nd ed. 2015).

[197] *Cf.* Rui Camacho Palma, *The Paradox of Gross Taxation at Source*, 38 INTERTAX 624 (2010).

[198] *Cf.* Theodore C. Sorensen, *Payments in Lieu of Taxes: A Development in American Law*, 30 Nebraska L. Rev. 86 (1950); Karen Nelson Moore, *The Foreign Tax Credit for Foreign Taxes Paid in Lieu of Income Taxes: An Evaluation of the Rationale and a Reform Proposal*, 7 AM. J. TAX POL'Y 207 (1988).

3. *Income allocation*

Under Pillar One, specifically Amount A, income is to be allocated to end market jurisdictions according to a fractional apportionment method based on a single factor, namely locally sourced revenues.[199] The first step is to identify the worldwide profits of an in-scope multinational group and then isolate nonroutine profits, leaving routine profits to be allocated according to traditional transfer pricing rules. The next step is to isolate 25% of the nonroutine share, again leaving the remaining 75% to be allocated according to traditional transfer pricing rules. The final step is to split the 25% between eligible market jurisdictions on the basis of a formula consisting of locally sourced revenues over worldwide revenues. In view of this architecture, Mitchell Kane and Adam Kern classify Pillar One's Amount A as a form of three-step formulary apportionment.[200] They then propose making Pillar One more progressive by adding an "Amount D" that would "apportion a fixed amount of nonroutine profit to developing countries."[201] Doing so, however, would come at the expense of adding even more complexity to the Pillar One structure.

Our proposal aims to benefit developing countries with a much simpler approach that deviates from Pillar One in three crucial ways. First, our proposal does not distinguish between routine and nonroutine profits, thus covering all of a company's business income. Second, it does not imply transferring taxing rights between countries, but instead adopts a limited double-tax approach that allows source states to claim a reasonable percentage of all business income in addition to what residence states tax. Third, in place of a formulaic approach tied to country- or company-level factors, our proposal apportions the agreed upon percentage among source states on an equal share basis. Equal sharing is justified for simplicity reasons, but the approach also finds support in recent scholarship on global distributive justice.

Philosopher David Miller argues that "when states agree to coordinate with one another by establishing rules to deal with [international trade and the provision of global public goods, such as preventing excessive climate change] (and human rights are not at issue), fairness requires that the costs and benefits of cooperation should be shared equally, per head of population."[202] Aaron James builds on Miller's theory to claim that the default position for distributing the gains of international trade in goods and services should be full equality. At the same time, James concedes that certain adjustments might be required in order to reflect the relative endowments of trading nations. Since doing so would reduce the gross gains of nations with smaller markets and low productivity levels that are typically less developed, James proposes a relative gains principle that accepts inequality to the extent that a larger share of the benefits of international trade flows to those nations.[203]

---

199 Explanatory Statement, *supra* note 191, at 52–53.

200 Mitchell Kane & Adam Kern, *Progressive Formulary Apportionment: The Case for 'Amount D'*, 102 TAX NOTES INT'L 1483, 1485 (2021).

201 *Id.* at 1484.

202 DAVID MILLER, JUSTICE FOR EARTHLINGS: ESSAYS IN POLITICAL PHILOSOPHY 12 (2013). *See generally* DAVID MILLER, NATIONAL RESPONSIBILITY AND GLOBAL JUSTICE (2007).

203 AARON JAMES, FAIRNESS IN PRACTICE: A SOCIAL CONTRACT FOR A GLOBAL ECONOMY 18, 181 (2012); Aaron James, *A Theory of Fairness in Trade*, 1 MORAL. PHIL. & POL. 177 (2014).

Drawing from James' work, Christians and van Apeldoorn note that it is virtually impossible to determine with precision how much each nation contributes to global wealth production. If so, the net gains of international economic cooperation must be assumed to be equivalent for all cooperating nations.[204] From this observation, Christians and van Apeldoorn derive an equal benefit principle of international taxation that asserts an even share of taxing rights for residence and source states. They suggest, however, that equal sharing is only fully justifiable once subsistence rights deficits in the concerned parties have been eradicated.[205] Mindful that some might dispute the existence of duties of assistance between nations, Christians and van Apeldoorn make a supplementary normative claim on how source taxation could be expanded by accounting for those deficits within existing tax approaches and processes.[206]

While structuring allocation schemes to first eliminate subsistence rights deficits may be the optimal approach from a global justice perspective,[207] our proposal adopts a more practical and arguably more politically attainable position, given the prevailing geopolitical climate. This is primarily due to the fact that recent events have demonstrated the unlikelihood of residence states agreeing to meaningfully sharing taxing rights in the near term, and even perhaps in the medium run.[208] This might be too cynical of a view, and perhaps the ethical stance is to insist on demanding that richer states "improve (or at least not worsen) the welfare of the least well-off citizens in all the cooperating states."[209] But judging from the dawdling pace in which Pillar One has progressed, explained in large part by unabated resistance from key residence countries such as the United States,[210] developing an alternative that does not hinge on the willingness of such countries to share taxing rights is warranted.

---

204 CHRISTIANS & VAN APELDOORN, *supra* note 74, at 116, 166–67.

205 *Id.* at 5 ("[U]ntil th[e] duty [of assistance] is met, the gains arising from international investment of capital from states that do not suffer subsistence rights deficits into states that do should be seen as belonging to the latter until such time as subsistence rights can be met. Only then may states press their entitlement to the wealth of their territory and demand that the gains of international investment and production be shared among them.").

206 *Id.* at 6 ("[E]ven when states are not directly responsible for either the existence or rectification of subsistence rights deficits, this does not mean that they are entitled to all of the gain that is produced as a result of such deficits. In fact, they may be entitled to none of it, depending on the circumstances that produced the gains in question.").

207 *Id.* ("[S]tates suffering subsistence rights deficits are entitled to (at least) all the gains arising from cross-border investment originating from reasonably affluent states, until such time as these deficits are eliminated. In practice, this requires residence states to cede the right to tax in such a way that enables tax at source rather than discouraging it.").

208 *See* Tsilly Dagan, *Just Harmonization*, 42 UBL L. REV. 331, 350 (2010) ("[W]orldwide redistribution, however, is harder to justify on grounds of self-interest . . . . It seems to require a certain level of altruism or at least a strong belief that this is "the right thing to do" and a sense of trust that all others who are similarly situated will also participate in this laudable endeavor, for otherwise, by redistributing away their own wealth they would simply join the ranks of the underprivileged without significantly alleviating their situation. I suspect that not all those who are better-off would willingly agree to put their wealth in the common pool, if faced with a reasonable alternative.").

209 Tsilly Dagan, *International Tax and Global Justice*, 18 THEORETICAL INQ. L. 1, 6 (2017). In political philosophy and political theory, there is an age-old debate on the limits and possibilities of ideal and nonideal theorizing. See, for example, the many contributions in the special volume of 33 SOC. PHIL. & POL'Y 1, 1–456 (2016), https://www.cambridge.org/core/journals/social-philosophy-and-policy/issue/57E2F0A3EB573DECC3960BA7261E7050?sort=canonical.position%3Aasc&pageNum=1&searchWithinIds=57E2F0A3EB573DECC3960BA7261E7050&productType=JOURNAL_ARTICLE&template=cambridge-core%2Fjournal%2Farticle-listings%2Flistings-wrapper&hideArticleJournalMetaData=true&displayNasaAds=false.

210 Sam Fleming, Jim Brunsden & James Politi, *US Upends Global Digital Tax Plans After Pulling Out of Talks with Europe*, FINANCIAL TIMES (June 17, 2020), https://www.ft.com/content/1ac26225-c5dc-48fa-84bd-b61e1f4a3d94; Reuven S. Avi-Yonah, *Pillar 1 and DSTs: OECD Optimism and U.S. Reality*, 111 TAX NOTES INT'L 299, 299–30 (2023); Nana Ama

That said, our model likely indirectly addresses subsistence rights deficits by reducing the amount of resources wasted in enforcing complex tax rules while securing a steady inflow of revenues for all countries. Moreover, it grants effective taxing rights to source countries for which the current rules generate no or very little tax revenue. In fact, the most challenging task is justifying the precise percentage of business profits that source states should be entitled to tax, regardless of whether residence states also choose to do so. The precise level of acceptable double taxation is fundamentally a policy choice that will need to be revisited in light of concrete impact assessments.[211] Such assessments should consider whether, on balance, any remaining negative effect is outweighed by the efficiency gains that are expected to stem from the adoption of a much simpler approach, in terms of reduced overall administrative and compliance costs. But as far as a normative justification is concerned, what matters is identifying the net gains of global commerce that justly belong to source states.

We start by noticing that there appears to be enough consensus in the literature that international trade has had a positive effect on global GDP,[212] with a recent study estimating that over the last three decades—since the major reform wave of the 1990s—the average increase corresponded to 1.0 to 1.5 percentage points per year.[213] In addition, institutions such as the United Nations, IMF, and World Bank all seem to concur in claiming that most of this growth may have accrued to Global South countries as a result of the removal of protectionist measures and other entry barriers to goods, services, and capital from Global North countries.[214] This could suggest that but for massive regulatory efforts to open up markets in

---

Sarfo, *DSTs, Destabilization, and the Rocky Road to Pillar 1*, 109 TAX NOTES INT'L 950, 950–55(2023). *Cf.* Dagan, *supra* note 208, at 356 ("If residence countries were, indeed, to give up (at least some of) their revenues, it could limit their ability to finance their welfare state. Countries of residence are thus faced with a tough choice: either they benefit host countries—and constrain their internal national wealth redistribution—or else they refuse to allocate more revenues to host countries—in order to maintain redistribution within their own states.").

[211] *Cf.* Edward Fox & Zachary Liscow, *A Case for Higher Corporate Tax Rates*, 167 TAX NOTES FED. 2021, 2036 (2020) ("Ultimately, policymakers must decide what the corporate tax rate will be. We cannot tell them exactly what that rate should be. But we can offer both guidance and the caution that, just as we do not know, neither do those who suggest low rates largely on grounds of international competition.").

[212] Jeffrey Frankel & David Romer, *Does Trade Cause Growth?*, 89 AM. ECON. REV. 394 (1999); T.N. Srinivasan & Jagdish Bhagwati, *Outward-Orientation and Development: Are Revisionists Right?*, *in* TRADE, DEVELOPMENT AND POLITICAL ECONOMY: ESSAYS IN HONOUR OF ANNE O. KRUEGER 3 (Deepak Lal & Richard H. Snape eds., 1999); EDWARD E. LEAMER, THE HECKSCHER-OHLIN MODEL IN THEORY AND PRACTICE 2, 40 (1995) (discussing the notion that growth is more easily sustained in open economies than closed ones and arguing that economic integration of low-wage and high-wage countries should lead to specialization, raising global GDP); Tarlok Singh, *Does International Trade Cause Economic Growth? A Survey*, 33 WORLD ECON. 1517, 1554 (2011) (arguing that most studies support trade's benefits and recognize GATT/WTO's role in promoting it, but the evidence is not entirely clear-cut: while macro data strongly back trade's positive impact on output and GDP growth, micro evidence may indicate that productivity affects trade more than trade affects productivity); Andrea Bassanini & Stefano Scarpetta, *The Driving Forces of Economic Growth: Panel Data Evidence for OECD Countries*, OECD Econ. Stud. n. 33, 2001/II, 9-56, at 28, 40–42 (2001).

[213] Irwin A. Douglas, *Does Trade Reform Promote Economic Growth? A Review of Recent Evidence*, NBER Working Paper 25927, 15, 37 (2019).

[214] UN, *The Bridgetown Covenant: From Inequality and Vulnerability to Prosperity for All*, UNCTAD, 4, paras. 17-19 (2021); IMF, *Global Trade Liberalization and the Developing Countries*, Issues Brief 08/01, para. II (2001) ("Moreover, developing countries would gain more from global trade liberalization as a percentage of their GDP than industrial countries, because their economies are more highly protected and because they face higher barriers."); World Bank Group [WBG], *Trade Has Been a Powerful Driver of Economic Development and Poverty Reduction*, World Bank Brief (2023). *See also* Kimberley Ann Elliott, *Opening Markets for Poor Countries: Are We There Yet?*, CGD Working Paper 184, at 16–17 (2009) (arguing that advanced economies have not yet fully opened up their markets for low-income countries).

the South, the global economy would be at least 30% smaller than its current size, and further that a larger share of the observed economic upswing of later decades is largely credited to source (developing) states.

Based on these assumptions, it appears justifiable to assert that the global overall net gain from international trade could be approximately equivalent to the 30% increase in global GDP. Given that a substantial portion of this economic growth may have primarily benefited the Global South, it becomes reasonable, from a normative standpoint, to propose that roughly 20% of affected business profits should consistently be taxed at source (reflecting the national net gain of international transactions at source). The remaining 80% of the relevant business profits are, subsequently, assumed to consist of two parts: 10% represents net gains linked to contributions to international transactions by the residence state, and the remaining 70% pertains to profits that are not subject to redistribution as they would have presumably occurred in autarky. However, as indicated, our proposal does not require the residence state to relinquish taxing rights. The objective is to merely augment taxing rights for source states, enabling them to tax 20% of business profits when both the nexus criteria outlined above are met. Allocating a 20% share to source states regardless of whether residence states tax 100% of the same base would logically imply some level of double taxation.[215] But as the analysis in Part II.B *supra* has shown, this outcome alone cannot be deemed to be distortive to global welfare.

4. *Legal certainty*

When more than one source state is implicated by the activities of a multinational group, allocating an extra 20% of the tax base to each of them would produce a cascading effect that could be seen as excessive for cross-border investing. To prevent this outcome, that percentage must be somehow split within acceptable parameters. One way is to divide the 20% in proportion to the share of locally sourced revenues, but doing so would disfavor smaller economies that are likely the ones in greater need of resources. At the same time, using development-centric metrics, such as the number of inhabitants, geographical attributes, gross national income (GNI), or the human development index (HDI),[216] would require a comprehensive consensus among a multitude of states that seems unlikely to materialize. Further, the challenges involved in applying more complex metrics risks increasing disputes between the jurisdictions involved, in addition to the obvious increases in administrative and compliance costs.

To ensure investors that the total tax base (inclusive of double taxation) does not exceed 120% of all business income, the best approach is to follow the equal benefit principle explored above. In this sense, if four source jurisdictions meet the revenue threshold under the proposed

[215] As discussed in Part II.C *supra*, there are compelling reasons to assume that there are strong incentives for residence countries to take unilateral measures (i.e., foreign credits or exemption) to resolve overlapping between residence and source taxes. Whether residence countries would take such measures, and the extent to which they would do so, is a national policy matter in our proposal.

[216] For a proposal based on HDI, see Pablo Mahu Martínez, *Distributive Profit Allocation Rules: A New Approach for an Old Problem*, 49 INTERTAX 144, 162–64 (2021).

nexus rule,[217] each could tax 5% of all global profits of a multinational. Note that in this model source states are also entitled to impose withholding taxes on outgoing payments to companies that do not generate enough revenue at source to meet the nexus threshold.

As more source jurisdictions meet the revenue threshold, global profits are expected to increase in absolute numbers. Even if each source jurisdiction's relative share of the extra tax base diminishes, the actual additional revenue that can be collected is likely to be greater. In practice, the actual number of eligible source jurisdictions is expected to exceed the number presented in the above illustrative scenario. Consequently, the incorporation of an additional source jurisdiction would exert a marginal influence on the portion of the extra tax base accessible to the existing jurisdictions.

Considering that most business profits are presently flowing to residence jurisdictions, either because there is no permanent establishment at source or because too little profit can be allocated to a permanent establishment under current rules, an equal splitting method would represent a considerable gain for many source jurisdictions. As already emphasized, the additional appeal of this model is that it would considerably reduce resource-draining implementation and enforcement, both because it is much simpler to apply in practice and because it does not require that residence jurisdictions agree to sharing taxing rights.

5. *Implementation*

When it comes to translating the proposed model into legal reality, there are different tools and approaches available, each with their own level of efficacy, coverage, and outreach. Since our proposal requires consolidating global profits to be split among the eligible jurisdictions, in a similar but much simpler manner than Amount A under Pillar One, key tools that have been in use for some time now at both the national and transnational levels include country-by-country reporting (CbCR), exchange of information agreements, and other tax transparency initiatives.[218]

CbCR, in particular, arose from Action 13 of the BEPS with the purpose of providing aggregate data on the global operations of multinationals with annual revenues above 750 million EUR to all concerned governments, including where group entities are located, what activities they perform, and how much profits they make.[219] Many countries, especially those

[217] Part A.2 *supra*.

[218] *See* Montano Cabezas, *Tax Transparency and the Marketplace: A Pathway to State Sustainability*, 10 MCGILL INT'L J. SUST. DEV. L. & POL'Y 179 (2014); Dan Misutka & Lauchlin MacEachern, *The Canada Revenue Agency's Tax Transparency Initiatives: Implications for a Corporate Governance Response*, 61 CANADIAN TAX JOURNAL 3 (2013); Arthur J. Cockfield & Carl D. MacArthur, *Country-by-Country Reporting and Commercial Confidentiality*, 63 CANADIAN TAX J. 627, 632 (2015); Roberto Codorniz Leite Pereira, *The Emergence of Transparency and Exchange of Information for Tax Purposes on Request as an International Tax Custom*, 48 INTERTAX 624, 634–39 (2020) ;Leyla Ates, *Cross-Border Tax Transparency: A Study of Recent Policy Developments in Turkey*, 44 DALHOUSIE L.J. 1 (2021).

[219] OECD/G20 Base Erosion & Profit Shifting Project, *Transfer Pricing Documentation and Country-by- Country Reporting, Action 13: 2015 Final Report*, at 9 (2015); OECD/G20 Base Erosion & Profit Shifting Project, *Action 13: Country-by-Country Reporting Implementation Package*, at 10 (2015); OECD/G20 Base Erosion & Profit Shifting Project, *Action 13: Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting*, at 3 (2015) [hereinafter *Guidance*]; OECD, *Country-by-Country Reporting XML Schema: User Guide for Tax Administrations and Taxpayers*, at 3 (2016); OECD, *Country-by-Country Reporting XML Schema: User Guide for Tax Administrations*, at 3 (Sept. 2017); OECD, *BEPS Action 13 on Country-by-Country Reporting: Guidance on the Appropriate Use of Information*

with lower administrative capacity, have struggled with using CbCR data,[220] but for our purposes it suffices that the data is enough to allow global consolidation in the aggregate. As CbCR does not currently cover all multinationals, our model would be aided by the other mentioned tools, including the Convention on Mutual Administrative Assistance in Tax Matters.[221]

In terms of effectively amending existing tax treaties, countries could pursue such an end via one-on-one negotiations with treaty partners, but a more straightforward approach is to reform widely used model conventions such as the ones produced by the OECD and United Nations. Even so, these models are nonbinding texts that create at maximum soft law, so real-world application still requires renegotiating treaty terms on a treaty-by-treaty basis.[222] Therefore, the most effective approach is the one currently adopted under the Pillar One project. Recently, the OECD released a series of extensive documents concerning Amount A. In particular, the OECD has made available a text for a multilateral convention, an explanatory statement, an understanding regarding certainty in rule application, and an overview document.[223] A new multilateral instrument is envisioned to work in a similar manner to the previous one developed in the context of Action 15 of the BEPS project,[224] that is, by way of altering multiple tax treaties at once upon entering into force.[225]

Contained in Country-by-Country Reports, at 4 (Sept. 2017); OECD, *BEPS Action 13 Country-by-Country Reporting: Handbook on Effective Tax Risk Assessment*, at 3 (Sept. 2017); OECD, *BEPS Action 13 Country-by-Country Reporting: Handbook on Effective Implementation*, at 3 (Sept. 2017); OECD, *Guidance on the Implementation of Country-by-Country Reporting: BEPS Action 13*, at 27 (Dec. 2019).

[220] *See* Annet Wanyana Oguttu, *Curtailing BEPS through Enforcing Corporate Transparency: The Challenges of Implementing Country-by-Country Reporting in Developing Countries and the Case for Making Public Country-by-Country Reporting Mandatory*, 12 WORLD TAX J. 167 (2020); Thomas Dubut et al., *Comprehensive Tax Treaties and Tax Information Exchange Agreements: Assessing Exchange of Information Mechanisms to Ensure Transparency in a Globalized World from the Perspective of Developing Countries*, 72 BULL. INT'L TAX'N 57 (2018); Ani Tri Wahyuni, Angga Wahyu Anggoro & Danny Sirait, *Implementation of Country-by-Country Reporting to Tackle BEPS: Assessment of the Potential Benefits*, 25 ASIA-PAC. TAX BULL. 1.

[221] OECD & Council of Eur., *The Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Amended by the 2010 Protocol*, at 3 (2011).

[222] Aitor Navarro, *International Tax Soft Law Instruments: The Futility of the Static v. Dynamic Interpretation Debate*, 48 INTERTAX 848, 851–53 (2020); Craig West, *References to the OECD Commentaries in Tax Treaties: A Steady March from "Soft" Law to "Hard" Law?*, 9 WORLD TAX J. 117, 149 (2017); Peter J. Wattel & Otto Marres, *The Legal Status of the OECD Commentary and Static or Ambulatory Interpretation of Tax Treaties*, 43 EUR. TAX'N 222, 234 (2003); Thomas Dubut, *The Court of Justice and the OECD Model Tax Conventions or the Uncertainties of the Distinction between Hard Law, Soft law, and No Law in the European Case Law*, 40 INTERTAX 1, 12 (2012).

[223] OECD, *The Multilateral Convention to Implement Amount A of Pillar One: Two-Pillar Solution to Address the Tax Challenges of the Digitalisation of the Economy* (2023); Explanatory Statement, *supra* note 191; OECD, *Understanding on the Application of Certainty for Amount A of Pillar One: Two-Pillar Solution to Address the Tax Challenges of the Digitalisation of the Economy* (2023). See also OECD, *The Multilateral Convention to Implement Amount A of Pillar One: Overview* (2023).

[224] Multilateral Convention to Implement Treaty Related Measures to Prevent Base Erosion and Profit Shifting, June 7, 2017, https://www.oecd.org/tax/treaties/multilateral-convention-to- implement-tax-treaty-related-measures-to-prevent-BEPS.pdf; OECD, Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, https://www.oecd.org/tax/treaties/explanatory-statement- multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.

[225] Michael Lebovitz et al., *If Pillar 1 Needs an MLI, Why Doesn't Pillar 2*, 107 TAX NOTES INT'L 1009, 1013 (2022); Robert Goulder, *Pillar 2 and Tax Treaties: MLI, Where Art Thou?*, 108 TAX NOTES INT'L 775, 778 (2022). For scholarly analyses of the workings of the previous MLI, see generally A MULTILATERAL CONVENTION FOR TAX: FROM THEORY TO IMPLEMENTATION (Sérgio André Rocha & Allison Christians eds., 2021); NATHALIE BRAVO, A MULTILATERAL INSTRUMENT FOR UPDATING THE TAX TREATY NETWORK (2020).

If there is ample political determination among a critical mass of states, a convention to simplify tax treaties could be instead designed to establish the three basic taxing rights proposed in this Article, but with a much shorter text. If appropriate, this new multilateral instrument could, like its predecessor,[226] include opt-in/opt-out clauses and the possibility of reservations, in order to permit source jurisdictions to choose between applying current rules or our proposed simplified approach. In any case, the convention should clarify that those that opt for the simplified approach will not impose taxation in excess of the limits discussed in Part III.A.3 *supra*. Making room for optional clauses could provide the flexibility necessary to accommodate diverse country interests, while securing greater buy-in from taxpayers that may currently have a permanent establishment that is taxed on a net basis, but that would not meet the revenue-based threshold in our proposal.

B. Comparison with rival proposals

Having laid out the main technical aspects of our proposed simplified tax treaty model, this Part compares it to two other broad-based systemic reform ideas that have been debated for some time in academic research and advanced through civil society advocacy, namely a destination-based cashflow tax (DBCFT) and global formulary apportionment. Each is discussed in turn.

1. Destination-based cashflow tax

Due to longstanding and well-known problems related to debt-over-equity bias and exposure to international tax avoidance, a number of economists have long advocated for wholly replacing existing corporate income tax regimes with a DBCFT.[227] The rationale chiefly rests on efficiency-based arguments that emphasize how customary profit-based tax approaches push firms towards restructuring in order to lower tax liabilities and states towards a race to the bottom in providing incentives to attract investments. These two effects are explained as resulting from profit taxation being tied to entity-level factors that can be relatively easily moved around, especially intangibles. In response, DBCFT proponents argue that a destination-based corporate tax is a more appropriate solution because firms cannot modify the location of their consumer base without stopping to sell to the respective customers.[228]

---

[226] *See generally* Nathalie Bravo, *Interpreting Tax Treaties in the Light of Reservations and Opt-Ins under the Multilateral Instrument*, 74 BULL. INT'L TAX'N 231 (2020); THE IMPLEMENTATION AND LASTING EFFECTS OF THE MULTILATERAL INSTRUMENT (Georg Kofler et al. eds., 2021).

[227] *See* Alan J. Auerbach *et al.*, *International Tax Planning under the Destination-Based Cash Flow Tax*, 70 NAT'L TAX J. 783 (2017); Alan J. Auerbach, *Demystifying the Destination-Based Cash Flow Tax*, BROOKINGS PAP. ECON. ANAL. 409 (2017); Alan Auerbach & Michael P. Devereux, *Consumption and Cash-Flow Taxes in an International Setting,* 10 AM ECON. J 69 (2018); Michael P. Devereux & John Vella, *Are We Heading Towards a Corporate Tax System Fit for the 21st Century?*, 35 FISC. STUD. 449 (2014); Michael P. Devereux & John Vella, *Gaming Destination-Based Cash Flow Taxes*, 71:3 TAX L. REV. 477 (2018); Michael P. Devereux & John Vella, *Implications of Digitalization for International Corporate Tax Reform*, 46 INTERTAX 550 (2018); Michael P. Devereux & John Vella, *Taxing the Digital Economy: Targeted or System-Wide Reform?*, 4 BRIT. TAX REV. 387 (2018); Michael P. Devereux, *How Should Business Profits Be Taxed? Some Thoughts on Conceptual Developments During the Lifetime of the IFS*, 40 FISC. STUD. 591 (2019).

[228] For an argument that the DBCFT cannot be analogized with other destination-based taxes, see Peter A. Bernes & H. David Rosenbloom, *The Destination-Based Cash Flow Tax is a VAT?*, 71:6a BULL. INT'L TAX'N 20 (2017).

In a coauthored book, five scholars, among economists and tax law professors, offer a principled approach defense of the DBCFT.[229] Starting from Adam Smith's classic tax canons,[230] the book proposes the five criteria of fairness, economic efficiency, robustness to avoidance, ease of administration, and incentive compatibility.[231] In addressing fairness between countries in particular,[232] the book references the Musgraves' work on inter-nation equity, but at the same time the book dismisses any fairness-based considerations as too vague to guide the proper allocation of the right to tax multinational profits.[233] In the end, the book confines the case for the DBCFT to a "second-best" view that can be summarized in two basic claims: (1) traditional corporate taxation is inherently flawed because multinationals can easily avoid paying taxes by exploiting all sorts of techniques of aggressive tax planning and profit shifting; and assuming (1) as a constant, then (2) the DBCFT is comparatively fairer because even though it tends to allocate more revenues to larger markets that are known to comprise relatively wealthier countries,[234] it would potentially increase revenues for everyone by ending tax competition. Yet, as one of the authors of that book stated in a previously single-authored publication, "an allocation of taxing rights following the location of customers would lead to an enormous swing of revenue between production countries and market countries . . ." and "it might also be that this shift benefits larger countries at the expense of smaller countries . . . ."[235]

In addition, several scholars have raised doubts that the DBCFT is capable of delivering on its promises, suggesting that it might still be prone to gaming by taxpayers and that rather than

[229] MICHAEL P. DEVEREUX ET AL., TAXING PROFIT IN A GLOBAL ECONOMY 267–333 (2020).

[230] These are known as the canon of equality or ability, the canon of certainty, the canon of convenience, and the canon of economy. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (ebook), Part II. Of Taxes.

[231] DEVEREUX ET AL., *supra* note 227, at 33.

[232] For a fairness-based analysis of the DBCFT focused on individuals and corporations rather than states, see William B. Barker, *A Common Sense Corporate Tax: The Case for Destination-Based, Cash Flow Tax on Corporations*, 61:4 CATH. U. L. REV. 955, 1000–01, 1003–04 (2012).

[233] *Id.* at 3 ("Fairness is an important issue, but it is also in many ways a much more difficult issue, since . . . there is no clear basis for how the rights to tax the profit of a multinational business ought to be distributed amongst countries."); *id.* at 15 ("[E]conomic efficiency is often underappreciated, and fairness turns out not to offer clear prescriptions for the business level taxation of profit."); *id.* at 35 ("[I]t makes little sense to think about fairness in the context of the taxation of businesses."); *id.* at 39 ("On the basis of fairness, should taxing rights be claimed more by the country of residence of the shareholders, the country where production takes place, or the country in which the final good is consumed? There does not seem to be any clear basis to answer this question. There is no 'scientific' method to identify the 'right' allocation of taxes between countries."); *id.* at 40 ("Ultimately, these notions of fairness are almost impossible to operationalize in designing a business- level tax on profit.").

[234] Christians & Magalhães, *supra* note 17, at 1175 fig.1.

[235] Wolfgang Schön, *One Answer to Why and How to Tax the Digitalized Economy*, 47 INTERTAX 1003, 1010, 1010 n.73 (2019). *See also* Krister Andersson, *Should We Use Value Creation or Destination as a Basis for Taxing Digital Businesses? Comments on the 2018 Klaus Vogel Lecture Given by Professor Michael Devereux*, 72 BULL. INT'L TAX'N 684 (2018) (claiming that taxing corporate income where consumption takes place will generate considerable revenue losses to exporting countries, including from production and labor, and a steep decline in incentives for innovation and development, especially for small periphery markets whose interests should be equally taken into account in any international reform); Shafik Hebous, Alexander Klemm & Saila Sausholm, *Revenue Implications of Destination-Based Cash-Flow Taxation*, 68 IMF ECON. PAP. 848 (2020) (arguing that universal adoption of the DBCFT could on average raise as much revenue as current corporate income taxes, but there would be winners and losers, the latter exemplified by countries with a large trade surplus); Johannes Becker & Joachim Englisch, *Unilateral Introduction of Destination-Based Cash-Flow Taxation*, 27 INT'L TAX & PUB. FINANCE 495 (2019) (arguing that "in contrast to what the label "destination-based tax" suggests, the DB[CF]T is actually a pure residence-based tax.").

putting an end to tax competition, it might just make tax competition switch places.[236] In 2017, the DBCFT was considered by the U.S. Congress following a proposal by former House Speaker Paul Ryan from the Republican Party, but it was eventually abandoned as unfeasible.[237] The principal reason for this rejection is that the DBCFT is such a radical departure from current practices that it could never work in a globalized world without a massive adherence of countries.[238] Even an economic superpower such as the United States may not be able to go it alone.[239] Hence, the DBCFT seems improbable to become a politically feasible replacement for the existing international tax system in the near term.

2. *Formulary apportionment*

An objection to our proposal may be that the simplified tax treaty model is not as comprehensive a solution as global formulary apportionment. Formulary apportionment is a long-lived idea that has been advocated by many scholars, civil society organizations, and tax activists (even if under different models),[240] and it is possibly the best known alternative to arm's-length transfer pricing.[241] The technique has long been employed by federalist countries

---

[236] *See* David S. Miller, *Tax Planning under the Destination Based Cash Flow Tax: A Guide for Policymakers and Practitioners*, 8 COLUM. J. TAX L. 295 (2017); Shaun Matos, *The Destination-Based Corporation Tax: A Solution to Formalism in Source-Based Taxation?*, 4 CAMBRIDGE L. REV. 94 (2019); Wei Cui, *Destination-Based Cash-Flow Taxation: A Critical Appraisal*, 67 TORONTO L.J. 301 (2017).

[237] *See* Reuven S. Avi-Yonah & Kimberly Clausing, *Problems with Destination-Based Corporate Taxes and the Ryan Blueprint*, 8 COLUM. J. TAX L. 229 (2017); Daniel Shaviro, *Goodbye to All That? A Requiem for the Destination-Based Cash Flow Tax*, 72:4/5 BULL. INT'L TAX'N 248 (2018).

[238] LAMMERS, *supra* note 17.

[239] *But see* Hebous, Klemm & Sausholm, *supra* note 233 ("Unilateral DBCFT adoption can generate negative spillover effects, which are found to be sizeable if the DBCFT country is large and integrated. We find that spillovers could prompt other countries to adopt a DBCFT, too, either as an immediate reaction, or in some cases in a later round, as a rising number of DBCFT countries raises the cost of maintaining source-based CITs [corporate income taxes]. Some countries, however, would never have a revenue incentive for adopting a DBCFT.").

[240] *See* Charles E. McLure Jr., *Replacing Separate Entity Accounting and the Arm's Length Principle with Formulary Apportionment*, BULL. INT'L TAX'N 586 (2002); Walter Hellerstein, *The Case for Formulary Apportionment*, 12 INT'L TRANSFER PRICING J. 103 (2005); Joann M. Weiner, *It's Time to Adopt Formulary Apportionment*, TAX NOTES 555 (2009); Reuven S. Avi-Yonah & Ilan Benshalom, *Formulary Apportionment – Myths and Prospects: Promoting Better International Tax Policies by Utilizing the Misunderstood and Under-Theorized Formulary Alternative*, 3 WORLD TAX J. 371 (2011); Alexander Ezenagu, *Faltering Blocks in the Arguments against Unitary Taxation and the Formulary Apportionment Approach to Income Allocation*, 17 ASPER REV. INT'L BUS. & TRADE L. 131 (2017); TAXING MULTINATIONAL ENTERPRISES AS UNITARY FIRMS (Sol Picciotto ed., 2017); Tomaso Faccio & Valpy Fitzgerald, *Sharing the Corporate Tax Base: Equitable Taxing of Multinationals and the Choice of Formulary Apportionment*, 25 TRANSNAT'L CORP. 67 (2018); Bill Parks, *It's Past Time for Formulary Apportionment*, 108 TAX NOTES INT'L 1411 (2022).

[241] For the different positions on this debate, see Robert H. Cutler, *Formulary Apportionment–Is This Alternative to the Arm's Length Standard Possible and Practical Under the United States' Current Tax Treaties?*, *in* 3 INTERNATIONAL TRADE AND BUSINESS LAW ANNUAL 153 (1997); Steve Christensen, *Formulary Apportionment: More Simple–On Balance Better?*, 28 L. & POL'Y INT'L BUS. 1133 (1997); Arthur J. Cockfield, *Formulary Taxation Versus the Arm's-Length Principle: The Battle Among Doubting Thomases, Purists, and Pragmatists*, 52 CAN. TAX J. 114 (2004); Roberto Franzé, *Transfer Pricing and Distribution Arrangements: From Arm's Length to Formulary Apportionments of Income*, 33 INTERTAX 260 (2005); Julie Roin, *Can the Income Tax be Saved? The Promise and Pitfalls of Adopting Worldwide Formulary Apportionment*, 61 TAX L. REV. 169 (2008); Antony Ting, *Multilateral Formulary Apportionment Model–A Reality Check*, 25 AUSTL. TAX F. 95 (2010); Rosanne Altshuler & Harry Grubert, *Formula Apportionment: Is It Better Than the Current System and Are There Better Alternatives?*, 63 NAT'L TAX J. 1145 (2010); Kimberly A. Clausing & Yaron Lahav, *Corporate Tax Payments under Formulary Apportionment: Evidence from the Financial Reports of 50 Major U.S. Multinational Firms*, 20 J. INT'L ACC., AUD. & TAX'N 97 (2011); Peter L. Faber, Letter to the Editor, *International Formulary Apportionment Is Not a Panacea*, TAX NOTES (2012); Ilan Benshalom & Yaron Lahav, *Will High Paying Jobs Go Abroad? Labour Shifting Responses to Formulary Allocation*, 28 AUSTL. TAX F. 754 (2013); Peter L. Faber, Letter to the Editor, *But Who Will Fix the Formulary Apportionment Fix?*, TAX NOTES 1145 (2013); J. Clifton Fleming Jr., Robert J. Peroni & Stephen E. Shay, *Formulary*

like Canada, Switzerland, and the United States (where provinces, cantons, and states have their own income tax regimes) and was equally considered for the precursor to the Canada-Mexico-United States Agreement (USMCA or CUSMA),[242] as well as by the European Union, first under the common consolidated corporate tax base (CCCTB) and lately under the Business in Europe: Framework for Income Taxation (BEFIT).[243]

Normally, when people talk about global formulary apportionment what they have in mind is a harmonized system that consolidates the totality of a multinational's profits on a worldwide basis and then spreads those profits across jurisdictions where the multinational maintains profit-making factors.[244] Three are the typical factors, namely assets, employment, and sales (known as the "Massachusetts formula"), but the weight attributed to each may vary according to the preferred model.[245] Given the prominence of intangibles today, four-factor formulas have also suggested, such as in the context of the G24 "significant economic presence" proposal mentioned in Part III.A.1 *supra*, as well as a proposal by India for amending domestic rules on profit allocation to permanent establishments and the EU's CCCTB and BEFIT proposals.[246] Alternatively, some scholars have argued that the optimal formula for a world where factors of production are mobile should rest exclusively on sales because the consumer's attachment to a

---

Apportionment in the U.S. International Income Tax System: Putting Lipstick on a Pig?, 36 MICH. J. INT'L L. 1 (2014); Wei Cui, *Residence-Based Formulary Apportionment: (In)Feasibility and Implications*, 71 TAX L. REV. 551 (2018); Michael McDonal, *Ready for My Close-Up, Mr. DeMille: Formulary Apportionment's Ticket Out of Palookaville*, 108 TAX NOTES INT'L 1081 (2022); Alistair Pepper, Jessie Coleman & Thomas D. Bettge, *Why It's Still Not Time for Global Formulary Apportionment*, 107 TAX NOTES INT'L 911 (2022).

242 Paul R. McDaniel, *NAFTA and Formulary Apportionment: An Exploration of the Issues*, 3 INTERTAX 105 (1994); Paul R. McDaniel, *Formulary Taxation in the North American Free Trade Zone*, 49 TAX L. REV. 691 (1994); Richard D. Pomp, *Issues in the Design of Formulary Apportionment in the Context of NAFTA*, 49 TAX L. REV. 795 (1994).

243 Martti Nieminen, *Destination-with-Credit Formula: A Simple Add-On that Would Make the CCCTB More Resilient in the Face of Tax Competition and Tax Planning*, 47 INTERTAX 490 (2019); Christoph Spengel & Kathrin Stutzenberger, *Comment on M. Nieminen: 'Destination-with-Credit Formula: A Simple Add-On that Would Make the CCCTB More Resilient in the Face of Tax Competition and Tax Planning'*, 47 INTERTAX 496 (2019); STEFAN MAYER, FORMULARY APPORTIONMENT FOR THE INTERNAL MARKET (2009); Joann Martens Weiner, *Practical Aspects of Implementing Formulary Apportionment in the European Union*, 8 FLA. TAX REV. 629 (2007); Antonio Russo, *Formulary Apportionment for Europe: An Analysis and a Proposal*, 33 INTERTAX 2 (2005); Reuven Avi-Yonah, Letter to the Editor, *Do Intangibles Fit BEFIT?*, 51 INTERAX 1, 1 (2023) (analyzing the two options for formulas, with and without incorporating intangible assets, under the BEFIT proposal). *But see* Robert Goulder, *BEFIT for Europe: Must We Do This Again?*, 112 TAX NOTES INT'L 301, 302 (2023) (explaining that BEFIT was presented by the European Commission as similar to the OECD's Pillar One "in that a partial formulary apportionment scheme is at hand" but different than the comprehensive formulary approach of the CCCTB).

244 OECD TPG, *supra* note 174, at 22 ("An approach to allocate the global profits of an MNE group on a consolidated basis among the associated enterprises in different jurisdictions on the basis of a predetermined formula."); UN, PRACTICAL MANUAL ON TRANSFER PRICING FOR DEVELOPING COUNTRIES xlii (3rd ed. 2021) ("Under formulary apportionment a formula is used to apportion the group's net income between the various entities and branches in the group. The formula normally uses factors such as property, payroll, turnover, capital invested or manufacturing costs.").

245 *See* Bharat N. Anand & Richard Sansing, *The Weighting Game: Formula Apportionment as an Instrument of Public Policy*, 53 NAT'L TAX J. 179 (2000).

246 G24, *supra* note 177, at 7 ("The users generally substitute assets and employees of the enterprise, therefore, while giving weightage to the user being the fourth factor, consideration must be given to the intensity of their participation."); Government of India, *supra* note 177, at 81 ("The Committee concluded that for [multidimensional business models where users are considered crucial to the business] . . ., users should also be taken into account for the purpose of attribution of profits, as the fourth factor for apportionment, in addition to the other three factors of sales, manpower and assets."); European Parliament, Committee on Economic and Monetary Affairs, Draft Report on the Proposal for a Council Directive on a Common Consolidated Corporate Tax base (CCCTB), at 11 (July 13, 2017) ("The formula apportionment for the consolidated tax base should comprise four equally weighted factors, namely labour, assets, sales by destination and collection and use of personal data of online platforms and services users ("DATA").").

country is based on personal residence, which is arguably harder to change through corporate tax planning.[247]

For decades on, the OECD considered formulary apportionment inconceivable,[248] so much so that avoiding the term might have seemed like a wise strategy to promote scholarly proposals with a similar outcome.[249] But as seen in Part III.A.1 *supra* in relation to Pillar One's Amount A, formulaic approaches are now at the center of the international tax debate, even if side-by-side with transfer pricing.[250] Despite a few claims in the literature that the OECD's two-pillar approach signals the embracement of unitary taxation,[251] apportioning profits according to a globally agreed formula is still very much a far cry from reality. Even if most countries could agree on a single formula, a shaky supposition in any case, the level of integration and complexity of the global economy coupled with the continuing advancement of digitalization make it implausible that formulary apportionment will be able to mitigate the most pressing challenges of the international tax system.[252]

At minimum, the fundamental normative question of how to fairly share profits of globally dispersed firms among jurisdictions would resurface in full swing at the moment of choosing factors to make up a global formula as well as their respective weight within the formula. While sales may benefit developed and emerging economies, lower-income countries are likely to gain only if a heavier weight is attributed to employment as measured by headcount rather than payroll.[253] Either way, discerning between types of revenue, accurately valuing assets, and correcting for differences in employment arrangements would again fall, in first instance, on

---

247 Reuven S. Avi-Yonah & Kimberly A. Clausing, *Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment,* BROOKINGS INST. (2007); Reuven S. Avi-Yonah, Kimberly A. Clausing & Michael C. Durst, *Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split*, 9 FLA. TAX REV. (2009); Susan C. Morse, *Revisiting Global Formulary Apportionment*, 29 VA. TAX REV. 593 (2010); Marco Runkel & Guttorm Schjelderup, *The Choice of Apportionment Factors Under Formulary Apportionment*, 52 INT'L ECON. REV. 913 (2011).

248 To this day, the latest version of OECD's transfer pricing guidelines dated 2022 continues to state that "OECD member countries . . . do not consider global formulary apportionment a realistic alternative to the arm's length principle . . . ." OECD TPG, *supra* note 174, at 35, para. 1.21.

249 François Vincent, *Transfer Pricing and Attribution of Income to Permanent Establishments: The Case for Systemic Global Profit Splits (Just Don't Say Formulary Apportionment)*, 53 CAN. TAX J. 409 (2005); Yariv Brauner, *Formula-Based Transfer Pricing*, 42 INTERTAX 615 (2014), *reprinted in* Brauner & McMahon Jr. eds., *supra* note 91, at 149.

250 For previous scholarly proposals that, kind of like Pillar One's approach, combined formulary apportionment with arm's length, see Ilan Benshalom, *Taxing the Financial Income of Multinational Enterprises by Employing a Hybrid Formulary and Arm's Length Allocation Method*, 28 VA. TAX REV. 619 (2009); Reuven S. Avi-Yonah, *Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation*, 2 WORLD TAX J. 3 (2010).

251 *See* Oliver Traidler, *Are the U.N. and OECD Walking Together into the Formulary Apportionment Abyss?*, 31 TAX NOTES INT'L 1191 (2020); Sol Picciotto & Jeffery M. Kadet, *The Transition to Unitary Taxation*, 108 TAX NOTES INT'L 453, 454 (2022); Sol Picciotto, Letter to the Editor, *Formulary Apportionment: The Last Best Hope for MNEs*, 108 TAX NOTES INT'L 437 (2022). When the BEPS project was proposed, some anticipated that formulary apportionment might have been underway. Robert Robillard, *BEPS: Is the OECD Now at the Gates of Global Formulary Apportionment*, 43 INTERTAX 447 (2015); Giammarco Cottani, *Formulary Apportionment: A Revamp in the Post-Base Erosion and Profit Shifting Era?*, 44 INTERTAX 755 (2016).

252 *See* Nadine Riedel, *The Downside of Formula Apportionment: Evidence on Factor Demand Distortions*, 17 INT'L TAX & PUB. FIN. 236, 257 (2010) ("The results indicate that multi-jurisdictional firms possess a substantial flexibility to adjust their payroll costs at the intensive margin in order to reduce their corporate tax burden under the German payroll apportionment system."); IMF, *supra* note 63, at 23.

253 IMF, *supra* note 64, at 40; ICRICT, *supra* note 195, at 10; Ruud de Mooij, Li Liu & Dinar Prihardini, *An Assessment of Global Formula Apportionment*, 74 NAT'L TAX J. 431, 451 (2019).

firms, possibly eliciting a new wave of litigation that would only replace current transfer pricing disputes. Even a single-factor formula based on sales might create administrative hurdles, as evidenced by the high level of complexity in the revenue sourcing rules of Amount A analyzed in Part III.A.2 *supra.* In sum, formulary apportionment may conceptually appear to be a simplified alternative to an arm's-length-based system, but it is doubtful that enforcing any formula will be a seamless process for most tax administrations, let alone in lower-income states.

That said, our proposal does not stand in the way of adopting formulary apportionment in the future. To the contrary, the simplified tax treaty model might be seen as a stepping-stone in that direction. But in staying closer to existing international tax rules, our proposal is arguably easier to achieve in the present, while opening up possibilities of further reforms moving forward.

CONCLUSION

That cross-border income should not be simultaneously taxed by residence and source states seems like an unbreakable mantra of international tax thinking and policymaking. But the prohibition of double taxation only really applies in respect to source states, which are disallowed to tax any portion of income that is allocated by treaties to the residence state. In contrast, nothing generally stops a residence state from imposing top-up taxation over a base that has already been taxed at source at a lower rate. This paradox often goes unnoticed in the literature due to a residence bias in the design of international tax rules. It is no surprise, therefore, that proposals for expanding source taxation advanced in scholarly and policy work often rely on the willingness of residence states to surrender some of their taxing rights, lest overlapping taxation unfold.

Contrary to this conventional wisdom, this Article set out to break with the double tax paradigm. We first showed that there are no robust grounds for claiming that the imposition of multiple taxes over the same asset or taxpayer is morally objectionable in its own right, or that avoiding double tax outcomes necessarily increases capital flows significantly. Based on these observations, we then proposed a simplified tax treaty model consisting of three basic taxing rights, in line with a revenue-based nexus, an equal-splitting income allocation method, and mechanisms for ensuring that double taxation does not become prohibitively costly to cross-border investing. Under this streamlined model, residence states may impose net-basis taxation on all profits of resident firms if they wish so, while source states are always entitled to collectively tax 20% of the same profits on a net basis as well as individually withhold on gross amounts paid to foreign firms that do not meet the nexus threshold, provided that the residence state offsets these withholding taxes via foreign tax credits.

To explain the mechanics of this model, we took inspiration from the framework of Pillar One, but we demonstrated that our proposal is much simpler and feasible, and that it is also normatively superior to alternative approaches such as the DBCFT and global formulary apportionment. By reforming existing tax treaties to accommodate an acceptable level of double taxation, it is possible to raise revenues for residence and source states at considerably lower costs of administration and compliance without restricting international business activities.