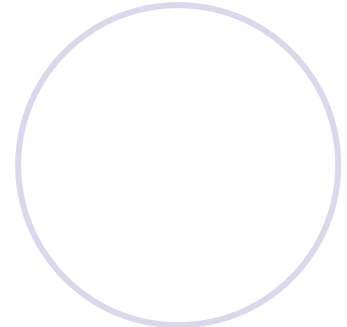
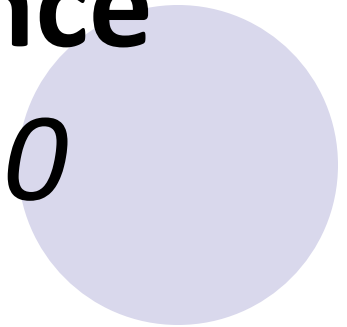
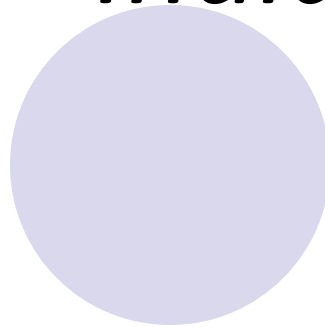
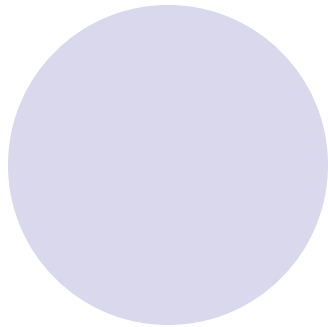


# ITRAF Annual Conference

*December 04-05, 2020*

*India*





# **The International Tax Regime and Global Power Shifts**

**Eduardo Baistrocchi**

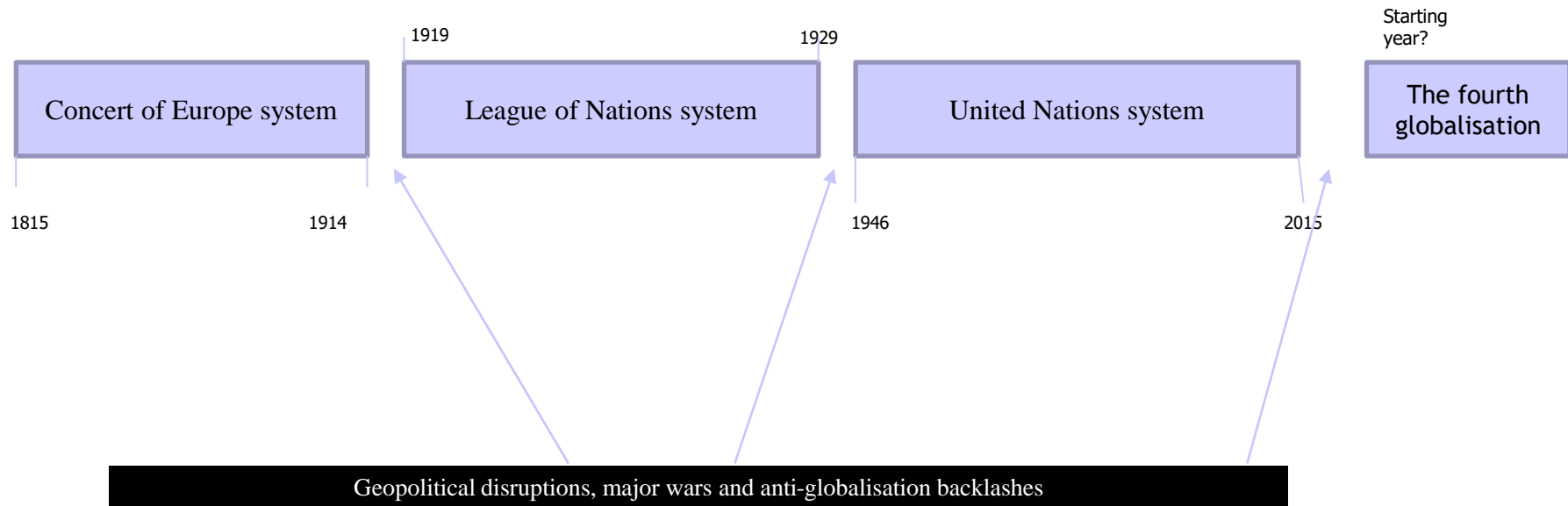
Forthcoming in the  
Virginia Tax Review, Vol. 40, No. 02, 2021.



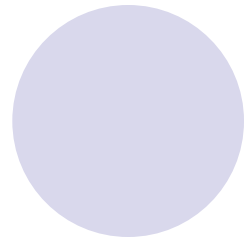
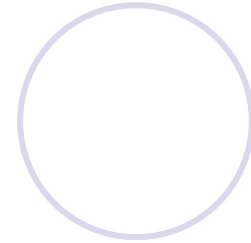
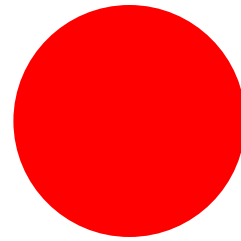
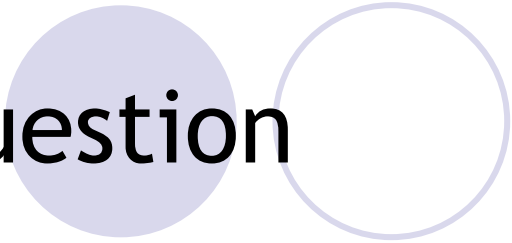
# Topics

- 1- The Context: three globalisation booms and three busts
- 2- Research Question
- 3- Theoretical Framework
- 4- Finding – The Spiral Evolution
- 5- A Theory of International Taxation
- 6- Conclusion

# Context: three globalisation booms and three busts



# Question



Is there correlation between global power shifts and the evolution of the international tax regime (ITR) since its emergence in the 1920s?

# Question- Relevance



Analysis is relevant because it brings normative lessons that could solve the new challenges that the ITR is facing in the early 21<sup>st</sup> century:

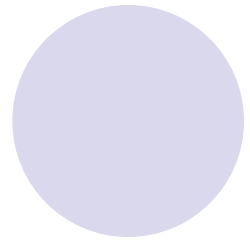
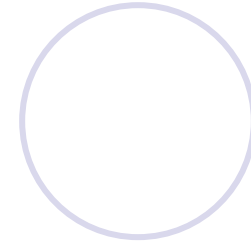
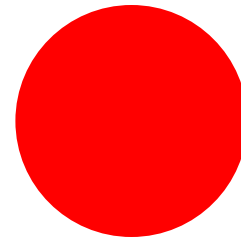
the increasing difficulties countries are facing in reaching consensus on how to deal with international taxation issues in emerging areas. Global digital commerce is a case in point.

# Theoretical Framework

Rules and Standards, as elaborated in the law and economics literature.

A jurisdiction can give content to norms *ex ante* (via rules) or *ex post* (via standards).

# Theoretical Framework



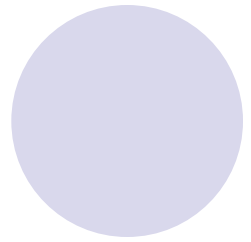
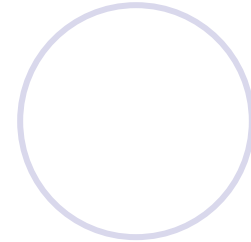
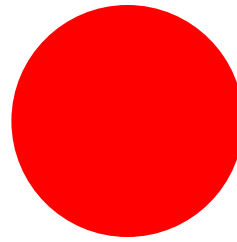
Examples:

Rule: ‘No driving in excess of 55 miles per hour’ is a rule. Violations are proscribed *ex ante* and no judgment is required by the subject of the regulation.

Standard: ‘Drive carefully’ is a standard. It requires contextual judgment from the subject and precise prohibitions are determined *ex post* through case law or a functional equivalent.

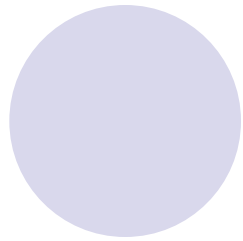
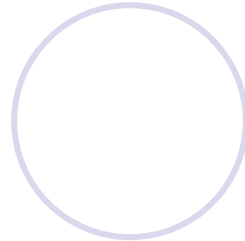
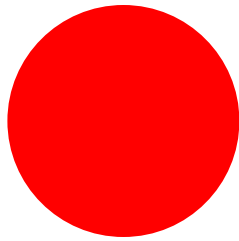
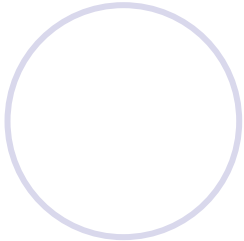
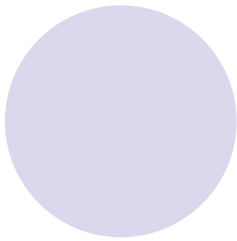


# Theoretical Framework



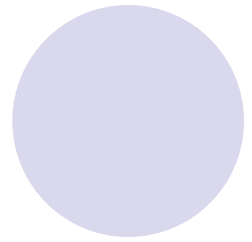
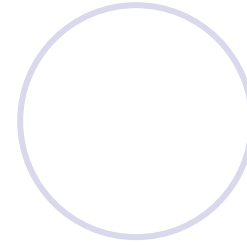
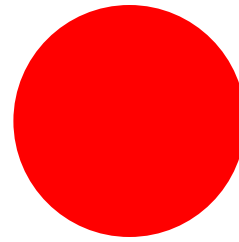
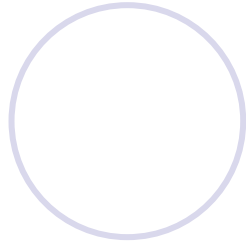
Rules and standards differ in at least the following crucial dimension:

- (i) the distribution of power within a legal system.



The Rule–Standard Spectrum		
	Patterns	Examples
#1	Pure Rule	The term “national”
#2	<i>Ex-ante</i> Procedural Regulation	APAs
#3	A Rule Embedded in One or More Standards	A Place of Extraction of Natural Resources
#4	A Standard Embedded in One or More Rules	Tax Treaty Interpretation
#5	<i>Ex-post</i> Procedural Regulation	Tax Arbitration
#6	Pure Standard	Principal Purpose Test

# Finding



There is usually a correlation between global power shifts and the evolution of the ITR.

The hegemon normally prefers a rule-based system over a standard-based one given the ITR's decentralized competitive structure. This hegemon's preference is based on the assumption that the former limits the decentralization of power within the ITR more than the latter does to a growing, decentralized global network of countries.

When external shocks (such as technological and/or regulatory financial innovation) emerges making the rule-based system unworkable, there is normally no better option for the hegemon than to accept an ITR shift towards the standard-based end of the spectrum, ideally under the hegemon's control until the hegemon's collapse.



# Global Power shifts in a Nutshell

A decorative graphic at the top of the slide features five circles. From left to right: a solid light purple circle, a hollow light purple circle, a solid red circle, a hollow light purple circle, and a solid light purple circle. The title text is overlaid on these circles.

The transitions from the first era to the second era and from the second era to the third era correlate with power shifts in the world.

The transition from the first era to the second era correlates with the power shift from the U.K. to the U.S. in the 1930s.

Likewise, the transition from the second era to the third era correlates with an emerging power shift from the West to the East, mainly China and India, since the early 21st century. Emerging countries again contribute over 50% of global economic output in purchasing power parity terms, as was the case before the first Industrial Revolution.

# The First and third Standard-based Era: Examples

	<b>1928</b>	<b>2016</b>
<b>League of Nations Draft Model, art. 5</b>	‘The competent administrations of the two Contracting States shall come to an arrangement as to the basis for [income] apportionment’.	
<b>OECD MLI, art. 17(3)(b)(ii)</b>		‘[I]ts competent authority shall endeavour to resolve the [corresponding adjustment] case under the provisions of a Covered Tax Agreement relating to mutual agreement procedure [governed by article 25 of the OECD Model]’.

# A rule-based regulation: An Example

The League of Nations appointed Sir Stamp as one of the four economists to study the problem of double taxation internationally in 1923.

Interestingly, Stamp suggested a rule for solving the double taxation problem outside the British Empire. Indeed, Stamp maintained that the best available method for solving the double taxation problem was exclusive residence jurisdiction, i.e., no source taxation.

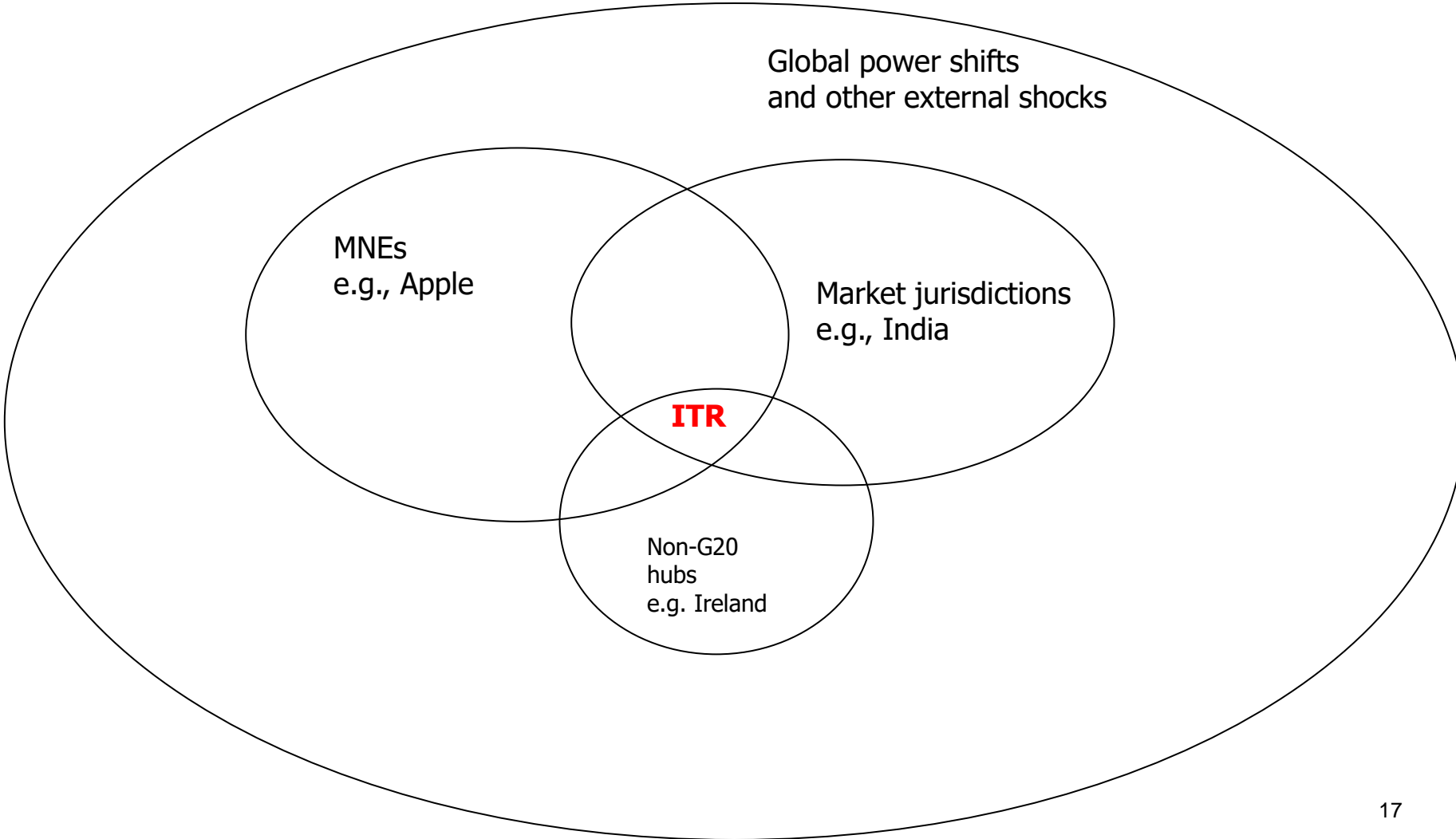


# A Theory of International Taxation

A new logic has emerged in the strategic interaction existing between G20 countries and non-G20 nodes in the last century. G20 countries *increasingly* compete against each other for capital, just as private firms compete for market share in a context of global power shifts.



# A Theory of International Taxation: Strategic Interaction between Three Oligopolies in a context of external shocks



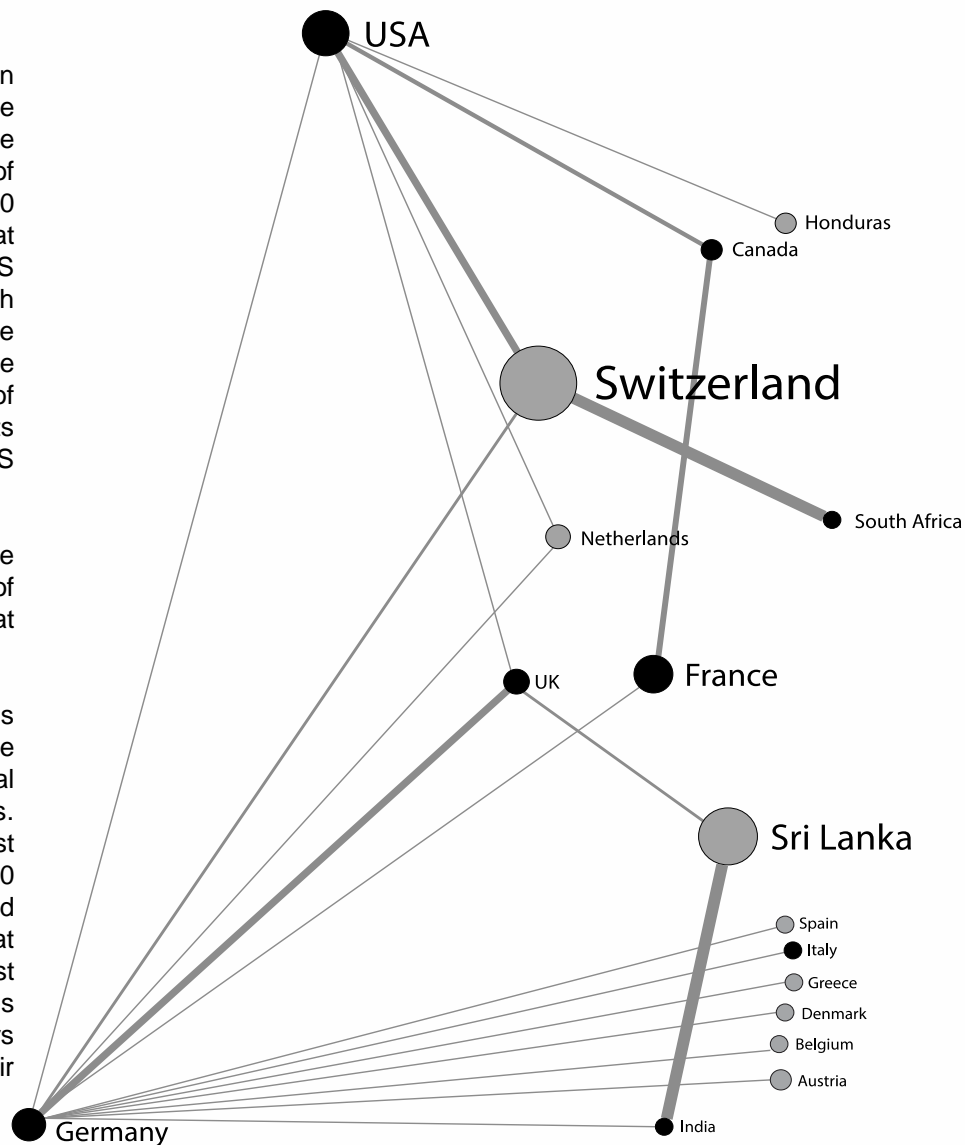
## The Evolving Network of Tax Treaty Disputes

G20 countries are shown in black and others in grey. The size of each country's node indicates the average share of disputes in other G20 countries that relate to that country. For example, the US has the largest node, which tells us that, on a simple average, US tax treaties make up the greatest proportion of disputes in G20 country courts (excluding cases in the US itself).

The thickness of each line indicates the average share of G20 disputes involving that treaty network.

A country's location is determined using the technique of principal component analysis. Countries that play the most similar roles in the G20 dispute network are placed closest together. Countries at the edges present the greatest differences, but this includes countries with large numbers of disputes concerning their treaties, which form poles.

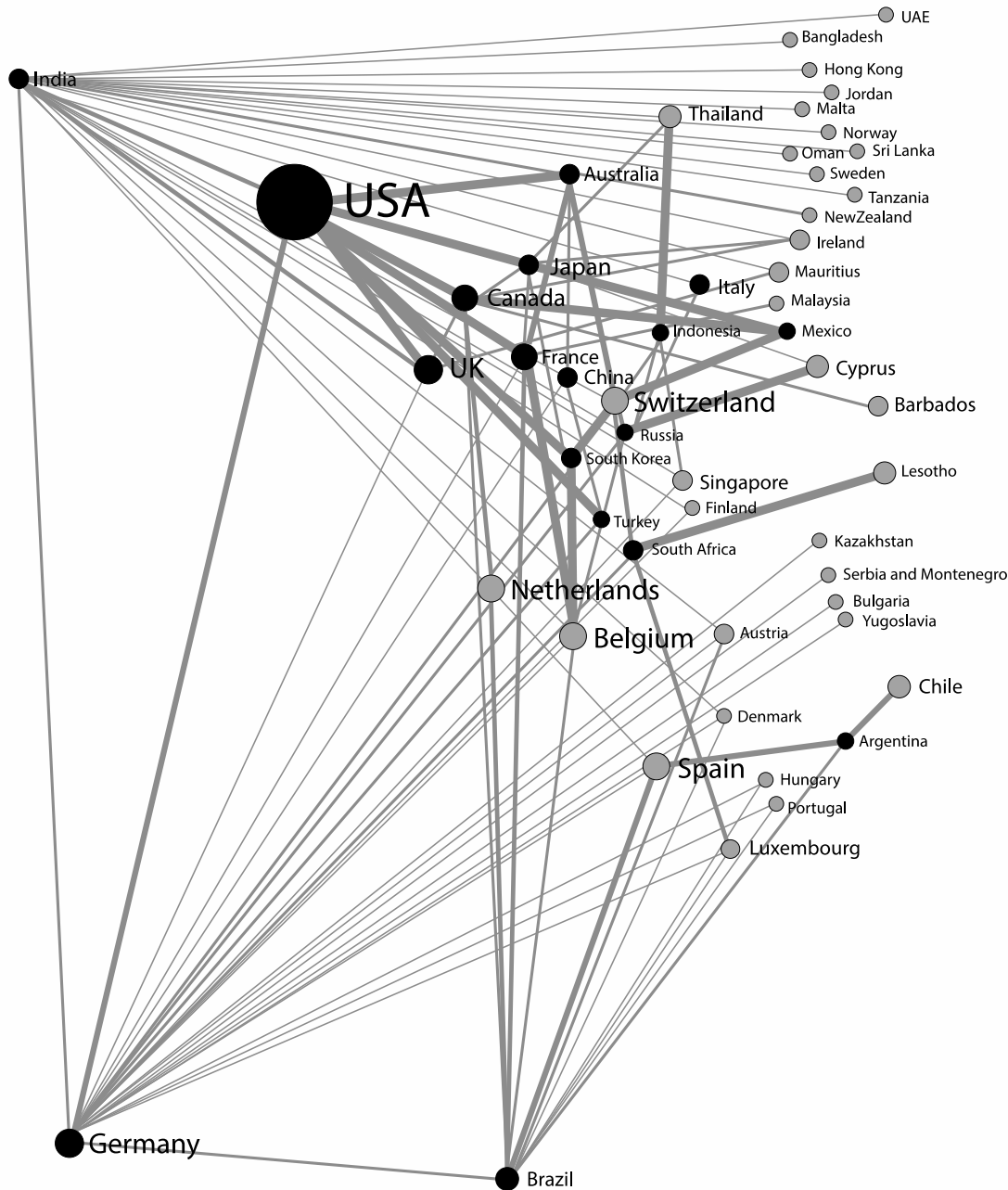
Other countries' positions relative to these poles indicate how closely connected they are to the poles.



1960s

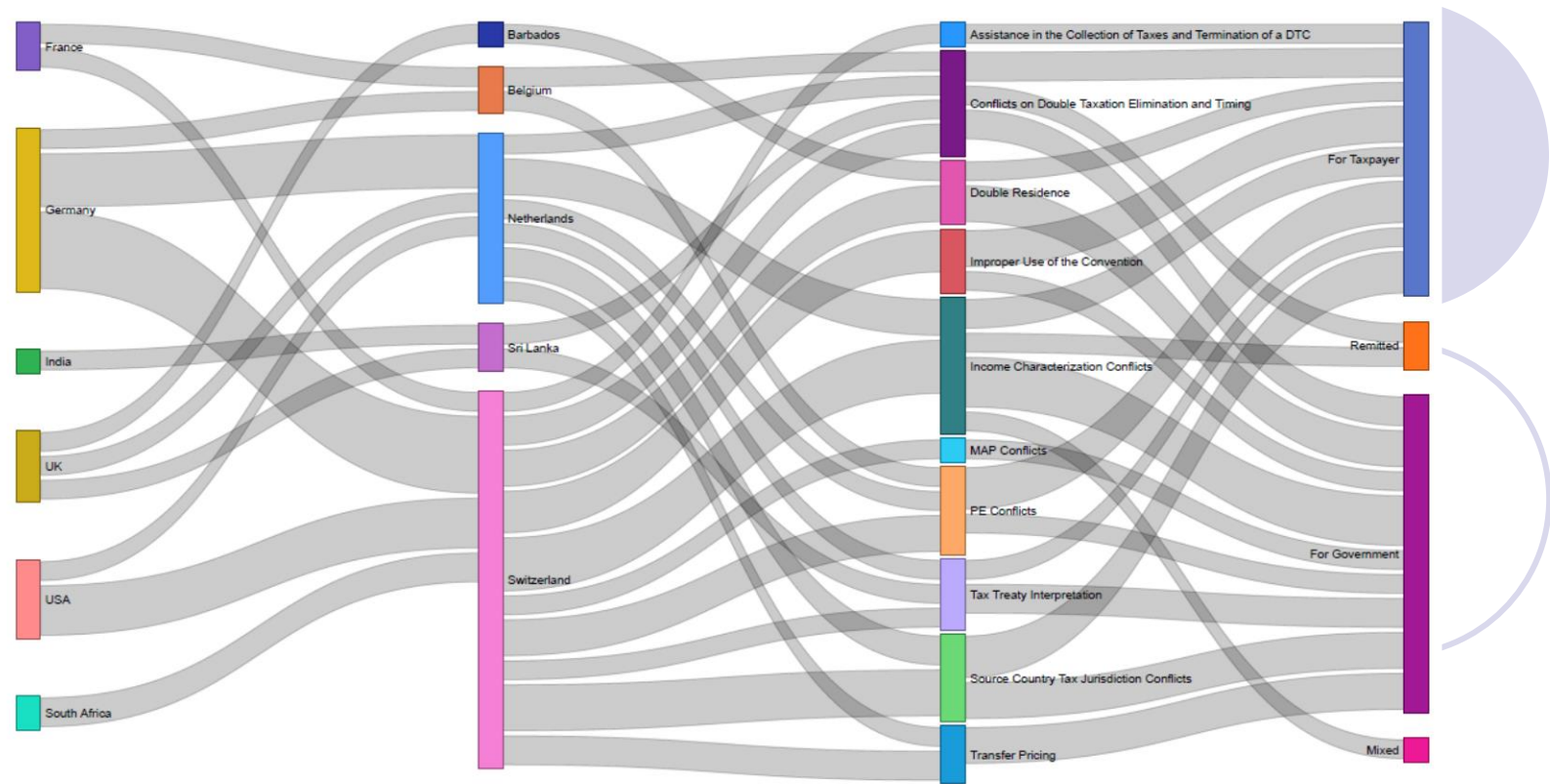
In the 2000s, the US, which has consistently been among the largest foci of treaty disputes, becomes overwhelmingly dominant, dragging most other participants in the network in its direction. India, which experiences an unparalleled upsurge in tax treaty disputes in the 2000s, has pulled away from the system alone.

We call this dynamic the Copernican revolution. This is so because 3 non-G20 hubs are now in the centre of the universe of leading tax treaty cases in G20 countries. Indeed, Switzerland is in the centre from the 1970s; The Netherlands and Belgium are also in the centre from the 1990s and 2000s, respectively.



**2000s**

## Tax Treaty Disputes between G20 Countries and Non-G20 Hubs in the 1960s



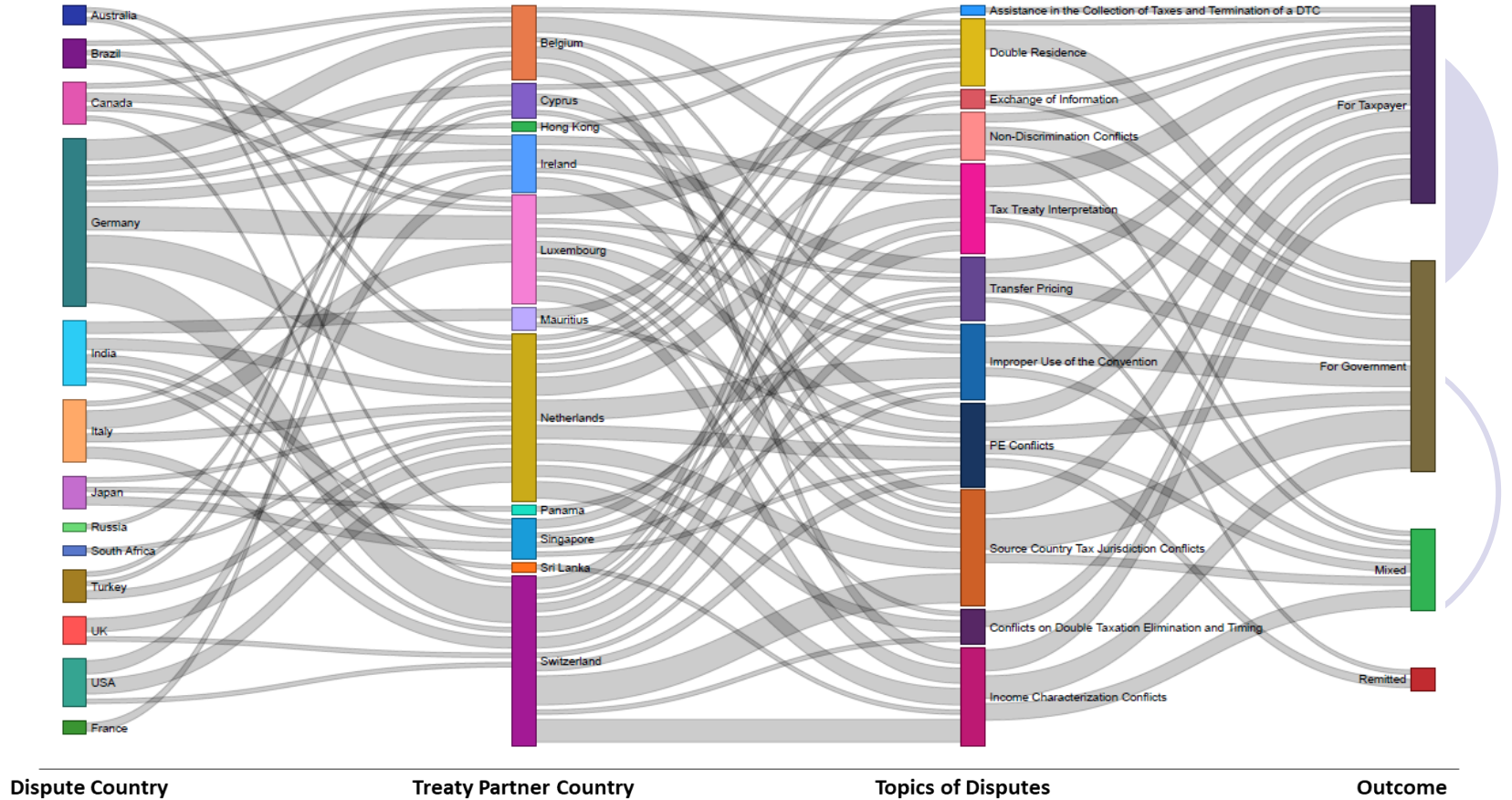
Dispute Country

Treaty Partner Country

Topics of Disputes

Outcome

## Tax Treaty Disputes between G20 Countries and Non-G20 Hubs in the 1990s





# The Spiral Evolution: Analysis

## 4.1. Assessing the Theory against the Empirical Evidence

### 4.1.2. Why the Evolution Has Been Spiral

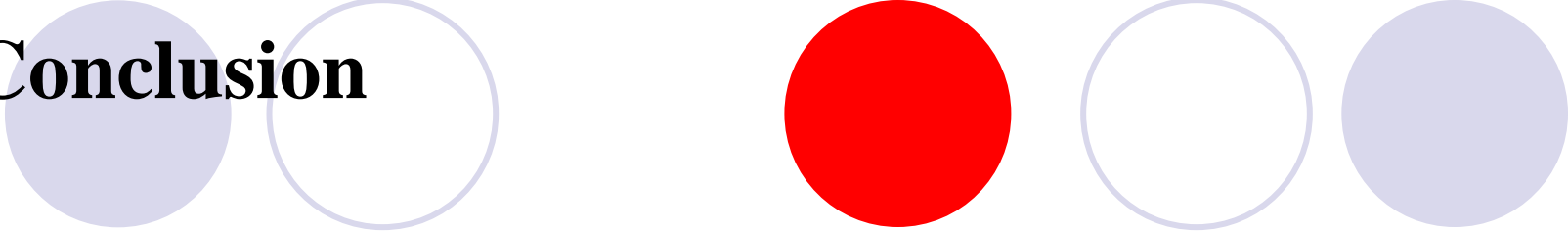
### 4.1.3. The ALP Evolution: From the Rule End to the Standard End of the Spectrum

### 4.1.4. The Spiral Evolution, Global Political Shifts and Innovation

### 4.1.5. The Spiral Evolution, Countries and MNEs

## 4.2. Implications: A Default Rule-based ITR to deal with Opportunistic Behaviour and Inequality

# Conclusion

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Global power shifts and innovation at the technological and financial regulatory levels have probably been two central driving forces in the evolution of the ITR since its origin in the early 20<sup>th</sup> century.