Transnational Legal Orders

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Settling and Unsettling the Transnational Legal Order of International Taxation

Philipp Genschel and Thomas Rixen

I. TLOS AS PROBLEM SOLVERS AND PROBLEM CREATORS

Transnational legal orders (TLOs) are formed to solve policy problems of a cross-border nature. In doing so, they often create new problems that trigger the formation of new TLOs. TLOs are problem solvers and problem creators at the same time. Partly, at least, the problems requiring transnational legal ordering are endogenous. This is why the stream of problems requiring transnational attention is unlikely to ever dry up and why the ecology of TLOs is unlikely to ever reach a steady state. Hence, in order to understand how TLOs "originate, consolidate and constrain behavior" (Halliday & Shaffer, Chapter 1: 2), it is important to take a broad and diachronic perspective. We have to look broadly at the field of related TLOs in order to understand how one TLO's solution becomes another TLO's problem, and we have to analyze the historical sequence in which problems are framed, taken up, and solved, because what happens first has crucial implications for what happens later. Our historical analysis of transnational legal ordering in international taxation serves to illustrate and elaborate this point.

International taxation, that is, the tax treatment of cross-border activities such as, most notably, foreign real or financial investment raises two main policy issues: international double taxation and international tax competition. International double taxation refers to the problem that cross-border activity is potentially taxable in more than one jurisdiction and may therefore carry a higher aggregate tax burden than does purely domestic activity. International tax competition refers to the problem that cross-border activity can be used for evading or avoiding high taxes at home and thus push the tax burden below that of purely domestic activity. Double taxation discourages efficient cross-border investment and results in welfare-reducing economic under-integration. Tax competition encourages inefficient cross-border investment and results in welfare-reducing over-integration. As we will show in this chapter, these issues are interdependent: The approach taken

to mitigating the problem of double taxation affects the shape and intensity of tax competition, and vice versa.

The TLOs in international taxation have attended to both issues sequentially. In the early decades, roughly the 1920s to the 1960s, the focus was almost entirely on double tax relief. In the short run, this narrow focus facilitated the formation of a TLO with a high level of issue alignment (since the 1950s, the OECD has emerged as the TLO's solid institutional center) and a high degree of normative settlement (the OECD's rules on double tax relief have been diffused widely as taken-for-granted guidelines for international taxation). In the long run, this narrow focus had unintended, if not completely unforeseen, consequences for tax competition. First, the TLO on double tax relief inadvertently invigorated tax competition. It opened new options for taxpayers to reduce their tax bills through cross-border tax arbitrage and left national governments free to vie for inbound tax arbitrage flows by aggressive low-tax strategies. Tax competition spread slowly during the 1960s and 1970s and accelerated during the 1980s, 1990s, and 2000s. Second, the TLO on double tax relief constrained the legal and political opportunity space for curbing tax competition: The normative settlement on double tax relief militated against any legal change undermining this settlement; the rise of tax competition created strong vested interests in tax competition that opposed any TLO change to curb it. Hence, the TLO of double tax relief simultaneously created demand for a TLO solution of the tax competition problem and hindered the supply of such a solution.

This dilemma triggered two types of responses: first, a reinterpretation of the rules of the double tax relief TLO and, second, the creation of a new TLO focused on tax competition. The strategy of reinterpretation aimed at subtly changing the operative meaning of TLO rules on double tax relief so as to limit their abuse for tax arbitrage purposes while at the same time leaving them notionally intact so as to protect the normative settlement around them. This strategy was pioneered by the United States, which introduced unilateral anti-avoidance legislation restricting taxpayer access to double tax relief in the 1960s, promoted the adoption of similar legislation by other states, and achieved a formal OECD endorsement of anti-avoidance rules in the 1980s. Still, the success of this strategy remained limited both in terms of protecting normative settlement and curbing tax competition. The second strategy – creation of a new TLO – was partly a reaction to this failure. The initiative came from the G7, which mandated in 1996 that the OECD take action against "harmful tax competition." The idea was to limit governments' freedom to abuse domestic tax policy for poaching foreign tax base. The instrument was to be common minimum tax standards. One main problem was whether to exclude the beneficiaries of tax competition (mostly so-called tax havens) from negotiations and simply impose

minimum standards on them or to include them and persuade them to cooperate voluntarily. In the end, the tax havens were included. They now participate in great numbers in the Global Forum on Transparency and Exchange of Information for Tax Purposes, which ensures widespread rule compliance but also limited rule effectiveness in curbing tax competition.

The remainder of the chapter is structured into six sections. In the next section, we introduce the issues of double taxation and tax competition and discuss their interdependence (Section II). Then we reconstruct the formation and institutionalization of the TLO on double tax relief (Section III) and analyze its impact on taxpayers, governments, and tax competition (Section IV). In the subsequent sections, we analyze the competition-induced TLO change. First, we focus on TLO change by reinterpreting established rules of double tax relief (Section V). Then we analyze the formation, fragile institutionalization, and impact of the new TLO on tax competition (Section VI). The final section summarizes the main findings and spells out lessons for the TLO research program (Section VII).

II. THE TRILEMMA OF INTERNATIONAL TAXATION: TAX SOVEREIGNTY, DOUBLE TAXATION, AND TAX COMPETITION

International double taxation and international tax competition have a common cause: national tax sovereignty, that is, the exclusive right of national governments to make tax law (legal sovereignty), to administer and enforce tax law (administrative sovereignty), and to claim all tax revenue for the national budget (revenue sovereignty). Tax sovereignty is a cause of international double taxation, because it empowers national governments to decide independently whether and to what extent cross-border activities are liable to domestic tax. The uncoordinated exercise of this power by multiple governments can lead to overlapping tax claims that subject cross-border activities to a higher tax burden than that of domestic activities. This creates a tax barrier between national jurisdictions that discourages cross-border activities, traps economic agents in national markets, and hinders international economic integration. Think, for instance, of foreign investment income that is fully taxed first in the source country of the investment and then in the residence country of the investor (e.g., Avi-Yonah 2006).

National tax sovereignty causes international tax competition because it empowers national governments to undercut the taxes of foreign governments. Taxpayers can exploit the resulting difference in national tax levels for arbitrage purposes: They engage, or threaten to engage, in cross-border activities that shift tax liabilities ("tax base") out toward jurisdictions with lower taxes and thus reduce their tax burden. Such tax arbitrage can take two forms. First, there is (illegal) tax evasion. Think, for instance, of individual investors concealing their foreign investment income in order to evade domestic tax in their country of residence. Second, there is tax arbitrage by (legal) avoidance. Think, for instance, of multinational corporate groups targeting their foreign direct investments at low-tax jurisdictions or structuring their intra-firm but cross-border commercial and financial transactions so as to shift paper profits to affiliates in low-tax jurisdictions and deductible expenses to affiliates in high-tax jurisdictions (for an accessible overview of basic avoidance techniques, see Arnold & McIntyre 1995: 8–17, 69–88). Taxpayer arbitrage can, in turn, trigger an interactive spiral of tax cuts by governments trying to attract inflows or to prevent outflows of mobile capital. This limits the ability to generate revenue from capital taxation, creates inequities in relation to immobile tax bases, and accelerates international economic integration (Tanzi 1995; Avi-Yonah 2000; Genschel & Schwarz 2013).

Governments cannot solve the twin problems of double taxation and tax competition *and* preserve national tax sovereignty at the same time. One of the three goals has to give: Governments can mitigate double taxation and keep national sovereignty largely intact but then have to face increased tax competition; they can mitigate tax competition in a sovereignty-preserving way by pushing up double taxation; or they can solve both problems simultaneously but then have to pool sovereignty at the international level. This is the trilemma of international taxation.

The sovereignty-preserving way to relieve double taxation is for governments to cut back their tax claims to cross-border transactions. Whether they do so unilaterally or by bilateral or multilateral agreement, the cutback reduces the risk of overlapping claims to the same transaction and thus reduces double taxation. However, it also reduces obstacles to international tax arbitrage. As double taxation decreases, the extra costs of cross-border transactions decrease, as well, and the incentives to exploit cross-national differences in tax level increase: The lower the tax barrier between national tax jurisdictions, the higher the probability that taxpayers will engage in cross-border activities to shift tax base into low-tax jurisdictions and that governments will engage in strategic tax cutting in order to attract inflows – or prevent outflows – of mobile base. Thus, double tax relief endogenously breeds tax competition.

The sovereignty-preserving way to curb tax competition is for governments to expand their tax claims to cross-border activities. This will increase the likelihood of double taxation. The tax barriers between national tax jurisdictions go up, which, in turn, decreases incentives for taxpayers to exploit differences in national tax levels by international tax arbitrage and incentives for the government to vie for international tax arbitrage through competitive tax cutting. Thus, international double taxation solves the tax competition problem.

The only way to simultaneously mitigate international double taxation and tax competition is to pool tax sovereignty internationally. The pooling may take

different forms but always involves a loss of national tax sovereignty. For example, by introducing harmonized minimum tax rates, governments can stop an unmitigated tax race to the bottom, but they have to give up legal sovereignty in order to do so. By creating an international system of tax information exchange, they can curb tax evasion. Under such a system, the source country informs the residence country about the foreign incomes of its residents and thus makes it risky for taxpayers to conceal such income: National tax authorities render administrative assistance to foreign authorities and, in turn, become dependent on foreign assistance. This requires a sacrifice of administrative sovereignty. Finally, to the extent that legal harmonization or administrative cooperation has redistributive consequences, their political viability may depend on revenue sharing between the governments involved. Think, for instance, of the EU savings tax directive or the pending Swiss-German double tax treaty, both of which oblige source countries to transfer part of their revenues to residence countries, thus undermining national revenue sovereignty.

III. THE FORMATION AND INSTITUTIONALIZATION OF THE TLO OF DOUBLE TAX RELIEF

The history of TLOs in international taxation is a history of attempts to balance and re-balance the trilemma of international taxation. The history starts in the early 1920s with negotiations under the auspices of the League of Nation over the creation of a multilateral regime for double tax relief.[1]

Double taxation was not a completely new issue. Even before World War I, taxpayers had occasionally complained about the double taxation of, for instance, cross-border inheritances, and some governments had already provided selective and unsystematic relief through unilateral legislation or bilateral double tax treaties (Seligman 1928: 37–57). Three factors ("facilitating circumstances") greatly increased issue salience after World War I. First, the war effort had pushed up tax burdens across the warring states (Steinmo 1993: 50–79), thus making double taxation more costly and burdensome for taxpayers. Second, the war had significantly accelerated a fundamental change in tax structure: The relative importance of taxes on immobile and easy-to-tax economic assets and activities (such as tariffs, tolls, and real estate duties) declined, whereas the importance of new taxes on potentially mobile assets and activities, such as, most prominently, personal or corporate income, increased. This made international double taxation more likely (Seligman 1928: 7–16). Finally, the war had undermined the nationalistic justification of double taxation as a protective wall around domestic economic resources and increased the

[1] This section draws heavily on Rixen 2008: 86–116.

normative appeal of double tax relief as a means of cultivating international peace by facilitating cross-border trade and investment (Carroll 1939).

In 1919, the newly founded International Chamber of Commerce (ICC) started calling for international cooperation to reduce double taxation. In 1921, the equally new League of Nations commissioned an expert report, and in 1925, it launched multilateral negotiations. The key players in these negotiations were the national governments of major industrialized economies (Argentina, Belgium, Czechoslovakia, France, Germany, Italy, Japan, the Netherlands, Poland, Switzerland, the United Kingdom, the United States, and Venezuela). The negotiators were technical experts from treasury departments rather than professional diplomats. Private actors such as the ICC participated in an advisory capacity. The negotiations focused almost exclusively on double tax relief. Given the substantial tax barriers between national jurisdictions, tax competition was a non-issue of little practical or political significance. Although some negotiators anticipated problems, they refused to address them explicitly before the issue of double taxation was settled (Rixen 2008: 120–122). This facilitated convergence on a sovereignty-preserving approach for providing double tax relief. The idea was to negotiate common rules for disentangling competing national tax claims. The rules would define which part of cross-border activities fall under the tax jurisdiction of which government and thus eliminate double taxation. At the same time, they would leave governments free to apply whatever tax they liked within their national jurisdiction and thus leave national tax sovereignty largely untrammeled. The rules would assign rights to tax without prescribing whether and how to exercise them: tax coordination rather than harmonization.

The major issue in the negotiations was the design of the rules: According to what principle should they disentangle competing tax claims? The question triggered considerable debate among the negotiators and in the emerging academic literature on international taxation. Two competing answers emerged that continue to structure international taxation to the present day: the source principle and the residence principle. According to the source principle, the right to tax cross-border income flows lies exclusively with the source country, that is, the country in which these flows originate (the country of employment, investment, or business activity). The residence principle, by contrast, assigns the right to tax exclusively to the residence country of the income recipient (the worker, investor, or parent company), that is, the destination country of cross-border flows. There were arguments in favor of both principles. The source principle was administratively convenient and reflected the legitimate concern of source countries to recover the costs of public goods provided to foreigners doing business in the domestic economy (benefit criterion). The residence principle, by contrast, allowed for progressive income taxation, because it assessed taxpayers on their total (worldwide) income rather than just their domestic income. This allowed adjusting the individual tax burden to the individual ability

to pay (ability to pay principle). Most important for the negotiations, the source principle benefitted the fiscal interests of capital-importing countries by assigning a larger part of the transnational tax base to them. The residence principle, in turn, benefitted capital exporters. Largely for this reason, the main cleavage during the negotiations was between the large capital importers of continental Europe (e.g., Italy, France, and Germany), which preferred a mostly source-based solution to the problem of double taxation, and large capital exporters (the Netherlands, the United States, and, most outspoken, the United Kingdom), which preferred a more residence-based solution (e.g., Graetz & O'Hearh 1997; Musgrave 2006).

The cleavage prevented agreement on a single binding multilateral treaty on double tax relief. Instead, the negotiators settled for a non-binding multilateral Model Convention in 1928 that was to serve as a template for binding bilateral double tax avoidance treaties. To further mitigate conflict between capital importers and exporters, the Convention offered three alternative templates rather than just one, providing different mixes of source- and residence-based elements. All three templates drew on the same basic rules and concepts, however. National governments were free to draw on the Model Convention or to ignore it partly or completely (Carroll 1939: 21–25). Hence, the coherence and obligatory character of this initial settlement were rather low. Perhaps surprisingly, from these rather inconspicuous beginnings grew a highly institutionalized TLO with strong issue alignment and normative settlement.

Consider issue alignment first. Two factors helped increase it over time. First, the unification and consolidation of the Model Convention: In 1928, the League of Nations established a permanent fiscal committee of eight (later nine) country representatives to regularly review the Convention and increase its coherence. Already during the 1930s, this committee achieved a substantial rapprochement of conflicting positions. After a short stint under the auspices of the United Nations, the OEEC's (later OECD's) Committee on Fiscal Affairs took over from the League's Committee in the 1950s. The first OECD Model Convention, published in 1963, consolidated the final compromise between source- and residence-based double tax relief (van den Tempel 1967). The primary right to tax "active business income" (i.e., individual wage income and corporate income from productive activity) was assigned to the source country (see OECD Model Convention, Article 7), and the primary right to tax "passive income" (interest, dividends, and royalties) was assigned to the residence country (see OECD Model Convention, Articles 10–12). The Model Convention provided the legal concepts for implementing these assignments and protecting them from foreign incursion. For instance, the concept of "permanent establishment" (OECD Model Convention, Article 5) was introduced to safeguard source countries' right to tax active business income. The concept constitutes domestic affiliates of foreign companies as taxpayers in their own right ("separate entities") taxable under domestic laws (i.e., the law of the source country). This bars the home country of the foreign parent company (the residence country) from extending its tax jurisdiction to the profits of these subsidiaries. To protect residence countries' right to tax passive income, the model convention proposed caps for the withholding tax that source countries may charge on such income (cf. Rixen 2008: 65–76).

The second factor increasing issue alignment was the failure of all attempts to supplant the OECD Model Convention with competing designs. Developing countries were generally suspicious of the Convention and looked for alternatives. In the early 1960s, the Commonwealth Chambers of Commerce suggested the creation of a new Convention that would pay more heed to the special needs of developing economies. But the committee in charge considered a radical departure from the OECD model impractical and dropped the idea. In the 1970s, the Latin American Free Trade Association (LAFTA) published an alternative Model Convention that was more heavily source-based than the OECD convention had been. However, it failed to gain currency because OECD countries refused to sign bilateral treaties on this basis. In 1980, the United Nations published a Model Convention that also aimed to extend the scope for source taxation. This convention did not fail; rather, it was absorbed into the OECD orbit. Conceptually similar to the OECD Convention, it came to be regarded as a moderate modification of the OECD Model Convention for the special case of treaty negotiations with developing countries rather than as a radical alternative. In a sense, the deference of the UN Convention to the OECD Convention buttressed the latter's authority as the uncontested core of the TLO of double tax relief (Vann 2010: 8).

Normative settlement increased in line with issue alignment. Settling occurred at three levels. At the *multinational level*, the frequency of radical rule change slowed down quickly after the 1930s, even though the precision of the rules greatly increased. With the first OECD Model Convention of 1963, the fundamental principles and the basic structure of the convention were finally settled. Almost all of the Articles of the current Convention were already present in the 1963 draft. To increase consistency in application, the OECD published a first comprehensive legal commentary of the Convention on an Article-by-Article basis in 1963. Continuously updated and refined, the Commentary serves as a key reference for governments, taxpayers, and the judiciary. It helps establish shared interpretations, crystallizes the emergence of a transnational expert community united by the conviction that adoption of the OECD Model is "*the* solution to international tax problems" (Vann 2010: 6), and increases rule predictability (Picciotto 1992). At the *bilateral level*, the norms of the OECD Model Convention are embedded in an increasing number of bilateral double tax treaties (DTTs). As Figure 4.1 shows, the number of DTTs remained low into the 1960s but grew rapidly thereafter. Although they are formally free to deviate

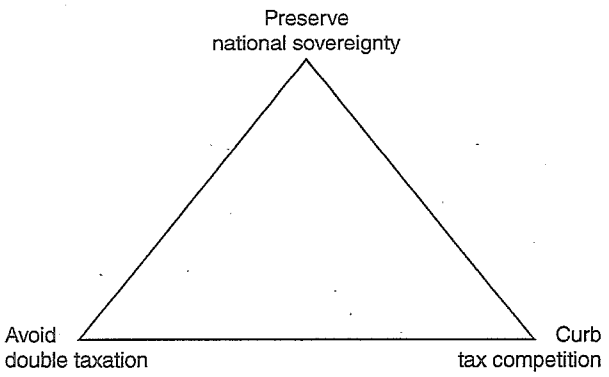

FIGURE 4.1. The trilemma of international taxation.

from the soft-law rules of the Model Convention, most governments follow those rules closely. Almost all of the more than 2,000 bilateral DTTs now in existence mirror the Convention's formal structure and content. Finally, settling also occurred at the *national level*. In addition to reciprocal relief under bilateral tax treaties, most governments also provide unilateral relief under domestic law for cross-border transactions with non-treaty partner countries. Even though it was initially not intended for this purpose, the Model Convention also serves as a reference point for this type of law. Most domestic laws of double tax relief broadly follow the principles and concepts of the Model Convention (active versus passive income, permanent establishment, etc.). As a consequence, the OECD Model Convention now represents the general consensus on international taxation; its principles, norms, and rules guide bilateral treaty bargaining but also effectively constrain domestic laws that countries apply to the taxation of cross-border events. It embodies a broadly accepted and taken-for-granted practice in international affairs (Avi-Yonah 2006).

What are the causes behind the secular trend toward institutional entrenchment (i.e., issue alignment and normative settlement)? First, decolonization: The rise of non-Western states mitigated intra-Western conflicts over source- versus residence-based double tax relief. With respect to non-Western states, all Western states were capital exporters. This facilitated their eventual convergence on the OECD Convention's heavily residence-based rules for taxing cross-border (passive) income flows. Second, power asymmetry: The Western countries dominated the world economy. They were the main global suppliers of real, financial, and human capital. The rest of the world depended on Western investment more than the West in turn depended on investment from the rest of the world. This gave Western governments extensive power to dictate the terms under which cross-border flows of investment income are taxed (cf. Surrey 1978a; 1978b). This is indicated by the high

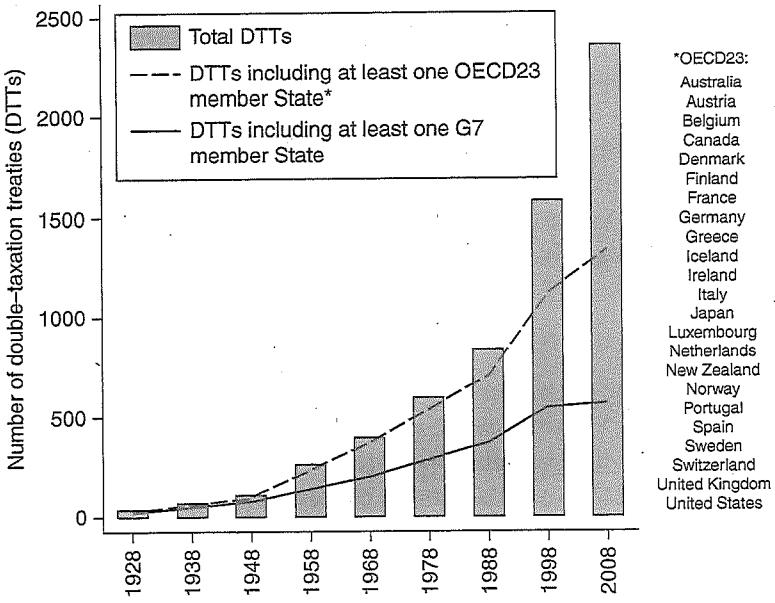

FIGURE 4.2. Number of DTTs worldwide.

share of bilateral tax treaties with OECD countries in general and G7 countries in particular (see Figure 4.2). It also explains why the OECD could virtually monopolize work on the Model Convention without undermining the Convention's global acceptance and effectiveness: If non-Western states refused to settle on the basis of that Convention, they did not receive any bilateral tax treaties at all, as illustrated by the sorry fate of the LAFTA Convention. Third, professional closure: The OECD's political preeminence in the area of double tax relief helped establish it as the preeminent site of technical expertise on this issue. By writing the rules of the game, the technical experts of the Committee on Fiscal Affairs enjoy a natural head start in knowing and interpreting them with authority. The foundations for this authority were laid in the period from the 1930s to the 1960s, when cross-border investment and capital mobility were low and international double taxation was a secondary concern of minor political salience. This allowed the experts to craft a compromise solution without major intervention from their political principals. The committee became the focal point of a transnational expert community of lawyers, administrators, and advisers. The OECD Model Convention was embedded in a broad epistemic consensus on "how to do double tax relief properly," which in turn reinforced its status as the self-evident reference point in matters of double tax relief once cross-border investments and capital mobility started to increase in the 1970s (Picciotto 1992: 35–39). Finally, network externalities: The model convention

reduces governments' transaction costs of providing double tax relief by proposing standard ways for disentangling national tax claims. In a way, it supplies common interface standards for the connection points between national tax jurisdictions. As is well known from information technology, the utility of interface standards increases in use (Arthur 1994): As the number of governments using the Model Convention in bilateral treaty bargaining and unilateral tax legislation increases, the incentive to also rely on the Convention in own bargaining and legislation increases. Compliance becomes self-reinforcing.

IV. UNINTENDED IMPACT: TAX COMPETITION

Overall, the TLO of double tax relief had "impact" as defined by Halliday and Shaffer (Chapter 1). First, it clearly produced behavioral changes on the national level, which solved the problem for which it had been designed. This impact unfolded slowly until the 1960s and more quickly thereafter, as it became increasingly common for governments to provide double tax relief on a unilateral or bilateral basis. The risk of efficient transnational transactions being blocked by national tax barriers decreased significantly. In addition, however, the TLO also had a secondary and unintended impact: It triggered behavioral and structural changes that generated a new problem – tax competition – as the trilemma of international taxation would lead us to expect.

Tax competition emerges from the interaction of two types of behavior: taxpayer arbitrage and strategic tax setting by governments. The TLO of double tax relief provides opportunities and incentives for both. Consider tax arbitrage first. The TLO of double tax relief facilitates arbitrage in two ways. First, it lowers the extra (tax) costs of transnational transactions, thus making it potentially more profitable for taxpayers to use such transactions for shifting tax base between high- and low-tax jurisdictions. Second, less obviously, it equips taxpayers with the essential instruments of arbitrage: By telling governments how to disentangle their tax claims to cross-border transactions, the TLO rules implicitly also tell taxpayers how to structure such transactions in order to move tax base out of reach for high-tax jurisdictions. Thus, all major strategies of corporate tax avoidance play on the Model Convention's rules for the taxation of "active business income" (Leibrecht & Rixen 2010). Most importantly, Article 7, which stipulates that permanent establishments are taxable as separate entities in their country of operation (source country), allows multinational groups to structure their internal commercial and financial relations such that taxable profits accrue mostly to group establishments in low-tax jurisdictions and deductible expenses to group establishments in high-tax jurisdictions. Multinational groups can, for instance, set up subsidiaries in low-tax jurisdictions for the tax-privileged holding of group assets (financial reserves, brands, patents, licenses, and technical and managerial know-how) – so-called

base companies. Base companies can then be used for stripping affiliated companies in high-tax jurisdictions of taxable profits, for example, by charging inflated transfer prices for the use of group assets (transfer price manipulation) or by capitalizing subsidiaries in high-tax locations by debt (thin capitalization).[2] In either case, the taxable profits of the high-tax subsidiary decrease, the taxable profits of the holding increase, and the after-tax earnings of the group as a whole rise.

Also, the major strategies of tax evasion are endogenous to the rules of the Model Convention,[3] especially Articles 10–13 on the taxation of passive income. Because these Articles assign taxing rights primarily to the residence country while capping the taxing rights of the source country, one obvious way for individual investors to reduce their tax bill is to invest abroad and (illegally!) conceal the resulting investment income from tax authorities at home. In this way, they only have to pay the low withholding taxes of the source country – if the source country charges any withholding taxes at all.

As a recent survey of the empirical literature shows, international tax arbitrage is now a major factor in corporate and individual income taxation (Genschel & Schwarz 2011). Corporate foreign direct investment and especially the reported profits (paper profits) of multinational corporate groups are highly sensitive to cross-national differences in taxation, testifying to high levels of corporate tax avoidance. Also, individual income tax evasion seems to be quite prevalent, especially out of high-tax countries and into tax havens. This exemplifies how TLOs can shift the boundary between market and state(s), as highlighted by Halliday and Shaffer (Chapter 1), in this case in favor of market actors' ability to avoid tax.

Consider strategic tax setting next: The sovereignty-preserving design of the TLO not only serves as a legal infrastructure for cross-border tax arbitrage, but it also leaves governments with ample scope to invigorate tax arbitrage by purposefully undercutting each other's taxes. The focus of this tax competition is on multinational corporations and rich individual investors. The key to luring in mobile corporate investments and profits is to offer corporations a low corporate tax burden either through a low general corporate tax rate or through selected tax advantages ("preferential tax regimes") for specific, presumably very mobile and tax-sensitive, corporate forms and activities (e.g., foreign-held companies, companies in special business zones, or holding or headquarter operations). The TLO of double tax relief allows for both

[2] Because interest is usually deductible against the corporate tax, loans given by the base company to subsidiaries in high-tax jurisdictions will reduce the taxable profits of the latter, swell the profits of the former, and, thus, increase after-tax earnings of the corporate group as a whole.

[3] Recall from Section II that tax evasion is illegal, whereas tax avoidance is not: Avoidance exploits loopholes and gray zones in tax law. It is in line with the letter of the law if not necessarily its spirit. Tax evasion, by contrast, breaks the law. In practice, the dividing line between the two is blurred because tax codes are often ambiguous and contain rather general anti-avoidance clauses.

strategies because it completely refrains from harmonizing (effective) tax rates. It also fails to effectively regulate corporate tax arbitrage between different national tax systems. It is completely silent on avoidance instruments such as thin capitalization and foreign base companies. And although it sets the so-called arm's length standard to curb transfer price manipulation, the standard is ineffective at its task. It requires prices in intra-corporate group transactions to be set as if the permanent establishments involved were completely distinct and separate enterprises doing business wholly independently of each other (OECD Model Convention, Article 7.2). However, the reason why multinational companies exist is that certain cross-border activities are difficult to transact between completely separate enterprises. Hence, there simply is no market price to evaluate objectively if Microsoft's Irish subsidiary charges Microsoft USA inflated royalties and license fees for copyrighted software code initially developed by U.S. software engineers and thereby artificially reduces the American corporate tax base (Sikka & Willmott 2010).

The key strategies for attracting inward investment by foreign tax evaders are low or no withholding taxes on (passive) investment income (interest and dividends) and generous protection of investor anonymity, for instance, by strict bank secrecy laws, bearer shares, or other instruments that purposefully conceal the personal identity of the holder. Again, the OECD Model Convention sets no effective bounds to these strategies. Although it proposes maximum rates for source country withholding tax rates on interest and dividends, it does not insist on any minimum rates. And although Article 26 provides for the mutual exchange of information among tax authorities, it effectively leaves it to each individual government to decide what type of tax information it is willing to collect and exchange.

Various indicators point to the spread of international tax competition. First, there is ample anecdotal evidence of the diffusion of special corporate tax regimes since the 1960s (Ruding Report 1992; Kemmerling & Seils 2009). Examples such as the Luxembourg or the Dutch Holding Company Regimes, the Belgian Co-Ordination Centers, or the Dublin Docks are (in)famous. Unfortunately, there is no internationally comparative time-series data. However, a recent count by the OECD suggests that all but four of a sample of twenty-two advanced Western democracies had at least one special corporate tax regime in 2000 (see Table 4.1). Second, since the mid-1980s, there has been a clear and pronounced downward trend in general corporate tax rates in the OECD (Table 4.1) and beyond (Genschel & Schwarz 2011). Third, withholding tax rates on individual investment income (non-resident interest income in Table 4.1) have also generally fallen since the 1980s. Fourth, as corporate and withholding tax rates have fallen, their correlation with country size has increased (Table 4.1). This is an important indicator of rising competitive pressure because, as the standard tax competition model from public finance shows, relatively small countries face stronger incentives to cut rates under tax competition than relatively large countries do, and

TABLE 4.1. *Indicators of tax competition for 22 OECD countries*

	Special corporate Tax regimes	General corporate Tax rate		Interest income non-residents	
	2000	1985	2007	1985	2007
Australia	1	50	30	—	—
Austria	1	61	25	5	0
Belgium	5	45	34	25	15
Canada	3	45	36	25	25
Denmark	0	40	25	0	0
Finland	1	60	26	—	0
France	2	50	34	25	16
Germany	2	63	39	0	0
Greece	4	44	25	56.8	10
Ireland	2	50	13	35	0
Italy	2	46	37	21.6	27
Japan	0	56	40	20	15
Luxembourg	3	40	30	0	0
Netherlands	7	43	33	0	0
New Zealand	0	45	33	—	—
Norway	1	51	28	0	—
Portugal	3	55	26.5	13.8	20
Spain	1	35	33	18	0
Sweden	1	60	28	0	0
Switzerland	2	35	34	35	15
United Kingdom	0	40	30	30	0
United States	1	50	39	30	30
OECD-22	**1.95**	**48.4**	**29.7**	**17.91**	**9.11**
Correlation with Country Size[a]	**−0.16**	**0.16**	**0.63**	**0.25**	**0.49**

[a] Correlations are with the population logarithm.
Source: Adapted from Genschel & Schwarz 2013.

they suffer smaller revenue losses in the competitive equilibrium. Intuitively, this is because for the small country, the revenue loss from a tax cut – that is, revenue forfeited from the (initially small) domestic tax base – is relatively minor compared to the major revenue gain from the inflow of part of the (initially large) foreign tax base of the other country. Hence, the small country faces a more elastic supply of the mobile

tax base than its large competitor does. In equilibrium, it will undercut the rate of the large country and attract a disproportionately larger share of the internationally mobile tax base. Smallness is an advantage under tax competition (Wilson 1999: 278) that explains why tax havens are always small countries.

The global rise of tax havens is the final indicator of the spread of tax competition. Tax havens are jurisdictions with very low or zero corporate and withholding tax rates or other tax attributes designed to attract foreign investors such as preferential corporate tax regimes and extensive secrecy legislation. Tax havens are not a completely new phenomenon, but their number and importance rose steeply after the 1960s. Depending on the classificatory scheme used, there are now between forty and seventy-two tax havens worldwide. These havens have attracted an increasing share of the globally mobile corporate and capital tax base since the 1980s. Allegedly, more than half of global cross-border lending and about 30 percent of Foreign Direct Investments pass through them (Palan et al. 2010). As a consequence, tax havens have undergone rapid economic growth over the past twenty-five years and are now considerably more affluent than are other countries (Hines 2005).

In Chapter 1, Halliday and Shaffer conjecture that one way in which TLOs produce impact is by changing how nation-states have impact on each other. The TLO of double tax avoidance is an example of this: It creates a structure that enables nation-states to exert competitive pressure on other governments and thus change their tax policies. Was this effect anticipated by the actors involved?

The trilemma of international taxation makes it look obvious that a sovereignty-preserving TLO of double tax relief must trigger tax competition (see Figure 4.1). Why did the tax experts and government officials not anticipate this outcome when negotiating the TLO in the 1920s and 1930s? As shown elsewhere (Rixen 2011: 210–212), they did indeed foresee an invigoration of tax avoidance and evasion, and they introduced (very limited) anti-avoidance rules into the Model Convention to prevent it. These rules include the arms-length standard for transfer pricing and the information exchange provisions (Article 26) mentioned at the beginning of this section. But, for one, they did not anticipate the actual magnitude of future cross-border arbitrage flows. Also, more importantly, they gave priority to solving the problem of double taxation. In fact, it was agreed that addressing issues of international tax evasion and avoidance should be conditional on successful double tax avoidance, which was the prevalent issue at the time. This only began to change from the 1960s onward, the period to which we turn in Section V.

V. RESILIENCE AND REINTERPRETATION

As Section IV showed, the very success of the TLO of double tax relief helped create a new problem: tax competition. The repercussions were felt most intensely by

the TLO's founders and promoters: the large, economically advanced states of the OECD area. They lost tax autonomy and tax base to each other and, perhaps even more importantly, to tax havens inside the OECD, such as Switzerland, Ireland, and Luxembourg, and those outside the OECD, such as Liechtenstein, the Cayman Islands, the Netherlands Antilles, and Hong Kong. Yet these repercussions failed to undermine the TLO. Rather than withdrawing support from it, the major Western states premised all strategies for curbing tax competition on its preservation. Why did they do so? What explains the resilience of the TLO of double tax relief?

One reason is sunk costs: The very success of the TLO in generating a large *installed base* of bilateral tax treaties and domestic tax laws incorporating elements of the OECD Convention militates against change. Ever more treaties have to be renegotiated, more domestic laws reformed, extensive case law overturned, and text books rewritten. All of this is difficult and costly. In a sense, therefore, the TLO's high level of normative settlement made it resistant to change (cf. Vann 1991: 100). A second reason is closely related: the lack of a plausible alternative on which governments could easily coordinate. Giving up on the OECD framework of double tax relief would not only imply a major write-off of sunk costs but also cause considerable uncertainty about whether a better arrangement would emerge. Third, the TLO's inbuilt distributive bias continues to benefit major OECD member states. Although these states may be suffering from tax competition with tax havens, they benefit from the Model Convention's residence-based rules on passive income in relation to *non*–tax haven states. Because most states continue to be non-havens, and because many of these non-havens heavily import Western capital and technical know-how, Western states have a vested interest in preserving the TLO. Fourth, and closely related, Western states have an interest in preserving the OECD as the single and uncontested center of the TLO because doing so locks in their disproportionate influence over the contents of the TLO rules. As Figure 4.2 shows, the share of DTTs involving at least one OECD treaty partner declined from roughly 85 percent in 1988 to just about 57 percent in 2008. DTTs are no longer an exclusive preserve of OECD countries. Yet non-Western countries continue to play a marginal role in the OECD Committee on Fiscal Affairs. Although experts from a few large non-OECD countries (Argentina, Chile, China, India, Russia, and South Africa) participate as regular observers, they do so on the committee's terms. This allows the OECD states to socialize rising non-Western powers into their way of doing double tax relief: Privileged control of a TLO of high issue alignment is an asset not easily surrendered. Finally, the problem of tax competition developed incrementally over many decades. During the 1960s, it was a minor nuisance that did not warrant major TLO change. By the time it had evolved into a major problem in the 1990s and 2000s, it had also undermined important prerequisites for major TLO change, as we will see in Section VI.

The search for TLO-compatible solutions to the tax competition problem went through two stages. The first stage from roughly the 1960s to the 1990s focused on the reinterpretation of central concepts of the TLO so as to reduce their scope for tax arbitrage. The second stage, which started in the late 1990s, focused on establishing a new TLO. This TLO was intended to operate alongside the old TLO on double tax relief and focus specifically on tax competition.

The process of TLO change by reinterpretation was started by the United States (for the following, see Rixen 2008: 120–131). In the 1960s, the United States began introducing comprehensive unilateral anti-avoidance legislation with the aim to hinder U.S. companies from using foreign subsidiaries for avoiding U.S. tax. For this purpose, it regulated the scope of arbitrage instruments, such as transfer pricing, thin capitalization, and base companies in tax havens (so-called Controlled Foreign Companies, or CFCs). The legislation was contested domestically because it threatened to put U.S. companies at a disadvantage vis-à-vis foreign competitors. Although most competitors also came from high-tax OECD countries, they arguably enjoyed a competitive advantage as long as their home countries allowed them to divert profits to tax havens and thus reduce their overall tax bill. In order to mitigate this disadvantage, the U.S. government actively lobbied foreign governments to adopt similar anti-avoidance legislation.

The legislation was also contested internationally because it contradicted central tenets of the OECD Model Convention. Take CFC legislation as an example: It reduces the incentive for U.S. companies to create CFCs in tax havens by taxing U.S. companies on (parts of) the CFCs' income. In other words, it consolidates the profits of U.S. companies and their tax haven establishments for U.S. tax purposes. This consolidation approach is rather different from the Model Convention's separate entities approach, under which different establishments belonging to the same multinational group are taxed separately each in its country of incorporation and in its country of operation (source country): The separate entities approach empowers the source country to decide how, if at all, to tax permanent establishments (including CFCs); the consolidation approach empowers the residence country of the parent company to include part of the foreign establishments' (passive) income in the parent company's taxable income. The contradiction is easily explained in terms of the trilemma of international taxation. The Model Convention's separate entities approach aims to relieve international double taxation and for this purpose risks to facilitate international tax arbitrage, whereas the consolidation approach of domestic CFC legislation aims to mitigate international tax arbitrage at the risk of causing international double taxation.[4]

[4] The arm's length principle underwent a very similar reinterpretation (Rixen 2008: 126–130).

The unilateral introduction of anti-avoidance legislation spurred conflict in the OECD Committee on Fiscal Affairs. Many experts regarded it as a violation of established TLO rules of double tax relief. In their view, governments had to explicitly reserve the right to use such legislation in their bilateral tax treaties in order to meet their treaty obligations. The principled opposition of the experts was eventually worn down by the powerful lobbying of the United States government and the diffusion of anti-avoidance legislation among other major OECD countries. In 1987, the OECD formally endorsed unilateral avoidance measures and encouraged OECD member states to adopt them. Although a 1989 report still insisted that these measures required a renegotiation of bilateral treaties, the 1992 Commentary on the Model Convention already noted that a "wide majority" of member states supported the view that anti-avoidance rules "do not have to be confirmed in the text of the convention to be applicable." In 2005, the Commentary finally simply stated that CFC legislation "is not contrary to the provisions of the Convention" (cited in Rixen 2008: 124). The Convention's rules of double tax relief remained unchanged. But their operative meaning was changed by complementing them with new anti-avoidance legislation that restricted taxpayer access to these rules. In other words, national anti-avoidance legislation was absorbed into the TLO of double tax relief by creatively reinterpreting the TLO's basic rules and concepts. Thus, for instance, complaints by tax havens that CFC laws infringed on their sovereign right to tax business income at source were countered by the OECD and its main member states with the notion of the "deemed dividend." According to this notion, the income of CFCs does not constitute active business income taxable at source but passive (dividend) income to be taxed at the hands of the CFC's shareholder in its country of residence. In this slightly contorted reading CFC rules, neither interfere with a tax haven's tax sovereignty nor do they constitute double taxation because passive income rightfully belongs to the residence country anyway (Rixen 2011: 214).

The combination of a stout rhetorical defense of the traditional sovereignty-preserving concepts of double tax relief (permanent establishments, separate entities approach, arm's length standard, etc.) at the multilateral level and the adoption of incompatible anti-avoidance policies at the domestic level was intended to both protect the normative settlement of the former and reign in tax competition at the same time. Unsurprisingly, it failed in both regards.

On the one hand, TLO change by reinterpretation failed to protect the normative settlement of the TLO rules of double tax relief. Although the basic rules of the OECD Convention remained formally unchanged, they lost their coherence and clarity by being meshed together with anti-avoidance laws, which effectively contradicted them. The rules no longer mean what they ostensibly say. This creates legal uncertainty, increases discretion in rule application, and reintroduces the risk of

unrelieved international double taxation (Vann 2010). The new anti-avoidance rules remain politically contested. Despite OECD endorsement, they lack the "taken-for-grantedness" enjoyed by the established concepts of double tax relief. As a recent survey shows, the international diffusion of anti-avoidance legislation is selective and incomplete. Of a sample of thirty-two OECD and CEEC countries, only eighteen have CFC or Thin Capitalization rules in place (Genschel & Schwarz 2011: 360). The propensity to adopt such rules is positively and significantly associated with country size, suggesting that positional interest in international tax competition rather than normative conviction drives the adoption process. The extent of normative settlement remains low.

On the other hand, the TLO adjustment by reinterpretation failed to effectively curb tax competition. Various factors contributed to this. Partly it is due to the limited geographical spread of unilateral anti-avoidance legislation noted earlier in this section. Partly it is due to the rat race that started between governments devising increasingly sophisticated anti-avoidance laws and corporate taxpayers reacting with increasingly sophisticated avoidance strategies to circumvent these laws: legal complexity increases and taxpayer compliance costs increase, but the constraining effect on arbitrage behavior remains moderate. Even more importantly, anti-avoidance laws failed to address the root cause of international tax arbitrage: the existence of tax rate differentials between countries incentivizing corporate profit shifting. Every government remained free to set its rates as low as it wanted. Finally, the TLO adjustment by reinterpretation failed to address the issue of cross-border tax evasion of individuals. The problem in tax evasion is not that taxpayers use rights they enjoy under the TLO of double tax relief to artificially shift tax base into low-tax jurisdictions. The problem is that they break TLO rules: They conceal foreign income that, according to the rules, they should declare in their country of residence. Reinterpreting the rules does not remedy this problem. What is required is effective cross-border information exchange. Obviously, however, tax havens making a living by attracting foreign tax evaders neither have the incentive to engage in effective information exchange nor, as we have seen in Section IV, does the OECD Model Convention force them to do so.

VI. A NEW TLO TO CURB TAX COMPETITION?

The 1996 G7 Summit in Lyon called on the OECD to establish a multilateral approach to tackle the issue of "harmful tax competition" (OECD 1998). This marked a radical departure from the reinterpretation approach discussed in Section V in two respects. First, it aimed to create a new TLO specifically for the problem of tax competition rather than deal with it under the aegis of the old TLO of double tax relief. Second, it focused on the root cause of tax competition: national tax

sovereignty. The new TLO should curb tax competition by constraining national freedom to engage in aggressive tax poaching strategies. There was also an important element of continuity, though: The institutional responsibility for the new TLO should rest with the OECD Committee on Fiscal Affairs.

The OECD project on harmful tax competition succeeded in its first aim: There is now a specific TLO dealing with a limited subset of tax competition–related issues, all of them having to do with transparency and information exchange in tax matters. The project largely gave up on its second aim: The pretension of setting common limits to national tax sovereignty was mostly dispensed with in 2001. Instead, the new TLO mimics central elements of the sovereignty-preserving set-up of the old TLO. There is now a non-binding Model Agreement on "Exchange of Information on Tax Matters" that serves as a template for a quickly rising number of bilateral Tax Information Exchange Agreements (TIEAs). Finally, there is less institutional continuity than had been initially anticipated. Responsibility for the new TLO on information exchange has progressively migrated out of the OECD arena and into a new Global Forum on Transparency and Exchange of Information for Tax Purposes Although it was set up under the auspices of the OECD Committee on Fiscal Affairs, the Global Forum is increasingly independent of the committee and operates as an international organization in its own right. With 105 member states from all over the world, it is much more inclusive than is the OECD Committee.

A number of facilitating circumstances precipitated the creation of the new TLO on harmful tax competition. First, governments began to realize in the 1990s that TLO adjustment by reinterpretation was not enough to solve the tax competition problem effectively. A more radical approach seemed to be required (Owens 1998: 231). Second, the EU Single Market Project raised fears of rampant intra-EU tax competition, especially as regards preferential corporate tax regimes (Ruding Report 1992). The European Union reacted with countermeasures like the Code of Conduct for business taxation and the Savings Tax Directive, and it lobbied in the OECD for shoring up these measures with parallel OECD action (cf. Kudrle & Eden 2003: 46–47). Third, the Clinton administration saw clear links between money laundering, criminality, and tax evasion and strongly favored multilateral efforts to curb all three forms of abuse (Palan et al. 2010: 210). Finally, the creation of the new tax competition TLO was facilitated by the dominance of left-of-center governments in EU member states and the United States. These governments were united in their sensitivity to issues of corporate and capital tax avoidance and arbitrage and in their openness to multilateral approaches to dealing with common problems.

The OECD Committee on Fiscal Affairs was charged with investigating the issue and in 1998 published a report on how to tackle it (OECD 1998). The report focused on low levels of taxation as the root cause of tax competition: "The absence of tax or

a low effective tax rate on the relevant income is the starting point of any evaluation" (OECD 1998: 21). But it refrained from proposing harmonized common minimum rates. Instead, it limited its ambition to reigning in two particularly "harmful" uses of low tax rates that served mainly or exclusively for "poaching" mobile tax base "rightly" belonging to foreign countries (OECD 1998: 16). One such harmful practice was the creation of tax havens. Tax havens are jurisdictions that have no or low general corporate tax rates and accept profits from "insubstantial" activities (such as letter box companies, booking centers, and similar sham operations) as active business income taxable under these rates. The other harmful practice was preferential tax regimes offering low rates of tax exclusively to foreign investors in defiance of much higher general levels of domestic tax applicable to residents ("ring fencing" of low tax so as to positively discriminate outsiders). The harmful effects of both types of aggressive low tax policies were confounded, in the view of the committee, by a general lack of transparency and a general unwillingness to exchange information with foreign tax authorities (OECD 1998: 28–30).

The distinction between tax havens and preferential tax regimes had an institutional and a political logic. Institutionally, the implicit understanding was that preferential tax regimes were the primary form of harmful tax competition inside the OECD and therefore could be addressed by the standard OECD procedures of common standard setting, self-reporting, and peer review among the member states. Tax havens, by contrast, were mostly non-OECD jurisdictions and had to be addressed differently. Politically, the assumption was that tax havens have a vital stake in tax competition and therefore cannot be relied on to cooperate voluntarily in curbing harmful tax practices, whereas countries with preferential tax regimes have a stake in protecting their regularly taxed domestic tax base from foreign tax poaching and therefore have much stronger incentives to cooperate (OECD 1998: 21–22, 27–28).

The curbing of preferential tax regimes largely followed this logic. In 1998, the OECD set up a Forum on Harmful Tax Practices under the aegis of the committee on Fiscal Affairs to coordinate the work. The member states reviewed existing tax law in light of the OECD report's criteria and, in 2000, published a list of tax havens and potentially harmful preferential tax regimes (OECD 2000). They then went through various rounds of review in order to delete those regimes from the list that were not considered harmful and to abolish or amend those that were. In 2006, the problem was officially declared solved: "[T]his part of the project has fully achieved its initial aims and ... the mandate given by the Council on dealing with harmful preferential tax regimes in Member Countries has therefore been met" (OECD 2006: 6).

Two factors facilitated this notional success. First, the criteria of harmfulness were handled rather laxly. This allowed the whitewashing of many preferential regimes

as not harmful and the amending others so as to circumvent the OECD's formal criteria of harmfulness. Some observers conclude, therefore, that the impact of the OECD project on preferential regimes was very low (Palan et al. 2010: 214). This may not be completely fair because some preferential tax regimes were in fact abolished. A second factor contributed to that: The soft-law OECD peer review process proceeded in the shadow of hard-law investigations in other TLOs. On the one hand, the European Commission scrutinized the preferential tax regimes of EU member states under the state aid rules of the EC Treaty and opened fifteen official infringement procedures in 2001. This sent a clear signal to EU member states that their regimes were at risk (Radaelli & Kraemer 2008: 327). On the other hand, some regimes on the OECD list, such as the U.S. Foreign Sales Corporation, were subject to dispute settlement procedures in the WTO. Hence, the OECD project may not have been completely inconsequential. Ireland, for instance, abolished all preferential regimes incriminated by the OECD. At the same time, however, it slashed its general corporate tax rate from 32 percent in 1998 to 12.5 percent in 2003. Hence, to the extent that the OECD's fight against preferential tax regimes was successful, it tended to increase competitive pressures on general tax rates (cf. Keen 2001).

The curbing of tax havens turned out to be much more difficult. The OECD blacklist of 2000 called on tax havens to remove the harmful features of their tax systems. All tax havens refusing to do so would be regarded as "uncooperative jurisdictions" and would have to face coordinated "defensive measures" by OECD countries (OECD 2000: 19–20). Predictably, tax havens reacted with outrage, protesting the OECD's neo-imperial assault on their tax sovereignty. Nevertheless, they signaled willingness to enter negotiations and to try to reach an agreement with OECD countries. This made it difficult for the OECD to continue its exclusionary, confrontational approach to dealing with tax havens. Also, there were OECD internal problems. First, the key criterion for identifying tax haven operations, the lack of "substantial activity," was diffuse. "For example, financial and management services may in certain circumstances involve substantial activities. However, certain services provided by 'paper companies' may be readily found to lack substance" (OECD 1998: 24). Any attempt to operationalize the criterion would have been contested among the OECD member states and would have involved the OECD in in-depth investigations of the tax havens (Kudrle 2005: 21). Second, with the coming to power of the new Bush administration in 2001, the United States defected from the OECD project. Partly, this was due to its instinctive dislike of multilateral approaches. Partly it was due to the suspicion that the project simply served for high-tax European welfare states to impose their tax views on the rest of the world, a view that was forcefully formulated and effectively brought to the attention of U.S. policymakers by well-organized business interest groups (Cloud 2001). Therefore, the United States pushed the OECD to curtail the project to the one

aspect it was interested in: transparency and information exchange (Webb 2004) – an interest that greatly gained in salience after 9/11.

As a consequence of these developments, the OECD project was set on a new course substantively and procedurally. Substantively, the initial aim of pressuring tax havens to adapt their domestic tax systems in terms of minimum tax rates or common tax base definitions was off the agenda. Tax havens retain the legal sovereignty to set taxes as low as they want. The substantial activity criterion was dropped from the list of criteria of tax haven status (OECD 2001: 10). The project's new focus was on forcing tax havens to share tax information and render administrative assistance across the border. Of course, this also implied a loss of sovereignty. As the trilemma of international taxation suggests, there is no way to curb tax competition and retain double tax relief without any sacrifice of sovereignty. But this time, the sacrifice concerned administrative sovereignty only: The aim was to deny tax havens the freedom to protect individual tax evaders from investigations by their home states. The entire complex of corporate tax avoidance dropped out of the picture.

Procedurally, the entire approach became more inclusive and consensual. A Global Forum on Taxation was set up in 2001 under the auspices of the OECD Committee on Fiscal Affairs to bring together OECD member states and offshore tax havens. The Global Forum engaged in developing criteria for the transparency of national tax systems and for the effective cross-border exchange of tax information. In the course of this work, the Forum developed a Model Agreement on Information Exchange (OECD 2002) that serves as a template for bilateral tax information exchange agreements in those cases where governments do not wish to enter into full-fledged bilateral double tax avoidance treaties. The Model Agreement imposed stricter informational obligations on governments than the old Article 26 of the OECD Model Tax Convention used to do. In fact, it led to a revision of that Article. Still, the level of obligation is rather low. Most importantly, the Model Agreement provides only for information exchange upon request, not the automatic exchange of information. This limits effectiveness considerably, as the requesting state has to present initial evidence of evasion: It has to know the information in order to officially request it (Sullivan 2007). The Forum also started a process of peer review in which the members of the Forum scrutinize each other's legal and administrative frameworks for information exchange (see, e.g., OECD 2009).

The work of the Forum received a boost after the financial crisis of 2008. In contrast to corporate tax competition that arguably was a facilitating factor in the unfolding of this crisis (Keen et al. 2010), the problem of tax evasion and lack of information exchange was not. Still, in a kind of political displacement activity, the G20 called on the Global Forum to step up its work (Rixen 2013; for a selection of fiery quotes, see Global Forum 2011a: Annex III). As a consequence of this, the Global Forum was reconstituted as the Global Forum on Transparency and Exchange of Information for Tax Purposes and was set up as an independent international organization even though it was still hosted by the OECD.

What is the impact of the new TLO on harmful tax competition? It is easy to find fault with the work of the Global Forum. It brackets the huge area of corporate tax avoidance that arguably is the most important one. And even in its area of application, individual tax evasion, it is unclear how effective it is. To be sure, it has tightened informational standards and reduced certain barriers to cross-border administrative cooperation. The peer review of legal and administrative practices of information collection and exchange show spectacular compliance with the Forum's rules (cf., e.g., Global Forum 2011b). The network of bilateral tax information exchange agreements is exploding. The network is far from complete, though, and certain network links seem rather irrelevant. It is not entirely clear, for instance, to what extent Monaco's bilateral information exchange agreements with Andorra, the Bahamas, Greenland, Liechtenstein, Luxembourg, Iceland, Qatar, Saint Kitts and Nevis, San Marino, and the Seychelles will contribute to reigning in global tax evasion. A recent empirical study concluded that "most tax evaders did not respond to the treaties but that a minority responded by transferring their deposits to havens not covered by a treaty" (Johannesen & Zucman 2012). In short, the activities of the Global Forum caused a modest relocation of deposits between havens but no significant repatriation of funds. Arguably, the main reason for this lack of impact lies in the shortcomings of information exchange on request. An automatic exchange of taxpayer information would potentially be more effective in curbing international tax evasion.

And, indeed, in recent developments, a group of countries pressured by the United States have signaled their willingness to engage in automatic information exchange. The U.S. government had unilaterally implemented the so-called Foreign Account Taxpayer Compliance Act (FATCA) requiring foreign banks to provide information on the accounts of American citizens to the U.S. government. Subsequently, several countries, including Germany, France, Italy, Spain, and the United Kingdom but also Switzerland, Austria, and Luxembourg, entered into negotiations with the U.S. government because they did not want their banks to directly provide information to a foreign government. In consequence, information is now automatically exchanged via these governments and that of the United States. It is conceivable that these developments – and current attempts to extend automatic information exchange within the EU savings tax directive – will lead to improvements in the OECD standard of information exchange (for details on this development, see, e.g., Grinberg 2012). But it is too early to come to definite conclusions on this issue.

In another very recent development, the United Kingdom and Germany, fueled by tax scandals that received wide public attention (e.g., Starbucks and Apple), have brought the issue of corporate tax avoidance back on the agendas of the G20 and the OECD. In response, the OECD has initiated a new project on "base erosion and

profit shifting" (OECD 2013a; 2013b). Although the OECD forcefully stresses the need for action, the concrete measures remain within the mode of reinterpretation, which proved futile in the past. It remains to be seen whether or not the stronger rhetoric signals a more profound change for the future of corporate taxation, so far the framework of sovereignty-preserving cooperation remains intact.

VII. LESSONS FOR THE TLO PROJECT

The tax case holds empirical and conceptual lessons for the TLO project. On the one hand, it highlights pertinent features of TLO creation, consolidation, and decay. On the other hand, it elucidates what a TLO is, how it differs from alternative concepts, and what the theoretical value added of this conceptual difference is.

We see four empirical lessons of the tax case for how "transnational legal orders (TLOs) originate, consolidate and constrain behaviors in spheres of social life" (Halliday and Shaffer, Chapter 1: 2). The first concerns the *origins* of TLOs. The initial creation of the Tax TLO was greatly facilitated by its narrow substantive scope. The negotiations focused almost exclusively on international rules for double tax relief and bracketed other problems of international taxation, including tax avoidance and evasion. This was not for sheer ignorance. Most negotiators were aware of these other problems and possible links to the issue of double taxation. Yet including these problems would have greatly complicated the negotiations and delayed the establishment of the TLO – perhaps ad infinitum. Starting small was the precondition for starting a TLO at all. As we surmise, this is often the case in TLO creation. They do not initially cover an entire "sphere of life" but only subsections of it. Their substantive, and perhaps also geographical, scope is narrow and selective rather than broad and encompassing. The short-run implication is high initial issue alignment: There is a close "one-to-one correspondence" between the TLO and a particular issue or set of issues. The long-run implication is that the high initial issue alignment carries the seeds of its own undoing. Precisely because the TLO initially deals only with one particular issue or set of issues in isolation, it is likely to create unintended (if not necessarily completely unforeseen) spillover effects on other issues: By ordering – "solving" – one particular problem, they reshape the problem context and may thus trigger a further round of legal ordering.

Our second lesson concerns the *consolidation* of TLOs. The Tax TLO consolidated in roughly the 1920s to the 1960s, at a time when its practical significance and political salience were rather limited. The volume of cross-border movements of goods, services, and factors of production was low. International double taxation was largely a non-issue for policymakers. This gave the small expert community of lawyers and public officials who cared for double tax relief for professional reasons the freedom to sort out norms and principles in de-politicized negotiations with

little or no political oversight. This greatly facilitated normative settlement and the emergence of a transnational "epistemic community" embodying it. The normative settlement constrained governments once the issue of double taxation gained in practical importance and political salience from the 1960s onward: The governments of the Global South would have preferred a more source-based order of double tax relief, whereas the United States and some other northern governments would have preferred an order that is less susceptible to tax avoidance and evasion. But the normatively settled TLO rules on double tax relief were resilient to these challenges. The basic structure and concept of the OECD Model Convention is still the same today as it was in the 1960s. These observations suggest that the de-politicization and professionalization of TLOs is conducive to their consolidation. Political contestation and high politics, by contrast, are likely to block or delay normative settlement.

The third lesson concerns the *impact* of TLOs. As the tax case shows, TLOs shape social relations and outcomes both by constraining and by enabling behavior. The primary purpose of TLOs is, of course, to constrain behavior in order to solve a given problem: The OECD Model Convention constrains how governments treat cross-border capital flows for tax purposes and thus solves the problem of international double taxation. As a byproduct of the constraints they impose, TLOs often enable new patterns of behavior that, in turn, may lead to follow-up problems and new initiatives for transnational legal ordering. Thus, the implementation of the OECD Model Convention in bilateral DTTs and domestic tax laws created new opportunities for cross-border tax evasion and avoidance, as well as new incentives for governments to engage in strategic tax setting in order to attract inward, and deter outward, evasion and avoidance flows. In this way, the solution of the old problem of double taxation spilled over into the new problem of tax competition. We conclude that TLOs have an inbuilt tendency toward issue expansion, overlap, and enmeshment. They often start small with close issue alignment but then tend to expand into adjacent issue areas, creating overlap with other already existing TLOs or with newly established TLOs. As a consequence, the initial issue alignment – if there ever was issue alignment – erodes. Although the OECD is still the focal organization in the international tax field, the field is increasingly crowded with new creations, such as the Global Forum, and new entrants, such as the G7, the G20, or the WTO. What used to be a single TLO is now better described as a TLO-complex (on the related concept of a regime complex, see, e.g., Keohane & Victor 2011).

Finally, because TLOs tend to create unintended follow-up problems and constrain the means for coping with them, *timing* and *sequence* matter in TLO development. It matters how the initial problem that triggers the creation of a TLO is framed and how it is ordered, because this will shape the TLO's intended and unintended impact on behavior and hence which problems and solutions for transnational legal ordering arise down the line.

The tax case further helps explain the value-added of the TLO concept and to see its distinct advantages over alternative concepts such as, perhaps most prominently for political scientists, the International Regime. Like the TLO concept, the concept of International Regimes is concerned with the dynamics of transnational lawmaking and with the national enactment of transnational law in public policy and domestic legislation (see Krasner 1983). The only obvious difference is that the Regime concept excludes the sub-national level, which the TLO concept explicitly includes. But what is the advantage? After all, sub-national local practices do feature in regime analysis as an exogenous source of the national interests that inform intergovernmental bargaining over, and national (non-)compliance with, regime rules. The advantage of including local practices in the TLO concept is that it allows us to conceptualize them as endogenous products of the transnational laws and national policies that they, in turn, shape and transform. The law itself creates the conflicts that propel its further evolution (Halliday 2009).

The history of the TLO of double tax relief highlights this recursivity of the law in an ironic way. Initially, the TLO was not planned as a legal order covering all territorial levels from the global to the local but as an International Regime applying to inter-state situations only: The rules of the Model Convention were supposed to coordinate national tax jurisdictions at their international interface; they were not supposed to change tax policies within national jurisdictions or to shape taxpayer behavior at the local level. Problems started when the rules trickled down to levels for which they had not been initially intended; that is, when taxpayers began using the rules of double tax relief as material for their private tax avoidance and evasion schemes and when national governments began to adapt their domestic tax policies so as to attract foreign tax avoiders and evaders. As the transnational rules of double tax avoidance settled at the lower level, they came under increasing pressure, which resulted first in their reinterpretation and then in attempts to create a new TLO on tax competition. In a regime perspective, these adjustments appear as a response to largely exogenous processes: globalization, tax competition, and the emerging conflict between large industrial democracies and small tax havens. The TLO perspective allows us to understand them as endogenous symptoms and causes of an infinite recursivity of global lawmaking, enactment, and change.

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