Tax Competition: Understanding History's Influence On the New Normal

by Jeffrey Owens and Joy W. Ndubai

Jeffrey Owens

Joy W. Ndubai

Jeffrey Owens is the head of the Global Tax Policy Center at the Institute for Austrian and International Tax Law at the Vienna University of Economics and Business (WU), and Joy W. Ndubai is a teaching and research associate at the WU Global Tax Policy Center.

In this article, the authors consider how international tax competition has developed over the last century and how countries and nongovernmental organizations have tried to address it through policy.

Tax competition has been a long-standing issue in the international tax arena, and its contribution to ensuring sufficient domestic resource mobilization to finance public services and sustainable development overall is in question. The system has largely operated based on the need for efficient allocation of resources and minimal distortion of market decisions and on the assumption that full cooperation on tax policy is possible.[1] As a result, competing national policies have had spillover effects; there have been more efforts to coax noncompliant countries to cooperate; and there is increasing dissatisfaction, particularly among developing countries, with the multilateral regime that has emerged over time. Given the role that new technologies play in the global economy, the revenue pressures arising from the impact of COVID-19, and the overall focus on global, as opposed to national, welfare,[2] a renewed effort to reevaluate the appropriateness of the system, particularly regarding emerging and realized risks, is underway. However, to understand the next steps, there is a need to reflect on the historical developments that led to the current status quo.

The History

The debate over the need to identify the characteristics of acceptable and unacceptable tax competition has been ongoing with differing emphasis since 1919 when the International Chamber of Commerce established a committee on double taxation and urged the League of Nations to provide a multilateral solution.[3] In 1920 the International Financial Conference recommended that the League of Nations "take up the question of double taxation."[4] The concerns

[1] Tsilly Dagan, *International Tax Policy: Between Competition and Cooperation* 50-52 (2018).

[2] *Id.*

[3] Andrew P. Morriss and Lotta Moberg, "Cartelizing Taxes: Understanding the OECD's Campaign Against Harmful Tax Competition," 4(1) *Columbia J. Tax L.* 17 (2012).

[4] League of Nations Committee of Technical Experts on Double Taxation and Tax Evasion, "Double Taxation and Tax Evasion — Report Presented to the Financial Committee of the League of Nations by the Committee of Technical Experts on Double Taxation and Tax Evasion" (Apr. 12, 1927).

began to receive increasing attention, and in 1922 the International Economic Conference added to the recommendations the need to address flight of capital.[5]

The League of Nations double taxation committee published its first report in 1923 and addressed both topics. It later agreed on a series of resolutions, which it submitted to the League of Nations Financial Committee in 1925.[6] The Financial Committee agreed with the resolutions but urged any future inquiries to consider "the disadvantage of placing any obstacles in the way of the international circulation of capital, which is one of the conditions of public prosperity and world economic reconstruction."[7]

By 1927 the League Committee of Technical Experts on Double Taxation and Tax Evasion had submitted draft conventions on the prevention of double taxation, the prevention of double taxation in the special matter of succession duties, administrative assistance in matters of taxation, and judicial assistance in the collection of taxes. In 1928 the League of Nations adopted and published a report on double taxation and tax evasion. Between 1930 and 1940, the committee frequently reviewed and updated the draft conventions, analyzed and compared national fiscal systems and bilateral conventions, and made recommendations to the Financial Committee.

In 1943 a regional conference with representatives from North and South America presented a draft tax treaty that sought to shift primary taxing rights to source jurisdictions.[8] The League Fiscal Committee rejected the proposal in 1946, leaving taxing rights in the hands of residence states and source jurisdictions dissatisfied.[9]

Those positions represented different models for dividing the tax base and tried to acknowledge the problems faced by different sets of countries in addressing double taxation.[10] After the League transitioned into the United Nations and membership broadened to include more developing countries, discussions about double taxation became even more complicated because there was a need to serve different systemic needs.[11] Those complications soon brought U.N. discussions to an end, and because the problems continued, the International Chamber of Commerce turned to the new Organization for European Economic Cooperation "for a forum within which to craft solutions to double taxation problems."[12]

In 1956 the organization's Fiscal Committee began its initiative to review and develop the League's draft convention. By 1961, when the OECD had been formally tasked with addressing cross-border taxation, European economic integration had increased significantly, trade barriers were falling partly because of the General Agreement on Tariffs and Trade, private financial transactions were growing fast, and capital was becoming more mobile.[13] The last item fostered competition and "pressure to produce where profitability is greatest."[14] Further, Europeans' accumulation of large U.S. dollar deposits in London banks in the 1950s and 1960s provided the foundation for the Eurodollar market and took advantage of connections the City of London had with jurisdictions associated with the United Kingdom.[15]

That created opportunities for jurisdictions such as the Channel Islands, Hong Kong, and British and Dutch Caribbean territories in the Americas that had historic ties to major economies but were not subject to their laws. Those jurisdictions had rudimentary financial infrastructure to service industries such as tourism or oil refining, and as semiautonomous units, were not subject to the domestic banking

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] For more, see Sébastien Leduc and Geerten Michielse, "Are Tax Treaties Worth It for Developing Economies?" in *Corporate Income Taxes Under Pressure: Why Reform Is Needed and How It Could Be Designed* (2021).

[9] *Id.*

[10] Morriss and Moberg, *supra* note 3, at 19.

[11] *Id.*

[12] *Id.*

[13] *Id.* at 25-26.

[14] Jeffrey Owens, "The David T. Tillinghast Lecture — Tax Competition: To Welcome or Not," 66(2) *Tax L. Rev.* 179 (2012).

[15] Catherine R. Schenk, "The Origins of the Eurodollar Market in London: 1955-1963," 35(2) *Explorations in Econ. Hist.* 221 (1998); and Morriss and Charlotte Ku, "The Evolution of Offshore: From Tax Havens to IFCs," *IFC Rev.* 7 (2020).

reserve requirements that U.K. and U.S. banks faced and lacked high direct tax rates.[16]

Companies were increasingly able to lower their tax costs by using international business structures provided by those types of jurisdictions. The emergence of "London and New York as rival financial centers after World War II drove down the cost of international business structures," and "banks, lawyers, accountants and other professionals in both cities aggressively competed for business both by pushing their national governments to lower regulatory costs and through innovation."[17] That spurred the emergence of various financial centers and tax havens and the adoption of competitive tax regimes that would eventually create political hostilities toward those facilitating tax avoidance and evasion.[18] As one commentator noted:

> These trends have had significant implications for tax policy, as cross-border investors generally [have been] looking to maximize their post-tax not their pre-tax returns. Countries may feel that they are increasingly in a position of competing as a location for [foreign direct investment] and, as a result, under pressure to reduce taxes on the return on investment, particularly their corporate income tax rate. . . . A second, but related challenge for tax policy from globalization is the greater ease with which business (especially multinational enterprises (MNEs)) can engage in aggressive tax planning activities, including by . . . moving earnings from one (higher tax) country to another (lower tax country) . . . profit shifting through transfer mispricing . . . [and] the arbitrage opportunities opened up by differences between tax regimes . . . countries may thus feel that they are competing not only for investment, but also for taxable profits.[19]

Intensifying tax competition resulted in the blurring of lines between competition for real economic activities and tax bases and the ensuing shifting of profits to park funds in financial centers that at the time offered anonymity. That caused alarm among many countries that wanted to take action against tax havens.

Early Responses to Tax Competition

The United States

The Bank Secrecy Act was amended in 1970 to require that banks and other financial institutions report to the IRS the deposit or withdrawal of more than $10,000 and implement other measures to increase information available to authorities.[20]

The 1981 Gordon report "called for coordinated action against tax havens," resulting in the cancellation of treaties with the British Virgin Islands and Netherlands Antilles and increased powers for the IRS to order a taxpayer's records or books if relevant to its return.[21] By 1985, with continued losses of revenue resulting from tax evasion through offshore jurisdictions, the Senate Permanent Subcommittee on Investigations recommended the imposition of sanctions on noncooperative tax havens.

The European Union

Efforts to address tax competition in the EU had materialized by the 1960s. Although at the time direct taxation matters had largely been left to the discretion of member states, there remained an obligation to ensure that rules, rates, and administration did not infringe on free movement of capital or discriminate against companies or nationals of other member states.[22] Directives or regulations on direct taxation required unanimity to be passed.[23]

The position regarding harmonization of direct taxation policies began to sway following the 1962 publication of the Neumark report, which tried to identify how differences in tax rates

[16] Morriss and Ku, *id.* at 7.

[17] Morriss and Moberg, *supra* note 3, at 27.

[18] *Id.* at 33.

[19] Owens, *supra* note 14, at 180.

[20] Morriss and Moberg, *supra* note 3, at 35.

[21] *Id.* at 34.

[22] Rachel Griffith and Alexander Klemm, "What Has Been the Tax Competition Experience of the Last 20 Years?" The Institute for Fiscal Studies WP04/05, at 21 (Feb. 2004).

[23] *Id.*

affected the free movement of capital and people and recommended a shift toward tax harmonization. By the late 1960s, the European Commission had introduced two proposals on rate and base harmonization, neither of which passed.[24]

France and Italy called for a measure aligning fiscal regimes and increasing exchange of information (EOI) among member states.[25] The 1992 Ruding report found that differences in tax regimes were distorting "the functioning of the internal market both for goods and for capital," a problem that was unlikely to be "reduced significantly through independent action by member states." Concluding that the EU could focus on the minimum necessary, the report recommended removing discriminatory and distortionary tax policies, introducing a minimum corporate tax rate and base to limit excessive tax competition, and increasing transparency on tax incentives to promote investment. The ambitious recommendations were too difficult to implement under the unanimity requirement, so the voluntary approach became the preferred means.[26]

In April 1996 the EU Council initiated a discussion on the need for coordinated action at the European level to tackle harmful tax competition by "reducing the continuing distortions in the single market, preventing excessive losses of tax revenue or getting structures to develop in a more employment-friendly way."[27] By 1997, the EU Council and representatives of member states adopted the resolution on the Code of Conduct on Business Taxation to curb harmful tax competition. As a "political commitment by member states," the objective was to examine, amend, or abolish harmful tax measures and refrain from introducing new ones.

The OECD

The OECD was initially tasked with addressing how to "minimize the transaction costs of doing business across different tax systems by creating a framework that could help solve double taxation issues."[28] The evolution of its responsibilities to include managing tax competition surfaced in 1970 when governments began to be frustrated by the impact international business structures offered by emerging financial centers were having on their ability to compete for investments. Also, revenue authorities in developed countries were facing constraints as a result of lacking or mismatched information about taxpayers operating in multiple jurisdictions.[29] By the 1980s, it had become clear that bank secrecy and the use of tax havens were pushing developed countries to compete for investment while erecting barriers for competitors.[30]

U.S. and EU efforts to insulate themselves from competition encouraged the OECD to work on the issue, resulting in a series of reports published in 1987 on potential measures to curb abuses arising from secrecy and the use of havens.[31]

The OECD Council met in May 1996 and stressed the need for an open and rules-based multilateral system that could support trade liberalization, calling on the OECD to "develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases."

Just one year after the EU Code of Conduct was adopted, the OECD published its report on harmful tax competition. The OECD distinguished between tax havens and harmful preferential tax regimes and identified tax transparency as a major priority for addressing tax competition. The landmark 1998 report offered solutions that emphasized the need for coordinated action at an international level to

[24] *Id.*

[25] Morriss and Moberg, *supra* note 3, at 37.

[26] Griffith and Klemm, *supra* note 22, at 22.

[27] EU Council, "Conclusions of the ECOFIN Council Meeting on 1 December 1997 Concerning Taxation Policy" (Dec. 1, 1997).

[28] Morriss and Moberg, *supra* note 3, at 19.

[29] *Id.*

[30] *Id.* at 34.

[31] *See* OECD, "International Tax Avoidance and Evasion: Four Related Studies" (1987).

enhance transparency and EOI, minimize the exploitation of tax havens and preferential regimes, and protect tax bases.

While most OECD members accepted the report, Switzerland and Luxembourg abstained. Luxembourg did not share the view that banking secrecy was necessarily a source of harmful tax competition and argued that the report adopted a partial and unbalanced approach by limiting its focus to financial activities. Switzerland thought a degree of tax competition had positive effects but acknowledged that it could have harmful consequences.

In 2001 U.S. Treasury Secretary Paul O'Neill said the country was reevaluating participation in the OECD's working group on harmful tax practices. He said the United States shared many of the serious concerns about the direction of the OECD initiative, including the "underlying premise that low tax rates are somehow suspect and by the notion that that any country, or group of countries, should interfere in any other country's decision about how to structure its own tax system." He questioned the potentially unfair treatment of some non-OECD countries, saying the United States "does not support efforts to dictate to any country what its own tax rates or tax system should be, and will not participate in any initiative to harmonize world tax systems." O'Neill said Treasury had "no interest in stifling the competition that forces governments to create efficiencies" and highlighted that the administration was working to lower tax rates.

Reservations like those changed the focus of the work to efforts to increase tax transparency and information exchange. The OECD also proceeded with the evaluation of preferential tax regimes, which in 2006 resulted in a progress report concluding that the work had been fully achieved.[32] Of 47 jurisdictions analyzed, the report identified 35 as tax havens (in 2009 all countries were removed from the list of noncooperative jurisdictions). The work on tax havens also addressed four OECD members that had excessively strict bank secrecy.

Rules to determine what was acceptable in tax competition were necessary but were not seen as a priority for countries.

Post-2001

Although efforts to enhance transparency and exchange of tax and financial account information continued, until 2008 most tax havens declined to sign information exchange treaties.[33] The political pressure cultivated by the impact of the global financial crisis and the revelation that the international financial architecture was no longer adequate led G-20 countries to champion the end of bank secrecy and crack down on offshore tax evasion and avoidance.[34] That gave way to the recognition that additional pressures such as mismatches in regimes, transfer mispricing, and profit shifting needed to be addressed.[35]

Harmful for Whom?

When corporate taxes first emerged after World War I, national markets had strong trade barriers and capital controls that limited the mobility of tax bases and "prevented any International spillover effects of national tax policy choices."[36] The lifting of trade barriers (primarily pushed by the negotiation of GATT) and capital controls provided companies with the opportunity to be mobile. That meant governments would need to introduce competitive policies that would attract individuals, businesses, and capital. The OECD harmful competition report noted that "tax policies in one economy [were] now more likely to have repercussions on other economies" and "high tax levels were believed to be unsustainable if tax levels were significantly lower elsewhere," explaining the race to reduce rates. Taxation then emerged as yet another basis on which to compete to attract investment and capital.

[32] OECD, "OECD Project on Harmful Tax Practices: 2006 Update on Progress in Member Countries" (2006).

[33] Niels Johannesen and Gabriel Zucman, "The End of Bank Secrecy? An Evaluation of the G20 Tax Haven Crackdown," 6(1) *Am. Econ. J.: Econ. Pol'y* 65 (Feb. 2014).

[34] *Id.*

[35] That in turn gave rise to the OECD base erosion and profit-shifting project through which the work on harmful preferential regimes was undertaken.

[36] Philipp Genschel, "Globalization, Tax Competition and the Welfare State," 30(2) *Pol. & Soc.* 247 (June 2002).

However, competition is a relative concept.[37] In business terms, it could refer to the ability to lower costs while maintaining or increasing output or improving quality. Economies are influenced by many factors that could provide those benefits, such as infrastructure, labor force, healthcare, political stability, and financial market development.[38] Competition can be based on all those factors, and countries can evaluate tax policy and administration as a stand-alone factor or consider how it could affect other economic aspects:

- if a tax system is perceived to be fair, there is an increased likelihood of compliance;
- good administration that deters evasion reinforces social cohesion and ensures no unfair advantages accrue to companies that evade tax;
- transparent and well-governed tax administration that addresses corruption, implements the laws consistently, and promotes certainty could encourage more investment;
- an efficient tax administration could reduce the amount of resources required for revenue collection
- low compliance costs and burdens could reduce the time spent on compliance, providing more time for income and wealth generation; and
- transparent and evidence-based tax policymaking, such as evaluating revenue lost as a result of tax incentives and reviewing cost-effectiveness, could encourage more efficient revenue raising and increase perceptions of fairness.[39]

Those objectives reflect a tax system more concerned with balancing efficiency, fairness, certainty, and simplicity; however, in the last 30 years, the emphasis has shifted toward efficiency — especially market efficiency.[40] That is meant to keep tax regimes from distorting market signals and avoid discouraging the supply of entrepreneurship, investment, and skills.

Countries' responses, at least initially, were to broaden their bases and lower rates as "the best way to collect revenues while ensuring that taxes distort business and household decisions as little as possible."[41]

In the last 20 years, OECD revenue statistics have shown that statutory corporate income tax rates have steadily decreased by a large amount. Some observers have noted that "the typical corporation is now facing half the nominal tax rate they faced 50 years ago, and at the same time their share of profits as a proportion of GDP has increased."[42] That phenomenon is known as the corporate tax rate-revenue puzzle. That puzzle shows that despite sharp reductions in corporate rates, average EU corporate tax revenues as a proportion of GDP have remained relatively stable in the last two decades.[43] That stability is largely explained by the growing profits of companies, and "the increase in the size of the corporate sector in the economy has positively contributed to sustain corporate tax collection."[44]

That has generally provided room and justification for governments to pursue increasingly competitive tax policies, which has led to "the introduction of harmful regimes and explains some of the current developments and frustrations in the international tax space."[45] The OECD's harmful competition report distinguished between acceptable and harmful preferential tax regimes and sought to discourage countries from engaging in harmful tax practices while acknowledging the objective of "reducing the distortionary influence of taxation on the location of mobile financial and service activities." The OECD recognized that countries' ability to design tax policies "aimed primarily at diverting financial and other geographically mobile capital" could erode other countries' tax bases, alter the structure of taxation by shifting part of the tax burden from mobile to relatively immobile

[37] Owens, *supra* note 14, at 173.

[38] *Id*. at 174.

[39] *Id*. at 175-176.

[40] *Id*. at 188.

[41] *Id*. at 187.

[42] Fabrizia Lapecorella and Owens, "Fireside Chat: Tax Competition — The New Normal" (Dec. 2019).

[43] Gaetan Nicodeme, Antonella Caiumi, and Ina Majewski, "What Happened to CIT Collection? Solving the Rates-Revenues Puzzle," EC Working Paper No. 74, at 15 (2018).

[44] *Id*. *See also* Lapecorella and Owens, *supra* note 42.

[45] Nicodeme, Caiumi, and Majewski, *supra* note 43, at 15.

factors and from income to consumption, and possibly hinder "the application of progressive tax rates and the achievement of redistributive goals." The impact of competition was clear; however, how countries viewed the underlying policies and their spillover effects was highly dependent on the relevant economic advantages and disadvantages. The 1998 OECD report states:

> Tax competition and the interaction of tax systems can have effects that some countries may view as negative or harmful but others may not. For example, one country may view investment incentives as a policy instrument to stimulate new investment, while another may view investment incentives as diverting real investment from one country to another. . . . [That] recognizes that many factors affect the overall competitive position of a country. Although the international community may have concerns about potential spillover effects, these decisions may be justifiable from the point of view of the country in question.

That dichotomy demonstrates the challenge of balancing global and national welfare, highlights that coordination is likely complex, and acknowledges that not all elements of tax competition can be addressed as harmful practices. With countries feeling increased pressure to compete by making their business tax regimes "more attractive not only in absolute terms, but also relative to other countries," the varying effects "raised questions about whether more international cooperation on tax policy might be desirable to avoid tax competition having pernicious effects."[46]

The OECD report determined that tax havens or preferential tax regimes could cause harm by distorting financial and investment flows, undermining the fairness of tax structures, discouraging taxpayer compliance, shifting tax burdens to more immobile bases, reshaping the desirable mix of taxes and public spending, and increasing administrative burdens for tax authorities and compliance burdens for taxpayers. Practices with all those effects were considered clearly harmful, while those with only some would range in the degree of harm. Factors to identify harmful preferential regimes and tax havens were therefore based on the imposition of zero or nominal rates, preferential features resulting in no or nominal tax rates that are ring-fenced, no transparency, a lack of effective information exchange, and a lack of substantial activity. The OECD acknowledged that there was no general minimum effective rate below which a country could be considered to be engaging in harmful tax competition. That shows that low or zero rates alone did not constitute a harmful tax practice and should be viewed in combination with the other factors.

However, after the global financial crisis, the IMF found that perceptions of the pernicious effects of tax competition continued to raise revenue concerns.[47] Increasing emphasis on the need to protect tax bases to ensure sustainable financing for public services made the international aspects of corporate taxation prominent in public debate.[48] The IMF determined that international corporate tax spillovers were affecting macroeconomic performance and the broader level and distribution of welfare across countries. It found that tax incentives were "significantly undermining revenue in developing countries" and were largely "a spillover reaction to policies pursued in other countries; a clear instance of tax competition." Moreover, corporate income taxes held greater importance in lower- and upper-middle-income countries than advanced ones, making their overall fiscal performance more vulnerable to pressure on corporate tax receipts.

By the time the OECD finalized the base erosion and profit-shifting reports in 2015, there was increasing public pressure for countries to restore the fairness of national and international tax systems. Concerns emerged about the ability to address harmful tax competition, which had been advanced under action 5, to curb the spillover effects of tax rules and practices. The IMF recognized that low or zero rates could have

[46] *Id.* at 187.

[47] IMF, "Spillovers in International Corporate Taxation" (May 9, 2014).

[48] *Id.* at 5.

spillover effects that without cooperation, could in turn create collective inefficiency, with some countries gaining and others losing.[49] The effect of national tax policies varies for each jurisdiction and in its degree of revenue impact; the largest concern, however, has been whether policy proposals can respond to all those effects for the revenue welfare of all countries.

The Challenges of Cooperation

The IMF concluded that the institutional framework for addressing international tax spillovers was weak and that an inclusive, less piecemeal approach to international tax cooperation was necessary. But the road to cooperation has not been straightforward, and both the EU and OECD have proposed various measures to encourage countries to participate in global coordination efforts.

The EU began listing third countries that were noncompliant with EU good governance principles, a process ultimately viewed as a coercive or persuasive effort to secure the compliance of third countries. Similarly, earlier OECD efforts to list uncooperative tax havens faced heavy criticism.[50] Many of the regimes identified were overhauled,[51] and a related exercise by the OECD Forum on Harmful Tax Practices to evaluate the harmfulness of preferential tax regimes produced similar results.[52]

Although notable progress has been made, the ability of current frameworks to fully address the spillover effects of domestic tax policies remains a challenge because of continuing perceptions that the fundamental features of the international tax system fail to fairly allocate taxing rights.

New Constraints for Governments

According to some observers, while countries will probably continue to reduce their corporate rates, "the proportion of revenue in terms of GDP is not going to increase as it has in the past." Instead, they say, "corporate revenues will most likely decrease in absolute amounts and as an overall proportion of GDP."[53] The space for aggressive competition is increasingly limited — it has become more expensive and is one constraint governments will face in trying to attract tax bases via reduced corporate rates.[54]

Although the OECD's harmful competition report is still relevant, some of its concepts might not be as easy to identify — for instance, tax havens, because nearly all countries have made commitments to become or are relatively compliant with minimum transparency and EOI standards.

One issue clearly remains: the lowering of tax rates. While the OECD tried to anticipate the potential challenges of continuing globalization and the growing ease of movement of income and capital, concerns of OECD members restricted the extent to which tax competition could be regulated. As a result, we have come full circle, with the OECD's new proposals to address the tax challenges of digitalization acknowledging that "global action is needed to stop a harmful race to the bottom."[55] Following the G-7 finance ministers' announcement regarding their commitment to a global minimum tax, U.S. Treasury Secretary Janet Yellen said that would end the corporate race to the bottom and help the global economy thrive "by leveling the playing field for businesses and encouraging countries to compete on positive bases, such as educating and training our work forces and investing in research and development and infrastructure."

In recent years, globalization, e-commerce, and the growing importance of intangible assets in the process of value creation have placed even more pressure on countries to compete for investment. Over almost 50 years, intangibles

[49] *Id.* at 13-14.

[50] *See, e.g.*, Alex Cobham, "Empty OECD 'Tax Haven' Blacklist Undermines Progress," Tax Justice Network (June 28, 2017).

[51] *See, e.g.*, EU Council, "Taxation: 2 Countries Removed From List of Non-Cooperative Jurisdictions, 5 Meet Commitments" (Oct. 10, 2019).

[52] For the latest on preferential regimes and zero or nominal tax jurisdictions, see OECD, "Harmful Tax Practices — Peer Review Results" (Aug. 2021).

Notably, the EU and OECD regimes to address harmful tax practices have been mutually reinforcing: "The EU began the exercise by borrowing a lot of OECD principles and practices, whilst the OECD has plugged in to EU context-based elements." *See* Lapecorella and Owens, *supra* note 42.

[53] *Id.*

[54] *Id.*

[55] OECD, "Addressing the Tax Challenges of the Digitalisation of the Economy — Public Consultation Document," at 24 (Feb. 2019).

have shifted from supporting to major assets, from 17 percent of all enterprise value on the S&P 500 in 1975 to 84 percent in 2018.[56] We have become a knowledge-based economy, which has increased mobility because knowledge holders are mobile. As a result, countries will continue to ask how to provide a more attractive environment, focusing on how to integrate that development in the global value chain.

Physical location is now of even less importance because the ability to earn income in a jurisdiction can no longer strictly be tied to physical presence, so the ability to compete based on other aspects of the tax system is of growing import. That will have important implications for developing countries whose tax administrations are restricted from or not prepared to evaluate the potential tax liabilities of entities using country-by-country reports or automatic information exchange. Proposals by the OECD inclusive framework to address the tax challenges of the digital economy are unlikely to bear fruit if countries find the solutions too complex to implement. Further, it will take time to arrive at a global consensus, a factor of great importance, given the revenue pressures arising from the economic impact of COVID-19. That is at least partly why unilateral policies, particularly digital services taxes or withholding tax solutions, might continue to be the preferred solution. For some countries, there is an increasing possibility that competition in the taxation of the digital economy will materialize.

Also, continued dissatisfaction with dispute resolution mechanisms in the tax sphere increasingly reveals the potential for tax policy to contradict or directly conflict with obligations in trade agreements and investment treaties. For instance, since facing a higher number of investor-state dispute settlement claims regarding tax measures, several countries are either considering terminating or have already terminated their bilateral investment treaties.[57] India, for example, has canceled all 58 of its treaties, and more recently lost an investor-state arbitration in Vodafone Netherlands' challenge of the applicability of capital gains tax to the purchase of a 67 percent interest in an India-based telecommunications company that was acquired through the indirect transfer of shares. After contesting the issue in the Supreme Court of India, which ruled in favor of Vodafone, then-Finance Minister Pranab Mukherjee introduced a retrospective amendment permitting tax authorities to tax indirect ownership transfers. MNEs have long used those kinds of transfers in developing countries to avoid the payment of taxes in the source jurisdiction by ensuring that the ownership of an asset or entity is held through an entity based in a tax haven with no or nominal capital gains taxes.

Even before the United States raised concerns about the proliferation of unilateral solutions to the challenges raised by the digital economy and resolved to determine whether they constitute trade and investment barriers that should be subjected to tariff-based sanctions, the implications of tax policy design for other aspects of international economic law had revealed themselves. For example, a 2016 Panama-Argentina case before the WTO dispute panel brought the EU list of noncooperative jurisdictions into the limelight when, after Argentina opted to introduce legislative measures against suppliers of financial services from uncooperative jurisdictions, Panama accused Argentina of discrimination that created a barrier to free trade. Although the WTO panel found in Panama's favor, the appellate body permitted the restriction of trade with tax havens for prudential reasons or in compliance with national laws so long as they were consistent and non-arbitrary, but it did not determine whether WTO rules had been violated, leaving a loophole for future disputes.

That was the first case to put into question the trade implications of tax transparency and the viability of defensive tax measures. Without a clear decision on the violation question, there remains a potential for disputes, and the challenges raised by the United States should be considered an emergent constraint for governments.

Access to dispute resolution mechanisms in the trade and investment spaces in which rulings

[56] Jenna Ross, "Intangible Assets: A Hidden but Crucial Driver of Company Value," Visual Capitalist, Feb. 11, 2020.

[57] Nihal Joseph and Nicholas Peacock, "Mixed Messages to Investors as India Quietly Terminates Bilateral Investment Treaties With 58 Countries," Herbert Smith Freehills LLP, Mar. 16, 2017.

are binding could offer a new perspective on how to manage or steer tax competition. On the one hand, investors might be able to challenge the validity of some schemes by invoking investment protections, or countries might contest tax measures that can be viewed as trade barriers, all with the implication of limiting the application of defensive tax measures. On the other hand, trade restrictions on subsidies could entitle countries to challenge preferential tax regimes — as seen with the EU state aid cases — and that may begin to form restrictions on acceptable tax competition.

Finally, the progress in adopting and implementing key tax transparency policies has borne more fruit for advanced economies than developing ones. The most recent OECD findings show that the establishment of EOI units across Africa is ongoing: From 2014 to 2018, the number of countries with units grew from five to 20, and 22 countries have provided their tax administrations with competent authority status.[58] That progression has required investment in capacity building, legal framework updates, systems management, and cultural change in administrations.

For CbC reporting, of the 35 countries evaluated, three began exchanges under the automatic EOI framework between 2017 and 2018, and two were expected to begin between 2020 and 2021. The remaining countries are still implementing EOI or evaluating the strategy to introduce automatic EOI.

To properly implement and reap the benefits of EOI and CbC reporting, developing nations need time. The impact of solutions for resolving some of the effects of harmful tax competition have not been fully experienced among those countries.

A New Floor for Tax Competition?

Despite the progress made in addressing harmful tax practices, tax competition is still thriving and even taking new forms. The desire to address the race to the bottom has, however, begun to change. The OECD's proposed minimum effective tax rate, a feature of the two-pillar solution to address digitalization, tries to respond to that and could act as a floor for tax competition. Recent developments have increased the momentum toward setting that floor.

In April the Biden administration presented the Made in America Tax Plan to address "the major flaws in the corporate tax code" and end "offshoring and profit shifting incentives." The plan introduced the stopping harmful inversions and ending low-tax developments (SHIELD) proposal to deny MNEs U.S. tax deductions if their affiliates are subject to low effective rates. The rate will be determined by reference to the OECD's two-pillar agreement or, if the plan takes effect before OECD consensus is reached, will be 21 percent. President Biden also included a compromise package for a minimum tax of 15 percent on the book income of large corporations reporting large profits to shareholders, whether digital or not. This proposal was presented to the G-7 in June and endorsed by the G-20 in July.

Also, in July the OECD inclusive framework met to discuss the two-pillar plan to reform international tax rules. Pillar 2 would tackle the remaining BEPS challenges by ensuring that MNEs pay a minimum level of tax regardless of where they are headquartered or operate. It tries to do so by using interlocking rules to ensure minimum taxation while avoiding double taxation or taxation where there is no economic profit. In a joint statement published July 1, 130 countries and jurisdictions (later rising to 134) committed to a minimum effective tax rate of at least 15 percent, which could act as a floor for tax competition and address competition "that has spillover effects on the base through profit shifting."[59]

The inclusive framework must consider how countries will react to further limitations on their sovereign right to design their tax systems. In 2001 the United States rejected any efforts to interfere with countries' tax systems. In contrast, in 2017 the U.S. Tax Cuts and Jobs Act introduced the global intangible low-taxed income regime, which introduced a minimum tax on the foreign income of MNEs, and in December 2019 then-U.S.

[58] OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, "Tax Transparency in Africa 2020: Africa Initiative Progress Report 2019," at 31 (2020).

[59] Lapecorella and Owens, *supra* note 42.

Treasury Secretary Steven Mnuchin expressed support for "a GILTI-like Pillar 2 solution." Some observers have noted that "the U.S. position has changed," a phenomenon that suggests "at least some support for interferences with the tax systems of countries."[60] That change of heart is reflected in the Biden administration's Made in America Tax Plan.

However, some questions regarding the pillar 2 blueprint have been raised, including how to impose it without too much complexity, how authorities will be able to ensure that every MNE pays a set amount of tax in every jurisdiction it operates in, and whether previous measures to coerce countries to cooperate will encourage wide-scale adoption of the new proposals.

Some risks have also been identified. Choosing the income inclusion rule will most likely result in revenue being collected by the country of residence, which is typically a rich and developed country, while the undertaxed payments rule — preferred by developing countries — may secure revenue for market jurisdictions. Ultimately, countries will need to ensure that they are getting their fair share. To fully enjoy the benefits of trade and investment, it may be time for more comprehensive rules that determine what constitutes acceptable and unacceptable tax competition.

New Frontiers for Competition

Constraints are not the only concern: Alternative measures to introduce competition outside the corporate income tax system must also be considered. Countries will need to review their entire tax systems because there are various ways to offer incentives, such as through special economic zones.

Countries are likely to expand the base for tax competition. They have switched from trying to attract financial capital to vying for the income base of high-net-worth individuals through numerous schemes, including the resident non-domiciled regimes, citizenship or residence by investment regimes, and golden passport regimes.

Digital nomads may further change the dynamic as more countries try to target those who are very mobile and may shift based on tax benefits. COVID-19 has demonstrated that knowledge is completely mobile and that work can be done remotely, which may lead to a greater competitive focus on personal income and property taxes. Some observers have said that phenomenon "needs to be read and analyzed in the context of the end of bank secrecy" and that "while there may be legitimate reasons for joining these regimes, they may still be subject to misuse and abuse."[61] That could deprive source countries of their fair share of tax, be used to circumvent the common reporting standards, or create loopholes in the information exchange network.

Where or What Next?

The IMF recently evaluated whether tax competition became more harmful between 2006 and 2020 and found that little has changed.[62] In 2006 the average statutory corporate rate in OECD countries was 27.1 percent and that there were perhaps two or three intellectual property box regimes, while in 2020 it was 23 percent, with more than 80 compliant patent box regimes, including some with tax rates of not more than 5 percent.

That's not to say that tax competition has not continued to intensify: The IMF also found evidence to suggest "that spillovers from corporate income tax competition are sizeable and tend to be larger for developing countries" and that "the cost of tax base spillovers from avoidance activities are larger in non-OECD countries (about 1.3 percent of GDP, on average) than in OECD countries (about 1 percent of GDP)."[63]

Given the pandemic's large toll on national treasuries, the welfare of domestic tax systems and their ability to provide sustained financing will be crucial. Countries will need to reconsider how they balance fairness and meeting citizens'

[60] *Id.*

[61] Lapecorella and Owens, *supra* note 42.

[62] IMF, "Chapter 6: Has Tax Competition Become Less Harmful?" in *Corporate Income Taxes Under Pressure*, *supra* note 8.

[63] *Id.*

needs against continuing to compete under a rapidly transforming global economy.

Without further reform to international corporate income tax arrangements, it is unlikely that tax competition will stop or become less harmful. If discussions to adopt an effective global minimum tax proceed, there could be a floor for corporate income tax competition, and economies will need to identify new ways to compete. As countries become more constrained in lowering rates and offering incentives, changes that do not directly affect tax revenue should be explored. One crucial factor could be improving tax certainty, which MNEs value as much as, if not more than, the tax burden.[64] Many regimes have been put in place to sustain the competitiveness of the economy in general. The overall preference for tax incentives has endured because they are self-managed and not transparent.

Governments should start thinking about how well and with what degree of tax certainty they can enforce or implement tax rules. They will need clear and simple legislation, consistent implementation, and appropriate use of all advances in information technology to improve services.

Administrative measures to provide tax certainty will also play an important role. Italy, for instance, has started a pilot international compliance assurance program, a voluntary option for a multilateral risk assessment and assurance process to provide MNEs with increased tax certainty.[65] Most MNEs have made it clear that paying more tax is not the issue — the knowledge that they can operate across borders with a sufficient degree of tax certainty is. That is why cooperative compliance and good tax governance will be key in providing certainty for taxpayers.[66] ■

[64] Lapecorella and Owens, *supra* note 42.

[65] For more, see OECD, "International Compliance Assurance Programme: Pilot Handbook 2.0" (2019).

[66] For more, see WU Global Tax Policy Centre, Project on Cooperative Compliance and Project on Tax Transparency and Corruption (2019-2023).