
Article

Unraveling the Tax Treaty

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INTRODUCTION

Coordination among nations over the taxation of international transactions rests on a network of some 2000 bilateral double tax treaties. The double tax treaties are, in many ways, the roots of the international system. That system, however, is in upheaval in the face of globalization, technological advances, abuse by treaty beneficiaries, and shifting political tides. Yet serious examination of the worthiness of tax treaties is largely confined to the albeit important question of whether tax treaties are beneficial for developing countries. Surprisingly little to no consideration has been paid to whether developed countries should continue to sign tax treaties with one another. In fact, little evidence or theory exists to support entrance into a tax treaty by countries like the United States. And, in some cases, tax treaties may be detrimental to their interests.

Although tax treaties may have, at one time, served salutary purposes, modern circumstances call into question their necessity. In short, tax treaties do not fulfill their purported objectives. Instead of alleviating double taxation, a dubious goal in and of itself for many reasons, the treaties are the means to achieve double non-taxation. This is because the tax treaties allocate taxing jurisdiction to the country of the taxpayer's residence, which often fails to impose a tax. Moreover, there is little evidence substantiating the claim that the treaties increase foreign direct investment. This is especially the case for a country like the United States, which does not benefit from the comity

considerations that the treaty system imparts. Functions such as information exchange may provide benefits but can be achieved through standalone treaties that do not allocate taxing jurisdiction.

Rather than meet their intended goals, tax treaties may inflict harm. Although recent scholarship laments the revenue losses imposed by the treaty system on developing countries,¹ even developed countries may lose revenue if they are net capital-importing. Although the United States was a capital exporter at the dawn of the treaty age, its role has since shifted. In fact, data that I have collected calls into question the widespread assumption that the United States gains revenues through the treaty system. It is my hope that these findings shift the burden onto treaty proponents to conduct formal revenue and economic analyses of treaties to justify their continuation. It perhaps seems surprising that these concerns have not been explored by policymakers in the United States but, as this Article argues, is less so when one considers the limited process and political economy dynamics to which such treaties are subject.²

Furthermore, the treaty system impedes fundamental reform of the international tax system. In the aftermath of recent tax legislation, many commentators have judged policies based on their compatibility with tax treaties.³ I argue that such criticism is misplaced; tax reform will continue to be in tension with

1. Kim Brooks & Richard Krever, *The Troubling Role of Tax Treaties*, in 51 SERIES ON INTERNATIONAL TAXATION: TAX DESIGN ISSUES WORLDWIDE 159, 159–62 (Geerten M.M. Michielse & Victor Thuronyi eds., 2015); see, e.g., John F. Avery Jones, *Are Tax Treaties Necessary?*, 53 TAX L. REV. 1, 2 (1999); Allison D. Christians, *Tax Treaties for Investment and Aid to Sub-Saharan Africa: A Case Study*, 71 BROOK. L. REV. 639, 644 (2005); Tsilly Dagan, *The Tax Treaties Myth*, 32 N.Y.U. J. INT'L L. & POL. 939, 941 (2000); Alex Easson, *Do We Still Need Tax Treaties?*, 54 BULL. FOR INT'L FISCAL DOCUMENTATION 619, 619–20 (2000); Lee A. Sheppard, *How Can Vulnerable Countries Cope with Tax Avoidance?*, 69 TAX NOTES INT'L 410, 410 (2013); Richard J. Vann, *International Aspects of Income Taxation*, in 2 TAX LAW DESIGN AND DRAFTING 718, 720 (Victor Thuronyi ed., 1998).

2. The process by which tax treaties are enacted stands in stark contrast to trade agreements, which are subject to full consideration in the Senate and House. See Rebecca M. Kysar, *On the Constitutionality of Tax Treaties*, 38 YALE J. INT'L L. 1, 33 (2013) (“[Tax t]reaties are . . . approved without fanfare by only part of Congress.”).

3. See, e.g., Reuven Avi-Yonah & Bret Wells, *The BEAT and Treaty Overrides: A Brief Response to Rosenbloom and Shaheen*, 92 TAX NOTES INT'L 383, 383 (2018); H. David Rosenbloom & Fadi Shaheen, *The BEAT and the Treaties*, 92 TAX NOTES INT'L 53, 53 (2018).

tax treaties precisely because the premise underlying the treaties has proven unworkable. Moreover, incremental change that comes from the sovereign exercise of taxing power may spur a more rational approach to international taxation. This bottom-up rebuilding of the international tax regime is likely a necessary step on the way to true international tax reform. Although there will be a temporary disruption to the international tax order, and one which will certainly pose transition costs, such adjustments are inevitable in the transition to the modern global and digital economy.

One way to ease the transition would be to employ an ordered mechanism to discard or scale down those treaty provisions that do the most harm—the ones that allocate taxing jurisdiction. One possible method is to leverage the OECD's new multilateral instrument that is currently being used to add anti-avoidance principles, new residency safeguards, and other provisions to existing treaties.⁴ Just as the new multilateral instrument can be used to supplement the tax treaties, it can also be used to dismantle their most noxious aspects, while leaving the more useful, or at least less harmful, provisions in place. It could also be used to reduce unnecessary mismatches in tax systems, coordinating definitions of income, residency, and source, all without forsaking taxing rights. Rather than assessing unworkable notions of economic neutrality, the challenge for the international tax system going forward will be to attempt some degree of coordination while also giving credence to national interests in setting revenue policy.⁵ This solution aims to thread that needle.

The new OECD/G20 Base Erosion and Profit Shifting Programme of Work (known in the industry as “BEPS 2.0”), the details of which were announced as this Article was in its late stages of production, could be seen as support for this Article's thesis. Ambitious in scope, BEPS 2.0 addresses tax challenges of

4. ORG. FOR ECON. CO-OPERATION & DEV., MULTILATERAL CONVENTION TO IMPLEMENT TAX TREATY RELATED MEASURES TO PREVENT BASE EROSION AND PROFIT SHIFTING (2017) (suggesting improvements to tax treaties).

5. See, e.g., TSILLY DAGAN, INTERNATIONAL TAX POLICY: BETWEEN COMPETITION AND COOPERATION 7 (2018) (arguing that the new international tax system must navigate between competition and cooperation); DANIEL N. SHAVIRO, FIXING U.S. INTERNATIONAL TAXATION 1–4 (2014) (questioning usefulness of notions of worldwide efficiency); Michael J. Graetz, *Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policy*, 54 TAX L. REV. 261 (2001) (same).

the new economy by modifying taxing rights and nexus rules and by proposing a global minimum tax and inbound base erosion rules.⁶ BEPS 2.0 would require radical revisions to existing tax treaties, in particular those provisions that I identify to be the most harmful.⁷

In Part I, this Article traces the history of the international tax and the bilateral tax treaty system up through the recent 2017 U.S. tax legislation. Part II explores the stated and unstated purposes of tax treaties, concluding that they ultimately fall short from the perspective of the United States. Part III examines possible harmful effects of the treaty regime, including revenue considerations, loss of autonomy over revenue policy, the hindrance of tax reform, and tax avoidance. Part IV offers process and political economy reasons for why U.S. treaty policy seems so misaligned with the national interest. Part V looks at ways in which the new multilateral instrument can be utilized to shed the most harmful treaty provisions while retaining, and perhaps creating, others.

I. BACKGROUND OF THE INTERNATIONAL TAX AND TREATY SYSTEM

Before investigating whether the current tax treaty system is effectuating its goals, it is useful to understand its roots. This Part explores the history of the global international tax system, beginning with the pre-tax treaty era. It then outlines the purposes and features of tax treaties. It concludes by discussing the current domestic rules on international tax.

6. See ORG. FOR ECON. CO-OPERATION & DEV., PROGRAMME OF WORK TO DEVELOP A CONSENSUS SOLUTION TO THE TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY (2019) [hereinafter OECD, INCLUSIVE FRAMEWORK], <https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf> [<https://perma.cc/65XR-JZK5>] (suggesting myriad solutions to tax challenges); ORG. FOR ECON. CO-OPERATION & DEV., SECRETARIAT PROPOSAL FOR A “UNIFIED APPROACH” UNDER PILLAR ONE (2019), <https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf> [<https://perma.cc/S9G6-8Z57>] (same); ORG. FOR ECON. CO-OPERATION & DEV., GLOBAL ANTI-BASE EROSION PROPOSAL (“GLOBE”)—PILLAR TWO (2019), <https://www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf> [<https://perma.cc/9RYW-J67N>] (same).

7. OECD, INCLUSIVE FRAMEWORK, *supra* note 6, at 22–23.

A. THE ROOTS OF THE INTERNATIONAL TAX SYSTEM

The primary predicament underlying international taxation is whether income should be taxed by the country in which the taxpayer resides (the residence country) or by the country where the income is earned (the source country).⁸ International tax rules endeavor to resolve this dilemma by deciding which country gets to tax the income.⁹

Deferring to either the source or residence country alleviates double taxation; but the two approaches differ as to which country gets the revenue.¹⁰ Typically, creditor—or capital-exporting—countries will favor residence-based taxation while debtor—or capital-importing—countries favor source-based taxation.¹¹ For instance, assume that there are two countries, France and Great Britain. A French business borrows money from a bank in Great Britain, and the question becomes whether France, as the source country where the business is located and where the business income is generated, or Great Britain, as the residence country of the bank getting the interest, gets to tax the interest income. If a country is capital-exporting, like Great Britain in this example, it will prefer a residence-based approach because it will get the revenues. If a country is capital-importing, like France, then a source-based approach yields it greater tax dollars.

The traditional historical account of international taxation emphasizes a 1923 report for the League of Nations by four economists (1923 Report), led by Edwin Seligman, an economist at Columbia University.¹² The 1923 Report rejected source-based taxation as resting upon a fallacy of the “benefits” theory of taxation—an exchange of government services for taxes.¹³ Instead, its drafters subscribed to the theory of taxation based on ability to pay concerns, i.e., those with the most resources contribute

8. Michael J. Graetz & Michael M. O’Hear, *The “Original Intent” of U.S. International Taxation*, 46 DUKE L.J. 1021, 1033 (1997); see, e.g., Ke Chin Wang, *International Double Taxation of Income: Relief Through International Agreement, 1921-1945*, 59 HARV. L. REV. 73, 81–82 (1945).

9. Graetz & O’Hear, *supra* note 8.

10. Adam H. Rosenzweig, *Thinking Outside the (Tax) Treaty*, 2012 WIS. L. REV. 717, 739–40.

11. Graetz & O’Hear, *supra* note 8, at 1033–34.

12. *Report Presented by Professors Bivens, Einaudi, Seligman, and Sir Josiah Stamp on Double Taxation Submitted to the Financial Committee*, League of Nations Doc. E.F.S.73 F.19 (1923) [hereinafter *1923 Report*].

13. *Id.* at 18, 48.

the most to revenues.¹⁴ Ability to pay supports taxation by the residence country since it is that country that is able to ascertain the worldwide income of its residents, not the country of source.¹⁵ Importantly, the four economists recognized that capital-importing nations would not fare as well under the residence-based approach and therefore recommended that such division of taxing jurisdiction only made sense where countries had similar economies.¹⁶

Several years later in 1928, the League of Nations drafted model bilateral income tax treaties for the relief of double taxation, which were influenced by the 1923 Report as well as other precedents.¹⁷ The League of Nations treaty was generous to the residence country, allocating investment income principally to that country.¹⁸ Although the source country had taxing jurisdiction over business income, such jurisdiction was limited to instances where the enterprise had a permanent establishment.¹⁹

The League of Nations treaty rejected an earlier model treaty, which would have utilized a methodology to split profits between source and residence countries in accordance with criteria such as sales.²⁰ In so doing, it catered to the mercantilist countries, who wished to tax more income as countries of residence rather than allocate income to where economic activity occurred.²¹ The rationale for this framework was premised on the “mercantilist belief that imperial countries were the source of

14. *Id.* at 18.

15. See Robert A. Green, *The Future of Source-Based Taxation of the Income of Multinational Enterprises*, 79 CORNELL L. REV. 18, 22 (1993).

16. *1923 Report*, *supra* note 12, at 48–49.

17. Graetz & O’Hear, *supra* note 8, at 1078 (emphasizing the 1923 Report, along with other sources such as the early U.S. international tax legislation and the work of the International Chamber of Commerce, as influences on the League of Nations treaty).

18. See *Report Presented by the General Meeting of Governmental Experts on Double Taxation and Tax Evasion*, League of Nations Doc. C.562.M.178. 1928.II.A., at 16–17 (1928).

19. *Id.* at 16.

20. Bret Wells & Cym H. Lowell, *Income Tax Treaty Policy in the 21st Century: Residence v. Source*, 5 COLUM. J. TAX L. 1, 6 (2013).

21. *Id.* at 34. As Wells & Lowell note, the discussion in the archives with regard to the political realities was “amazingly frank.” *Id.* The framers of the treaty all seemed to be aware that capital exporting nations were benefitting from the choice at the expense of the colonized.

capital and know-how while the colonies were passive suppliers of goods or services with little value-added functionality.”²²

The 1928 model treaty served as the backbone of the tax treaty network, influencing the model income tax treaties of the Organization for Economic Cooperation and Development (OECD), the United Nations, and the United States. The international tax system evolved such that the default was source-based taxation with treaties as an elective, bilateral mechanism for countries to shift to residence-based taxation.²³ Even today, the more than 3000 bilateral income tax treaties have a fundamental structure based on the League of Nations treaty.²⁴ This residence-based approach to taxation has since been embraced by the United States Treasury Department numerous times²⁵ and, more generally, through the United States’ adherence to the double income tax treaty system.²⁶

The world has obviously changed since the 1920s, with a massive growth in international capital flows, the creation of the global economy, and the rise of the multinational corporation. All of these developments increase the stakes at issue but also underscore that the foundations of the international tax system—the categories of source and residence—are inherently malleable concepts. Multinational corporations can avoid taxa-

22. *Id.* at 10.

23. Rosenzweig, *supra* note 10, at 741–42.

24. See Reuven S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301, 1303 (1996). The UN Model treaty gives more generous taxing rights to source countries, but it is fundamentally based on the OECD Model, and its influence has been limited. Sergio André Rocha, *International Fiscal Imperialism and the “Principle” of the Permanent Establishment*, 64 BULL. FOR INT’L TAX’N 1, 2 (2014).

25. DAVID F. BRADFORD & U.S. TREASURY TAX POLICY STAFF, BLUEPRINTS FOR BASIC TAX REFORM 89–90 (2d ed., rev. 1984); *Selected Tax Policy Implications of Global Electronic Commerce*, DAILY TAX REP. (BNA) No. 226, Nov. 22, 1996, at 16; see also EXEC. OFFICE OF THE PRESIDENT, THE PRESIDENT’S TAX PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH, AND SIMPLICITY (1985) (proposing residence-based taxation).

26. To be sure, the origins of the international tax system are not neat and tidy. The foreign tax credit rules of the early international tax system, for instance, were swayed by a key Treasury advisor, T.S. Adams, who argued for the primacy of source-based rather than residence-based taxation. Graetz & O’Hear, *supra* note 8, at 1027. Although residence-based taxation has reigned supreme since the dawn of the tax treaty system, this is more of a departure from, rather than a continuation of, the original international tax rules of the United States. *Id.* at 1027–28.

tion by shifting capital income and IP to tax havens and by arbitrating differences in tax systems. The transfer pricing regime that attempts to stop profit shifting is premised on a legal fiction, dividing an economic firm into legal units from various countries, that thus far has proven unenforceable.²⁷ Finally, competition for investment and capital has created aggressive tax competition, leaving many nations starved for revenue.²⁸

It thus is worth examining whether the approach to international tax embodied in the treaty system continues to be relevant. For decades, the international tax system was praised as “remarkably stable and successful,”²⁹ but few would conclude that this continues to be the case.

B. PURPOSES AND FEATURES OF TAX TREATIES

Tax treaties have stated and unstated purposes. First and foremost among the former, tax treaties are designed to eliminate double taxation.³⁰ Double taxation occurs when more than one country lays claim to taxing an item of income.³¹ Tax treaties attempt to deal with double taxation by either (1) limiting source country taxation on investment income or business income that

27. Patricia Gimbel Lewis, *What You Really Need To Know About Transfer Pricing*, CORP. COUNS. BUS. J. (June 25, 2012), <https://ccbjournal.com/articles/what-you-really-need-know-about-transfer-pricing> [<https://perma.cc/PF94-92TH>] (“The proliferation of transfer pricing rules and their enforcement around the world threatens to strangle our tax system and that of other countries in trying to administer these rules.”).

28. Michael J. Graetz, *Foreword—The 2017 Tax Cuts: How Polarized Politics Produced Precarious Policy*, 128 YALE L.J.F. 315, 328 (2018).

29. Graetz & O’Hear, *supra* note 8, at 1026; *see also* Jones, *supra* note 1, at 2.

30. Almost all tax treaties emphasize their purpose of avoiding double taxation by stating in the recital of the treaty the following: “Convention Between the United States of America and ___ for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.” Philip F. Postlewaite & David S. Makarski, *The A.L.I. Tax Treaty Study—A Critique and a Modest Proposal*, 52 TAX L. 731, 734 n.2 (1999). The OECD Model Convention makes no explicit mention of avoiding double taxation, but did so until 1977. MODEL TAX CONVENTION ON INCOME AND ON CAPITAL I-7 (ORG. FOR ECON. COOPERATION & DEV., 2017) [hereinafter OECD MODEL TREATY]. The preamble to the treaty was changed not to reject that purpose but to account for the fact that the treaty also addressed other concerns as well. *Id.*; Mitchell A. Kane, *International Tax Reform, the Tragedy of the Commons, and Bilateral Tax Treaties* 42 (May 1, 2018) (unpublished manuscript) (on file with author).

31. Marius Eugene Radu, *International Double Taxation*, 62 PROCEDIA SOC. & BEHAV. SCI. 403, 403 (2012).

lacks a significant and continuous presence in the source country (the permanent establishment requirement), (2) requiring the residence country to provide an exemption of foreign source income or a tax credit for foreign taxes paid, or (3) coordinating the rules of both countries.³² Tax treaties further establish competent authority procedures, and, more recently, binding arbitration, such that tax authorities commit to resolving issues of double taxation.³³ Tax treaties also endeavor to refine definitions of residency to reduce instances of double taxation.³⁴

Another stated goal of tax treaties is to limit fiscal evasion. Treaties attempt to achieve this through information sharing provisions, which require tax authorities to disclose information to one another regarding taxpayers residing in one country who have tax obligations in the other country.³⁵ These provisions typically override domestic confidentiality laws that bar governments from releasing tax information.³⁶ This enables the residence country to more readily identify foreign source income of its residents.

In recent years, tax treaties have been critiqued for focusing solely on double taxation rather than double non-taxation, which has plagued the international tax system in recent decades.³⁷ In response to these concerns, there are efforts to revise the stated purposes of treaties. As a result of the OECD/G20's project

32. Rosenzweig, *supra* note 10, at 729, 739–40; *see, e.g.*, UNITED STATES MODEL INCOME TAX CONVENTION art. 23 (U.S. DEP'T OF THE TREASURY, 2016) [hereinafter U.S. MODEL TREATY] (“[D]ouble taxation will be relieved as follows . . . In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income applicable to residents and citizens: . . . the income tax paid or accrued to [the other treaty country] by or on behalf of such resident or citizen . . .”).

33. U.S. MODEL TREATY, *supra* note 32, art. 25.

34. *See, e.g., id.* art. 4.

35. *See, e.g., id.* art. 26 (requiring the competent authorities of each treaty party to share information that would assist in carrying out the treaty provisions or domestic tax laws).

36. *See* ORG. FOR ECON. CO-OPERATION & DEV., KEEPING IT SAFE: THE OECD GUIDE ON THE PROTECTION OF CONFIDENTIALITY OF INFORMATION EXCHANGED FOR TAX PURPOSES 11 (2012).

37. This dynamic partially stems from tax competition, which distorts the allocation of capital and results in revenue losses worldwide. Reuven S. Aviyonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1576–78 (2000).

against Base Erosion and Profit Shifting (BEPS project), a multilateral instrument has been developed to update existing tax treaties to conform to treaty-related minimum standards and to close gaps with existing rules. The multilateral instrument allows countries to choose among various off-the-shelf updates to existing tax treaties.³⁸ Through a novel matching process, if a country's partners in existing tax treaties also choose a particular change, the treaty is automatically updated subject to domestic ratification procedures.³⁹

The new instrument provides an option whereby treaty countries can adopt a preamble that commits to the elimination of double taxation "*without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.*"⁴⁰ It implements this language through rules such as minimum standards limiting treaty shopping, a new anti-abuse standard, and rules against hybrid mismatches.⁴¹ The United States Treasury indicated that the United States did not sign the instrument, in part, because U.S. domestic tax provisions, as well as its negotiating position for a number of years, already limit treaty shopping and abuse.⁴² Sixty-eight countries and jurisdictions have, however, signed on to the effort.⁴³

38. See ORG. FOR ECON. CO-OPERATION & DEV., *supra* note 4 (providing options a party may apply to its tax treaties).

39. See ORG. FOR ECON. CO-OPERATION & DEV., MULTILATERAL INSTRUMENT MATCHING DATABASE, <https://www.oecd.org/tax/treaties/MLI-database-disclaimer-and-manual.pdf> [<https://perma.cc/36GF-RQAU>].

40. ORG. FOR ECON. CO-OPERATION & DEV., *supra* note 4, art. 6, ¶ 1 (emphasis added). The multilateral instrument further provides that the participating countries can amend their treaties preamble to include a desire "to develop an economic relationship" between the treaty countries or "to enhance their co-operation in tax matters." *Id.* art. 6, ¶ 3.

41. *Id.* art. 7.

42. See Jessica Silbering-Meyer, *68 Sign the Multilateral Instrument*, REUTERS: ANSWERS FOR TAX PROF. (Oct. 25, 2017), <https://blogs.thomsonreuters.com/answerson/68-sign-the-multilateral-instrument-mli/> [<https://perma.cc/84RF-XDZA>]. Treaty shopping provisions are aimed at reducing the ability of residents of non-treaty party jurisdictions to obtain benefits of the treaties. ORG. FOR ECON. CO-OPERATION & DEV., *supra* note 4, at 8. The new anti-abuse rule is formulated as a general test whereby the "principal purpose" of transactions have to be unrelated to obtaining treaty benefits. *Id.* at 23. The hybrid mismatch rules aim to neutralize the ability for taxpayers to produce multiple deductions for a single expense or to obtain a deduction in one jurisdiction with no offsetting income inclusion in another jurisdiction. *Id.* at 84.

43. *Five Things To Know About the OECD's Multilateral Instrument*, DAILY TAX REP. (BNA) No. 116, June 16, 2017, at 11.

Although the treaties themselves, as well as treaty commentaries, refer to the elimination of double taxation as their primary goal, some commentators have emphasized that modern tax treaties have focused primarily on the reduction of withholding taxes.⁴⁴ Although addressing double taxation necessarily leads to a reduction in tax liability, the inverse is not true. Thus, tax treaties may simply reduce tax rates without addressing double taxation.⁴⁵

The following chart summarizes the main features of tax treaties and specifies the corresponding article of the treaties. In Part V, I revisit this chart to discuss which articles of the treaties should be maintained or should be unraveled. I refer to features 2 and 3, which together limit source country taxation over business and investment income, as the “jurisdictional provisions” of tax treaties. These provisions are the primary subject of my critique.

Main Treaty Features	Article Number ⁴⁶
1. Residency Rules/Limitation on Benefits	Articles 4, 22
2. Permanent Establishment Requirement (Jurisdictional Provision)	Articles 5, 7
3. Limiting Source Country Withholding Tax on Investment Income (Jurisdictional Provision)	Articles 10–13
4. Alleviation of Double Tax Requirements	Article 23
5. Non-Discrimination Provisions	Article 24
6. Transfer Pricing/Dispute Resolution	Article 25
7. Information Exchange Provisions	Article 26

44. See, e.g., Patrick Driessen, *Is There a Tax Treaty Insularity Complex?*, 135 TAX NOTES 745, 748 (2012).

45. *Id.*

46. The Articles in the chart refer to U.S. MODEL TREATY, *supra* note 32.

C. THE DOMESTIC RULES ON INTERNATIONAL TAXATION

1. Worldwide v. Territorial

Tax treaties lack operative provisions of law. Instead, they mostly function as jurisdictional overlays to the domestic rules of taxation, restricting a state's claim to tax a certain item of income.⁴⁷ Tax treaties limit the domestic rules by allocating the right to tax income to one treaty country or by requiring relief from double taxation.⁴⁸ Importantly, a tax treaty does not create tax obligations, which are created by the operative domestic law.⁴⁹ Additionally, under the "savings" clause of the treaties, the residence countries retain the right to tax worldwide income.⁵⁰ Thus, the curtailment of source country jurisdiction only applies to foreign nationals, not to a resident of the contracting state.

The domestic rules of international tax are as varied as the number of countries that employ them, but a few generalizations can be made. Commentators refer to two different types of international tax systems: worldwide and territorial.⁵¹ A worldwide system of taxation subjects foreign earnings to taxation, typically with relief of double taxation through a foreign tax credit.⁵² A territorial system of taxation exempts such earnings altogether.⁵³

The majority of developed countries have shifted, in recent decades, towards territoriality.⁵⁴ In reality, however, the distinction between territorial systems and worldwide systems is blurred, and the systems exist along a continuum.⁵⁵ Developed

47. Rebecca M. Kysar, *Interpreting Tax Treaties*, 101 IOWA L. REV. 1387, 1411 (2016).

48. For instance, Article 12 of the U.S. Model Treaty provides only the country of residence can tax royalty income. U.S. MODEL TREATY, *supra* note 32, art. 12. Article 23 requires the provision of tax credits to alleviate double taxation. *Id.* art. 23.

49. *See* Kysar, *supra* note 47, at 1411.

50. U.S. MODEL TREATY, *supra* note 32, art. 24, ¶ 4.

51. *See, e.g.,* J. Clifton Fleming, Jr. et al., *Expanded Worldwide Versus Territorial Taxation After the TCJA*, 161 TAX NOTES 1173, 1173 (2018).

52. *Id.* at 1174.

53. *Id.*

54. *See, e.g., id.* at 1175.

55. *See* MARK P. KEIGHTLEY & JEFFREY M. STUPAK, CONG. RESEARCH SERV., R44013, CORPORATE TAX BASE EROSION AND PROFIT SHIFTING (BEPS): AN EXAMINATION OF THE DATA 17–18 (2015) (discussing the futility of the

countries with territorial systems, for instance, have anti-profit shifting rules that tax certain types of highly mobile foreign income, which are presumed to be located offshore simply for tax reasons.⁵⁶ These foreign systems could thus be more properly described as quasi-territorial. The United States' international tax system, both new and old, also lies on a spectrum, as discussed below.

2. The U.S. Rules—Pre- and Post-2017

Experts often referred to the former U.S. international tax system as worldwide since it subjected foreign earnings to U.S. taxation.⁵⁷ However, the former system never fully taxed these earnings. Taxation could be deferred, even indefinitely, by parking active income in foreign subsidiaries.⁵⁸ In contrast, taxation could not be deferred on passive income, which was, and still is, taxed on a current basis under the anti-deferral rules of subpart F and the passive foreign investment company regime.⁵⁹ Additionally, the transfer pricing regime attempted to prevent companies from shifting too much income abroad to their foreign affiliates by charging non-arm's length prices. These rules are notoriously ineffective, yet they continue to be relevant under the new system.

Since the taxation of foreign source income by the United States might subject such income to double taxation, the United States has long offered a foreign tax credit for foreign taxes paid

worldwide and territorial labels); Daniel N. Shaviro, *The New Non-Territorial U.S. International Tax System*, 160 TAX NOTES 57, 57 (2018).

56. Such rules commonly take the form of controlled foreign corporation (CFC) rules, which provide for current inclusion of income from closely held corporations. Although historically the province of worldwide tax systems, in 1980, France adopted CFC rules to combat abuses of its territorial system. Sebastian Dueñas, *CFC Rules Around the World*, TAX FOUND. 5 (June 2019), <https://files.taxfoundation.org/20190617100144/CFC-Rules-Around-the-World-FF-659.pdf> [<https://perma.cc/3VC9-4TG3>].

57. *Territorial vs. Worldwide Taxation*, SENATE REPUBLICAN POL'Y COMM. (Sept. 19, 2012), <https://www.rpc.senate.gov/policy-papers/territorial-vs-worldwide-taxation> [<https://perma.cc/U7XN-D6LW>].

58. See *U.S. Tax Reform: A Guide to Income Tax Accounting Considerations*, ERNST & YOUNG: GLOBAL TAX ALERT 7 (Dec. 12, 2017), [https://www.ey.com/Publication/vwLUAssets/US_tax_reform_-_A_guide_to_income_tax_accounting_considerations/\\$FILE/2017G_07168-171Gbl_US%20tax%20reform%20A%20guide%20to%20income%20tax%20accounting%20considerations.pdf](https://www.ey.com/Publication/vwLUAssets/US_tax_reform_-_A_guide_to_income_tax_accounting_considerations/$FILE/2017G_07168-171Gbl_US%20tax%20reform%20A%20guide%20to%20income%20tax%20accounting%20considerations.pdf) [<https://perma.cc/CD5L-78D8>].

59. See 26 U.S.C. §§ 951, 1291 (2018).

on such income. The credit was first enacted in 1918,⁶⁰ long before the United States' entrance into its first tax treaty in 1932.⁶¹ The effect of the credit is such that the United States collects residual taxation when its tax rate exceeds the foreign rate.⁶² When the foreign rate equals or exceeds the U.S. rate, U.S. tax liability is eliminated.⁶³

The new regime has been labeled a territorial system because the foreign income of foreign subsidiaries can escape taxation altogether through the new participation exemption provision.⁶⁴ Here again, however, the territorial label fails since individuals, branches, and smaller shareholders are still subject to taxation on foreign income. Furthermore, there is a minimum tax regime, called the global intangible low tax income, or "GILTI" regime, which subjects some foreign income of 10% corporate shareholders to a current 10.5% tax (and allows a foreign tax credit offset for 80% of foreign taxes paid).⁶⁵ Lawmakers created these worldwide features since a move to pure exemption, as opposed to deferral, would have worsened incentives to shift income abroad.

In addition to the participation exemption and minimum tax regimes, the 2017 tax legislation also enacted two other notable reforms. In the foreign derived intangible income, or "FDII" regime, Congress provided a special low rate on export income.⁶⁶ Through the base erosion anti-abuse tax, or "BEAT" regime, the legislation also bolstered source-based taxation by targeting profit stripping by U.S. firms making deductible payments to foreign affiliates.⁶⁷ The BEAT subjects such payments to a minimum tax of 10%.⁶⁸ Features of these new rules are in arguable tension with bilateral tax treaties,⁶⁹ a point which will be treated more fully below.

60. See Revenue Act of 1918, ch. 18, 40 Stat. 1057 (1919).

61. See Herbert I. Lazerow, *The United States-French Income Tax Convention*, 39 FORDHAM L. REV. 649, 649 n.1 (1971).

62. Elisabeth A. Owens, *United States Income Tax Treaties: Their Role in Relieving Double Taxation*, 17 RUTGERS L. REV. 428, 432 (1963).

63. *Id.*

64. This is the case so long as the domestic shareholder owns at least 10% of the stock of the subsidiary. 26 U.S.C. § 245A (2018).

65. *Id.* §§ 250(a)(1), 951A, 960.

66. *Id.* § 250.

67. *Id.* § 59A.

68. *Id.*

69. See *supra* notes 23–24 and accompanying text.

II. DISCARDING PURPORTED PURPOSES OF TAX TREATIES

As mentioned above, there are both stated and unstated purposes of tax treaties.⁷⁰ The treaties themselves set forth double taxation relief and the prevention of fiscal evasion as their aims, yet commentators have hypothesized other motivations behind the treaties as well. Part II explores how all of these goals go largely unfilled.

A. ALLEVIATION OF DOUBLE TAXATION

1. Availability of Unilateral Relief

The need to alleviate double taxation served as the impetus for the tax treaty regime.⁷¹ The conventional account is that, without tax treaties, multiple countries will lay claim to the same item of income.⁷² The predominant explanation for why we care about double taxation is that it “represents an unfair burden on existing investment and an arbitrary barrier to the free flow of international capital, goods, and persons.”⁷³

Tsilly Dagan has illustrated, however, that even without tax treaties, countries have incentives and mechanisms to alleviate double taxation unilaterally.⁷⁴ Instead, Dagan argues that tax treaties serve “much less heroic goals,” such as easing administrative burdens and harmonizing tax terminology.⁷⁵ More nefariously, Dagan contends tax treaties shift revenues from developing to developed countries.⁷⁶ The IMF has agreed with Dagan’s

70. See *supra* Part I.

71. See *supra* Part I.B.

72. *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Canada: Hearing Before the S. Comm. on Foreign Relations*, 105th Cong. 4 (1997) (“The traditional objectives of U.S. tax treaties have been the avoidance of international double taxation and the prevention of tax avoidance and evasion.”); OECD MODEL TREATY, *supra* note 30, at I-5 (“[A] main objective of tax treaties is the avoidance of double taxation in order to reduce tax obstacles to cross-border services, trade and investment . . .”).

73. H. David Rosenbloom & Stanley I. Langbein, *United States Tax Treaty Policy: An Overview*, 19 COLUM. J. TRANSNAT’L L. 359, 365–66 (1981).

74. Dagan, *supra* note 1, at 941.

75. *Id.* at 939.

76. *Id.*

view, noting that tax treaties based on the OECD model “significantly constrain the source country’s rights” and cautions against developing countries entering into such treaties.⁷⁷

Dagan concludes tax treaties involve something other than elimination of double taxation.⁷⁸ U.S. and global history lends support to Dagan’s conclusion. The United States enacted the foreign tax credit almost fifteen years before entering into tax treaties.⁷⁹ And the credit applies to residents of non-treaty and treaty countries alike. Today, most countries include in their tax

77. INT’L MONETARY FUND, IMF POLICY PAPER: SPILLOVERS IN INTERNATIONAL CORPORATE TAXATION 12 (2014), <https://www.imf.org/external/np/pp/eng/2014/050914.pdf> [<https://perma.cc/4AHY-44VB>]; see also Mindy Herzfeld, *The Case Against BEPS: Lessons for Tax Coordination*, 21 FLA. TAX REV. 1, 16–17 (2017). Predating Dagan’s analysis by several decades were comments by Elisabeth Owens who, focusing on the United States, argued that “tax treaties play a very marginal role in relieving double taxation” because “the U.S. has unilaterally provided for the avoidance of double taxation . . . through the foreign tax credit provisions of the Internal Revenue Code.” Owens, *supra* note 62, at 430. More recently, commentators have reflected on the diminished role of tax treaties but without much elaboration or normative assessment. Dagan, *supra* note 1, at 945 (making this point); see, e.g., JOSEPH ISENERGH, INTERNATIONAL TAXATION: U.S. TAXATION OF FOREIGN PERSONS AND FOREIGN INCOME 55:2 (2d ed. 2000) (“Tax treaties are principally concerned with the apportionment of tax revenues between the treasuries of the treaty countries.”); see also PAUL R. MCDANIEL & HUGH J. AULT, INTRODUCTION TO UNITED STATES INTERNATIONAL TAXATION 151 (1977) (concluding that double taxation is eliminated through unilateral measures and that tax treaties serve a more modest function of refining these measures to reflect the relationships of the two treaty countries); Pierre Gravelle, *Tax Treaties: Concepts, Objectives and Types*, 42 BULL. FOR INT’L FISCAL DOCUMENTATION 522, 523 (1988) (adopting the view that tax treaties merely “refine[] and improve[]” the domestic mechanisms to alleviate double taxation); Julie Roin, *Rethinking Tax Treaties in a Strategic World with Disparate Tax Systems*, 81 VA. L. REV. 1753, 1766–67 (1995) (arguing that unilateral measures to reduce double taxation has lessened the need for taxpayers to rely on treaty provisions). The ALI, in contrast, has concluded that “[t]here is remarkably broad and well-established consensus among governments of various political and economic persuasions that it is in their interest to enter into income tax treaties.” AM. LAW INST., FEDERAL INCOME TAX PROJECT: INTERNATIONAL ASPECTS OF UNITED STATES INCOME TAXATION II, PROPOSALS ON UNITED STATES INCOME TAX TREATIES 5 (1992). Even the ALI, however, also admitted that many treaty goals can be achieved through domestic legislation, outside of the treaty process. Instead, countries modify their domestic laws only to derive reciprocal dispensations from the other country. *Id.* at 12–13.

78. Dagan, *supra* note 1, at 982–88.

79. See Steven A. Dean, *Philosopher Kings and International Tax: A New Approach to Tax Havens, Tax Flight, and International Cooperation*, 58 HASTINGS L.J. 911, 944 (2007).

treaties the same mechanism for double tax relief that they provide outside of the tax treaty context.⁸⁰

2. Double Taxation Relief Through Harmonization?

The unilateral domestic relief of double taxation through foreign tax credits, deductions, or exemption is not fail-safe. Gaps exist such that double taxation results even in the face of such mechanisms. Do treaties then step in to resolve such matters? If a country taxes domestic source income, then one function of a tax treaty might be to ensure that what constitutes domestic (as opposed to foreign) source income is understood by all parties.⁸¹ In fact, treaties serve no such purposes, instead leaving the definition of source to the domestic rules. Although some treaties contain re-sourcing rules that treat an item of income as foreign source if a treaty partner is permitted to tax it, these rules are not always comprehensive.⁸² This amounts to a significant amount of double taxation that is left to be resolved through the treaty's administrative solutions, such as the mutual agreement procedure and, increasingly, binding arbitration.⁸³ Although such dispute resolution procedures might be important, they need not be accompanied by the shifting of tax jurisdiction between countries and could instead be set forth as standalone agreements.⁸⁴

80. DAGAN, *supra* note 5, at 7.

81. Owens, *supra* note 62, at 430.

82. The U.S. Model Treaty currently has a general re-sourcing rule that is fairly comprehensive. See U.S. MODEL TREATY, *supra* note 32, art. 23(3). It is intended to ensure that a U.S. resident can obtain a foreign tax credit when a treaty partner taxes the item of income in question. U.S. DEPT OF THE TREASURY, TECHNICAL EXPLANATION ACCOMPANYING THE UNITED STATES MODEL INCOME TAX CONVENTION OF NOVEMBER 15, 2006, at 74 (2006), <https://www.treasury.gov/press-center/press-releases/Documents/hp16802.pdf> [<https://perma.cc/4JKZ-RKLZ>]. Many treaties in force, however, have far less comprehensive re-sourcing rules. See TAX SECTION, N.Y. STATE BAR ASS'N, REPORT NO. 1313, REPORT ON TREATY RE-SOURCING RULES 26–27 (2014), https://www.nysba.org/Sections/Tax/Tax_Section_Reports/Tax_Reports_2014/Tax_Section_Report_1313.html [<https://perma.cc/HQU8-525R>] (identifying treaties that either do not have general re-sourcing language or impose limits on the general re-sourcing rules).

83. See U.S. MODEL TREATY, *supra* note 32, art. 25 (describing the mutual agreement procedures for resolving disagreements that arise under the treaty).

84. Brooks & Krever, *supra* note 1, at 166.

Treaties also do not resolve conflicts of characterization, again leaving a significant amount of double taxation in place.⁸⁵ This is because the treaties defer to the domestic rules to assign character of income. For instance, suppose the residence country characterizes income as royalties, thereby concluding that such income is exempt from source country taxation under the treaty and is taxable by the residence country. Further suppose the source country characterizes the income as compensation from personal services, in which case it is rightly subject to taxation by the source country under the treaty. This produces a conflict, which the treaties do not resolve.⁸⁶

Double taxation may also occur because the treaties do not contain a uniform and ascertainable definition of “covered taxes,” or the taxes for which the treaty country must provide relief from double taxation. In the U.S. Model Treaty, for instance, Article 2 states that the treaty applies to “Federal income taxes imposed by the Internal Revenue Code” and also covers “identical or substantially similar taxes that are imposed after the date of [the signing of the treaty] in addition to, or in place of, the existing taxes.”⁸⁷ The term “covered taxes” is notoriously difficult to interpret and, in recent years, has become the subject of intense debate.⁸⁸

85. *Id.* at 168.

86. See *Boulez v. Comm’r*, 83 T.C. 584, 589 (1984) (holding that payments to a music conductor were compensation for services—a category that did not get benefits under the relevant treaty—rather than royalties, which would have been tax-free under the treaty). The U.S. Model Treaty provides that if a term is not defined by the treaty, then the country that is applying the treaty should use its tax law to supply the term’s meaning, “unless the context otherwise requires.” U.S. MODEL TREATY, *supra* note 32, art. 3(2). One interpretation of Article 3(2) is that only the source state can invoke it since it is the one typically applying the treaty. Avery Jones, *supra* note 1, at 18. The residence state, however, could take the position that it should apply its domestic laws in interpreting whether it must give relief for double taxation. *Id.* In such cases, double taxation might ensue. *Id.*

87. U.S. MODEL TREATY, *supra* note 32, art. 2.

88. See Fadi Shaheen, *Income Tax Treaty Aspects of Nonincome Taxes: The Importance of Residence*, 71 TAX L. REV. 583, 607, 609–10, 612–14 (2018); Richard S. Collier & Michael P. Devereux, *The Destination-Based Cash Flow Tax and Double Tax Treaties 7* (Oxford Univ. Ctr. for Bus. Taxation, Working Paper No. 17/06, 2017), <https://eureka.sbs.ox.ac.uk/6808/1/WP1706.pdf> [<https://perma.cc/DU37-CSMC>]. Most recently, whether the new BEAT, enacted in the 2017 U.S. tax legislation, falls within the scope of Article 2 has become an area of live concern given that regime’s only partial creditability of foreign tax credits. See *infra* notes 90–92 and accompanying text.

Avoidance of double taxation is also often not achieved because transactions involve jurisdictions beyond those mentioned in the tax treaties.⁸⁹ Moreover, treaties address only “juridical rather than economic double taxation,” thereby allowing some double taxation to occur.⁹⁰

Tax treaties could resolve many of the above such matters, but the treaty language is often very general and its structure interstitial. This lack of specificity and comprehensiveness is most certainly a conscious choice by the treaty parties, who are reluctant to grant double tax relief in close cases. For the most part, these are precisely the cases not granted relief under domestic law, and so one is left to wonder what tax treaties accomplish that is not already achieved under the domestic law.

3. Double Taxation as Red Herring

Even if tax treaties were necessary to avoid double taxation, it is unclear whether that goal should be pursued. To achieve double taxation relief would require more complete coordination, which may be undesirable given the centrality of taxation to the governmental function. As Daniel Shaviro has argued outside of the treaty context, nations may be reluctant to forfeit their independence in this area.⁹¹ Additionally, defining source “correctly” is, in many contexts, a fool’s errand: economically speaking, multiple and overlapping jurisdictions generate income.⁹² Finally, Shaviro argues that the principle of taxing all income once will

89. See EMILY FETT, TRIANGULAR CASES: THE APPLICATION OF BILATERAL INCOME TAX TREATIES IN MULTILATERAL SITUATIONS 20 (2014); Ruth Mason, *U.S. Tax Treaty Policy and the European Court of Justice*, 59 TAX L. REV. 65, 113–14 (2005).

90. Yariv Brauner, *Treaties in the Aftermath of BEPS*, 41 BROOK. J. INT’L L. 973, 986 (2016); see also Wei Cui, *Minimalism About Residence and Source*, 38 MICH. J. INT’L L. 245, 266–67 (2017) (arguing that the focus on double taxation overlooks the economic incidence of taxes). Juridical double taxation is when the same taxpayer has to pay tax twice on the same income. FETT, *supra* note 89, at 60. Economic double taxation occurs when different taxpayers have to pay tax twice on the same income. *Id.*

91. SHAVIRO, *supra* note 5, at 113.

92. *Id.*; see also Hugh J. Ault & David F. Bradford, *Taxing International Income: An Analysis of the U.S. System and Its Economic Premises*, in TAXATION IN THE GLOBAL ECONOMY 11, 30 (Assaf Razin & Joel Slemrod eds., 1990) (contending that “source” lacks economic foundation). *But see* Mitchell A. Kane, *A Defense of Source Rules in International Taxation*, 32 YALE J. ON REG. 311, 323 (2015) (defending the coherence of source rules although not necessarily on economic grounds).

likely not enhance global efficiency.⁹³ This is because countries vary in their tax rates; therefore, taxing income once, and only once, does not yield any locational neutrality in investment decisions.⁹⁴ Instead, taxpayers will decide where to conduct activity based on where the lowest tax rate can be obtained.⁹⁵ In the real world, because of differences in tax regimes, double taxation of income may even *increase* global efficiency, if, for instance, this would create neutrality between a taxpayer facing a 40% rate in Country A versus a 20% rate in Country B.⁹⁶

Shaviro, however, goes on to conclude that the avoidance of double taxation may nonetheless be a worthy goal of bilateral tax treaties if the treaty countries have the same tax rates and equal cross-border capital flows.⁹⁷ In that situation, the avoidance of double taxation creates economic surplus by establishing neutrality between single-country and cross-country income.⁹⁸ Because the countries are similarly situated, the concessions made by Country A in the above example in forgoing taxation of Country B's residents are balanced by Country B's similar concessions regarding its own residents.⁹⁹

In reality, however, it is extremely unlikely that the two countries will be identically situated, both in tax rates and investment flows.¹⁰⁰ This is especially true over time.¹⁰¹ Moreover, even if such homogeneity exists, the existence of tax havens creates imbalance between the two countries since it is likely that one country's rules allow for more or less income-shifting to such havens.¹⁰² It is thus unclear what goal the avoidance of double taxation is serving, even in the treaty context. Indeed, the heterogeneity of treaty countries may explain the above observa-

93. SHAVIRO, *supra* note 5, at 114.

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* at 115.

98. *Id.*

99. *Id.*

100. See Elke Asen, *Corporate Tax Rates Around the World, 2019*, TAX FOUND. (Dec. 10, 2019), <https://taxfoundation.org/publications/corporate-tax-rates-around-the-world/> [<https://perma.cc/QQ6N-HBFM>] (examining global tax rate data).

101. See *id.* (discussing global tax rate changes since 1980).

102. SHAVIRO, *supra* note 5, at 115–16.

tion—that treaties do not in fact ameliorate double taxation. Doing so would serve no efficiency goal nor would it be of equal desirability to each country.

Another recent debate in the academic literature exposes what little work the concept of double taxation accomplishes in the treaty network. Recent proposals to reform the U.S. international tax system deviate from the model of full creditability of foreign taxes under a worldwide system.¹⁰³ Shaviro, for instance, has proposed a reduced rate for foreign source business income and the allowance of a deduction, rather than a credit, for foreign taxes paid.¹⁰⁴ Part of Shaviro's rationale stems from the conclusion that the foreign tax credit's 100% marginal reimbursement rate (MRR) problematically makes taxpayers insensitive to foreign tax rates.¹⁰⁵ This insensitivity is against the national interest because the U.S. government ends up footing the bill for higher taxes abroad. Shaviro's approach is similar to other proposals, such as Option Z and that of the former Obama administration.¹⁰⁶ It also has been partially implemented in the 2017 legislation through the GILTI regime, which allows foreign tax credits of only 80%.¹⁰⁷

It is an open issue whether these proposals or the GILTI regime comply with Article 23 of the treaties, but there is a persuasive argument that incarnations of them do.¹⁰⁸ Historically, the foreign tax credit has reduced tax liability dollar for dollar.¹⁰⁹ Fadi Shaheen argues, however, that it is acceptable to divide a

103. See, e.g., Daniel N. Shaviro, *Rethinking Foreign Tax Creditability*, 63 NAT'L TAX J. 709, 710 (2010) (arguing for deductibility of foreign source income rather than full creditability); see also Michael J. Graetz & Itai Grinberg, *Taxing International Portfolio Income*, 56 TAX L. REV. 537, 570 (2003) (reaching similar conclusions for foreign taxes on passive income).

104. Shaviro, *supra* note 103.

105. *Id.*

106. Shaviro himself notes these similarities. See Daniel Shaviro, *Response to Comments on Fixing U.S. International Taxation*, 9 JERUSALEM REV. LEGAL STUD. 132, 140–41 (2014) [hereinafter Shaviro, *Response*]; Daniel Shaviro, *The Crossroads Versus the Seesaw: Getting a "Fix" on Recent International Tax Policy Developments*, 69 TAX L. REV. 1, 38–39 (2015) [hereinafter Shaviro, *Crossroads*].

107. 26 U.S.C. § 960(d)(1) (2018).

108. Article 23 requires either exemption or a credit for foreign taxes. U.S. MODEL TREATY *supra* note 32, art. 23.

109. Shaviro, *Response*, *supra* note 106, at 709.

dollar of foreign source income and allow credits on only a portion of the dollar so long as the other portion is exempted.¹¹⁰ Option Z would have followed this approach explicitly, providing that foreign source income was 60% taxable with foreign tax credits and 40% exempt.¹¹¹ Shaheen's argument is that, under both the U.S. and OECD model treaties, these types of proposals are treaty-compliant so long as the exempt piece and the creditable piece of the income add up to at least 100%.¹¹² GILTI is a variation of this approach, albeit more generous, since it is taxing only 50% of foreign source income while allowing foreign tax credits for 80% of foreign taxes paid.¹¹³

Mitchell Kane agrees with Shaheen's general conclusion that, so long as the income can be separated into exempt and creditable portions, a mixture of these two approaches is treaty-compliant.¹¹⁴ Kane goes further to add that treaties prevent the resident country from causing its residents' foreign source income to be taxed at a higher rate than domestic source income (taking into account both countries' taxes).¹¹⁵ This means that if the source country imposes a higher tax than the residence country, then the residence country cannot impose any residence-based tax. If the source country taxes at a lower rate, then the residence country can tax the shortfall, but only up to its rate on domestic source income.

Drawing upon League of Nations documents, Kane argues that double taxation does not really mean double taxation.¹¹⁶ Instead, in the treaty sense, the relevant inquiry is simply whether the overall tax burden exceeds what would have been imposed by the residence country on domestic source income.¹¹⁷ Tax treaties, in other words, are about capping rates rather than double taxation per se. In pursuing this goal, they strive towards a particular result rather than a particular method.¹¹⁸

110. Fadi Shaheen, *How Reform-Friendly Are U.S. Tax Treaties?*, 41 *BROOK. J. INT'L L.* 1243, 1269–70 (2016).

111. *Id.* at 1278.

112. *Id.* at 1278–79.

113. JANE G. GRAVELLE & DONALD J. MARPLES, *CONG. RESEARCH SERV.*, R45186, *ISSUES IN INTERNATIONAL CORPORATE TAXATION: THE 2017 REVISION* (P.L. 115-97), at 4 (2019).

114. Kane, *supra* note 30, at 28–29.

115. *Id.* at 41.

116. *Id.* at 47.

117. *Id.*

118. *Id.*

Under this framework, what obligation to credit foreign taxes does the residence country have when it imposes a lower rate on foreign source income than it does on domestic source income? Kane admits this is a question that the treaty drafters did not specifically contemplate, but using the above framework, this set of facts should reduce the burden of juridical double taxation and the corresponding obligation arising under Article 23.¹¹⁹ In such cases, Kane reasons that a partial credit, rather than a dollar for dollar credit, will satisfy Article 23 so long as the overall tax burden does not exceed that imposed on domestic source income.¹²⁰

Both Kane's and Shaheen's analysis seem to suggest that Article 23's central concern is aggregate tax burden rather than the method of double tax relief, albeit Kane's conclusion is more explicit in this regard. If double taxation seems like a normatively empty goal, does aggregate tax burden fare any better? It would seem, after all, that investors care about the overall level of tax they are paying rather than whether income is technically taxed once, twice, or multiple times. Double taxation could lead to better tax results than single taxation, if, for instance, two countries imposed a 10% tax and a single country imposed a 30% tax on an item of income.

It seems rational, then, that countries should care more about overall taxation rather than double taxation. It also seems in the countries' interest to preserve a mixture of double tax relief methods, as Kane concludes.¹²¹ From the perspective of the residence country, worldwide taxation with full foreign tax credit relief cuts off tax competition since the source country cannot set the tax burden on the foreign source income.¹²² In contrast, under an exemption system, the source country can do so.¹²³ But the former system also makes its investors insensitive to local tax rates and may overly burden its residents. From the perspective of the source country, it may prefer residence country exemption since it gets to set the tax rates, however, the source country may also enjoy the ability to increase revenues without

119. *Id.* at 50.

120. *Id.*

121. *Id.* at 52.

122. *Id.* at 54.

123. *Id.*

the foreign resident facing an increased tax burden, as is possible under the credit system.¹²⁴

In Kane's view, both residence and source countries would prefer a treaty that preserves policy mixture so that they can balance these various and competing goals, rather than a system that forces them into pure credit or pure exemption approaches.¹²⁵ And, under Kane's view, the former system is indeed what we have.¹²⁶ Kane is likely right that a hybrid approach to international taxation makes the most sense strategically and indeed is reflected in the treaties and nearly all international tax systems. But a further question arises as to whether the treaty is doing any work here.

If it is in the unilateral interest of both nations to have a mixed system, then that is likely what will arise without tax treaties. Indeed, the flexibility of the treaties, as interpreted by Kane and Shaheen, means that neither nation has settled upon which degree of rate competition versus revenue collection they would prefer, instead leaving it up to the domestic policies of the residence country. The source country, in other words, remains beholden to the policy choices of the treaty partner.

One concession that the source country does obtain, at least under Kane's view, is that overall taxation will be capped at the residence country's tax rate on domestic source income.¹²⁷ Query, however, whether this is any sort of meaningful promise. Overall taxation still depends on the domestic rates of the residence country; nothing in the treaty prevents very high taxation so long as the residence country also imposes such rates on domestic source income. There are political and practical constraints, however, on the ability of the residence country to tax foreign source income more heavily than domestic source income.

In fact, it is generally the opposite that we worry about—that foreign source income goes *undertaxed* by the residence country. This outcome results because there are convincing reasons a residence country would prefer to more lightly tax foreign source income than domestic source income.¹²⁸ While location-specific rents, as well as a robust labor market, might support a

124. *Id.* at 55.

125. *Id.*

126. *Id.*

127. *Id.* at 54–55.

128. Shaviro, *Crossroads*, *supra* note 106, at 10–11.

high U.S. tax rate on domestic source income, such factors likely do not support taxation of foreign source income at the same levels.¹²⁹ In other words, it is efficient for a country to tax foreign source income at a lower rate than domestic source income because it can exercise its market power more with respect to the latter, thereby making the former more tax-elastic.¹³⁰ On the other hand, the residence country should prefer to impose *some* degree of taxation on a resident company's foreign source income since doing so discourages profit-shifting and also brings in revenues.¹³¹

Perhaps because of this balancing act, every tax system unilaterally seems to tax foreign source income of resident companies more lightly than domestic source income.¹³² In the old worldwide system, the United States' tolerance of deferral effectively created a disparity in the rates on domestic and foreign source income, favoring the latter.¹³³ Under the new system, that choice is more explicit, with foreign source income obtaining a 50% deduction.¹³⁴ And in pure territorial systems, active foreign source income is exempt.¹³⁵ Thus, it seems that this purported goal for tax treaties—to constrain the top rate residence countries can impose on foreign source income—would likely be achieved in the absence of the treaties. Although Kane and Shaheen's careful work is helpful in detailing how tax treaties can accommodate partial creditability of foreign taxes, we have yet to find a good reason for tax treaties in the first place.

In short, without the concept of double taxation as a guide for setting jurisdictional limits, there does not seem to be any basis to have strict reciprocity of rates through a bilateral solution. Domestic legislation could instead achieve lower withholding rates. Reciprocity, as a goal of tax treaties, comes under further scrutiny when one examines the asymmetry of investment flows and tax systems, as discussed below.¹³⁶

129. *Id.*

130. *Id.*

131. Shaviro, *supra* note 55, at 63.

132. Shaviro, *Response*, *supra* note 106, at 138.

133. Shaviro, *Crossroads*, *supra* note 106, at 2.

134. 26 U.S.C. § 250 (2018).

135. Shaviro, *supra* note 55, at 57.

136. *See infra* Part II.D.

B. THE PREVENTION OF FISCAL EVASION

The other stated purpose of tax treaties is the prevention of fiscal evasion.¹³⁷ Traditionally, this rationale supported the exchange of relevant information. Article 26, which implements this principle, however, is ineffective. In both the U.S. and OECD Model Treaties, a party does not have to provide information which “is not obtainable under the laws or in the normal course of the administration” or which “would disclose any trade, business, industrial, commercial, or professional secret or trade process.”¹³⁸ For many years, countries like Luxembourg and Switzerland took the position that these carve-outs specifically allowed bank secrecy to trump information exchange.¹³⁹

More generally, a treaty is an odd mechanism to induce banking havens to share information. The United States may care very deeply about wanting information from a banking haven, but there is no reciprocal desire on the haven’s side.¹⁴⁰ They therefore have no incentive to fulfill their agreement.¹⁴¹ Moreover, when evasion spans multiple countries, the bilateral format of the income tax treaty does little to solve the problem.¹⁴²

To the extent exchange of information by international agreement is desirable, there are other means to achieve it. Tax information exchange agreements (TIEAs), based on a 2002 OECD model agreement, allow countries to exchange information on taxpayers without also reallocating taxing jurisdiction.¹⁴³ In their first decade, over 500 TIEAs were signed.¹⁴⁴

137. See, e.g., U.S. MODEL TREATY, *supra* note 32 (entitling the treaty as “for the avoidance of double taxation and the prevention of tax evasion”).

138. *Id.* art. 26(3); OECD MODEL TREATY, *supra* note 30, art. 26(3).

139. Lee A. Sheppard, *Don’t Ask, Don’t Tell, Part 4: Ineffectual Information Sharing*, 53 TAX NOTES INT’L 1139, 1142 (2009).

140. *Id.* at 1140.

141. *Id.*

142. *Id.*

143. ORG. FOR ECON. CO-OPERATION & DEV., AGREEMENT ON EXCHANGE OF INFORMATION ON TAX MATTERS (2002), <https://www.oecd.org/tax/exchange-of-tax-information/2082215.pdf> [<https://perma.cc/K7G3-AK6P>].

144. *Tax Information Exchange Agreements (TIEAs)*, ORG. FOR ECON. CO-OPERATION & DEV., <http://www.oecd.org/tax/exchange-of-tax-information/taxinformationexchangeagreementstieas.htm> [<https://perma.cc/HL5M-NKHW>] (listing such agreements). To be sure, this number includes tax havens signing agreements with one another, expressing a commitment that likely cannot be taken seriously.

Newer tools, like domestic legislation and implementing bilateral agreements, can also be used to yield information exchange. In 2010, for instance, the United States enacted the Foreign Account Tax Compliance Act (FATCA) to stop tax evasion by its residents.¹⁴⁵ FATCA requires foreign banks and financial institutions to provide information on U.S. taxpayers and their financial accounts.¹⁴⁶ The novel feature of FATCA is a 30% withholding tax on U.S. source income paid to taxpayers that have not provided information regarding their residency or identity of their owners.¹⁴⁷

FATCA requirements, in most cases, violated the financial institutions' countries' internal laws.¹⁴⁸ Intergovernmental agreements (IGAs) became necessary to implement FATCA.¹⁴⁹ According to the U.S. Treasury, the United States has agreed to 113 IGAs since 2010.¹⁵⁰ Subsequent to FATCA, the OECD developed the Common Reporting Standard (CRS) based on the IGAs.¹⁵¹ The CRS is an automatic information exchange, which over 100 countries have agreed to implement, and allows other countries to implement FATCA-like obligations with non-U.S. counterparties.¹⁵²

Clearly, FATCA has been a watershed act and, along with the rise of other instruments, calls into question the continuing

145. Though initially introduced as a separate bill, the Foreign Account Tax Compliance Act was passed as part of the Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010). The primary provisions of FATCA relevant to this discussion are codified at 26 U.S.C. § 1471 (2018).

146. 26 U.S.C. § 1471(c).

147. *Id.* § 1471(a).

148. John S. Wisiackas, *Foreign Account Tax Compliance Act: What It Could Mean for the Future of Financial Privacy and International Law*, 31 EMORY INT'L L. REV. 585, 599 (2017).

149. *Id.* at 596.

150. *Foreign Account Tax Compliance Act (FATCA)*, U.S. DEP'T TREASURY, <https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx> [<https://perma.cc/78CB-FJZM>] (last updated Jan. 13, 2020) (listing such agreements). These agreements are at various stages of completion and, in some cases, have only been agreed to in substance.

151. *Major Enlargement of the Global Network for the Automatic Exchange of Offshore Account Information as over 100 Jurisdictions Get Ready for Exchanges*, ORG. FOR ECON. CO-OPERATION & DEV. (May 7, 2018), <http://www.oecd.org/tax/major-enlargement-of-the-global-network-for-the-automatic-exchange-of-offshore-account-information-as-over-100-jurisdictions-get-ready-for-exchanges.htm> [<https://perma.cc/M5UK-Z4MA>].

152. *Id.*

relevance of Article 26. Although IGAs, in their current form, lack reciprocal commitments by the United States, IGAs have done much to eliminate bank secrecy worldwide and have also influenced a global information exchange network. The information exchange world has clearly moved beyond double income tax treaties.

That being said, because IGAs were entered into outside of the Article II treaty process, the executive branch asserted their legality by characterizing them as add-ons to existing tax treaties.¹⁵³ If the United States jettisoned the information exchange provisions in the treaties (which I do not recommend), then this could jeopardize the legality of the IGAs. Even if this was the case, however, there are additional arguments supporting the legality of the IGAs on a standalone basis, either as binding administrative guidance or as congressional-executive agreements.¹⁵⁴

There is, however, an additional concern that if the jurisdictional provisions of the treaties are unwound, then political economy considerations will also lead to less support of the information exchange provisions. Under this view, taxpayers tolerate information exchange only because they are receiving relief of source country taxation in exchange. I am somewhat dubious of this account. In fact, the reverse dynamic has been present. Until recently, the information exchange requirements jeopardized the United States' entrance into new tax treaties, with Senator Rand Paul blocking action on the treaties for almost a decade out of protest of FATCA.¹⁵⁵ Information exchange has proliferated and evolved into a strong norm in the international arena, and the FATCA regime thus far has withstood strong pressure against it. If this concern remains, however, the jurisdictional provisions could be weakened but not eliminated, which I discuss in Part V below.¹⁵⁶

153. Susan Morse, *Why FATCA Intergovernmental Agreements Bind the U.S. Government*, 70 TAX NOTES INT'L 245, 246 (2013). For a view disputing this characterization, see Allison Christians, *The Dubious Legal Pedigree of IGAs (and Why It Matters)*, 69 TAX NOTES INT'L 565, 565 (2013).

154. Morse, *supra* note 153, at 246–47.

155. Diane Ring, *When International Tax Agreements Fail at Home: A U.S. Example*, 41 BROOK. J. INT'L L. 1185, 1197–206 (2016).

156. See *infra* Part V.

C. DOUBLE NON-TAXATION

In accordance with the BEPS plan, the purpose of treaties has since grown to encompass the principle of double non-taxation, supporting devices like limitation on benefits provisions and the unilateral override provisions in the new U.S. Model Treaty.¹⁵⁷ Although these developments combat treaty abuse and double non-taxation, they are effectively solving problems created, in part, by the treaties themselves. Therefore, they cannot be invoked to justify the existence of tax treaties, as will be explained below.

What is double non-taxation and why is it problematic? After all, almost every type of taxation distorts economic activity, so should not less taxation assist in the free movement of capital? Double non-taxation generally means income that is otherwise typically taxed in one jurisdiction ends up being taxed nowhere. The phenomenon is sometimes referred to in the literature as stateless income or homeless income.¹⁵⁸ The OECD describes double non-taxation as leading to “a reduction of the overall tax paid by all parties involved as a whole, which harms competition, economic efficiency, transparency and fairness.”¹⁵⁹ One primary concern with double non-taxation is the creation of a race to the bottom, whereby all jurisdictions are worse off due to tax competition.¹⁶⁰ Another concern is the preference of cross-border income as contrasted with wholly domestic income, a concern expressed in the state aid cases.¹⁶¹

Resolving the phenomena is difficult as a conceptual matter because the problem results from the sovereignty of countries over their own tax systems. Since tax treaties, in their current incarnation, never require taxation of income but instead function as devices that limit taxing jurisdiction, it is unclear how they can ever solve the problem of double non-taxation. Instead,

157. For example, the new model treaty denies treaty benefits to beneficiaries of “special tax regimes,” or special tax preferences put in place by some countries. See Allison Christians & Alexander Ezenagu, *Kill-Switches in the U.S. Model Tax Treaty*, 41 *BROOK. J. INT’L L.* 1043, 1048 (2016).

158. See, e.g., Edward D. Kleinbard, *The Lessons of Stateless Income*, 65 *TAX L. REV.* 99, 99 (2011); Bret Wells & Cym Lowell, *Tax Base Erosion and Homeless Income: Collection at Source Is the Linchpin*, 65 *TAX L. REV.* 535, 538 (2012).

159. *ORG. FOR ECON. CO-OPERATION & DEV., ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING* 15 (2013).

160. See Ruth Mason, *Tax Rulings as State Aid FAQ*, 154 *TAX NOTES* 451, 452 (2017).

161. See *id.* at 459.

tax treaties tend to create double non-taxation because they allow taxpayers to combine reduced treaty rates on source-based withholding taxes with favorable domestic tax rules.¹⁶² In order to fix double non-taxation, domestic law must be utilized, and, at best, tax treaties may be designed to not make the situation worse.¹⁶³

What features of tax treaties, then, give rise to double non-taxation? This stems from the grand bargain struck between source and residence countries, with the residence countries obtaining the right to tax “residual income” after a minimal amount of income has been allocated to the source country.¹⁶⁴ As Bret Wells and Cym H. Lowell have stated, “Our treaties were premised on the concept of allocating income to prevent double taxation, but the result is that they have achieved double non-taxation.”¹⁶⁵ The two demonstrate that the phenomenon of double non-taxation arises from the League of Nations’ choice to adopt a residence-based approach rather than one based on profit-splitting.¹⁶⁶

The question that the tax treaties were originally trying to resolve was how to allocate income between a parent company, typically located in a mercantilist country like England (the “residence” country, in today’s terminology), and its supply, manufacturing, and shipping subsidiaries, typically located in British Commonwealth countries like India (the “source” country).¹⁶⁷ The subsidiaries would pay “base erosion payments,” such as royalties, service fees, and leasehold payments to the parent,

162. Christians & Ezenagu, *supra* note 157, at 1046.

163. David Rosenbloom has made a similar point, arguing that international tax arbitrage exploits the differences in domestic laws. See H. David Rosenbloom, *The David R. Tillinghast Lecture: International Tax Arbitrage and the “International Tax System,”* 53 TAX L. REV. 137, 164–65 (2000). Tax treaties, in Rosenbloom’s view, are always elective and to the benefit of the taxpayer. In that regard, treaties do not have the leverage to combat tax arbitrage. *Id.* at 164.

164. This term has been defined as the “portion of income earned by all parties to cross-border transactions (‘combined income’) that remains after a routine return has been allocated to each of the related parties for the functions and risks that it performs (‘residual income’).” Wells & Lowell, *supra* note 20, at 5 n.9.

165. *Id.* at 5.

166. Wells and Lowell label the phenomenon of double non-taxation as “homeless income.” *Id.*

167. *Id.* at 10.

which would be deductible against their colonial income tax.¹⁶⁸ In this manner, residual profits were stripped out of the source country, leaving it only the ability to tax routine profits.¹⁶⁹

Under these facts, the income is being taxed by the mercantilist country. With the interposition of a holding company situated in a tax haven, however, the residual profits could be shifted to a jurisdiction that does not tax such income through base erosion payments. Although the colonial country could assert that the arm's length principle allocates it a certain portion of the profit, typically transfer pricing methods are limited to the income that should be received by the source country, thereby failing to police the income allocated to the holding company.¹⁷⁰ As Wells and Lowell note, this planning strategy primarily stems from several elements bound up in the tax treaty framework: (1) the decision to allocate residual income to the residence country, with the source country only taxing local operations, (2) the interposition of a holding company that is not treated as a permanent establishment and is entitled to receive residual income (and thereby treated as situated in the residence country), and (3) the deployment of one-sided transfer pricing.¹⁷¹

In pursuing the approach ultimately adopted by the League of Nations treaty, the four economists were aware of the danger that holding companies in tax havens posed.¹⁷² They recognized that such subsidiaries allowed the allocation of income to a country that was neither a source or residence country, thus creating the potential for electivity into a low-taxed regime.¹⁷³ Perhaps, though, they glossed over these concerns because they assumed the residence country would ultimately find ways to tax such income. As it turns out, however, income shifted to holding companies has gone largely untaxed by residence countries.¹⁷⁴ Tax competition has spurred residence countries in this direction, less they face expatriation by their multinational corporations to a country that does not tax such income.¹⁷⁵

168. *Id.* at 11.

169. *Id.*

170. *See id.* at 12.

171. *Id.* at 12–13.

172. *1923 Report, supra* note 12, at 49.

173. *Id.*

174. Wells & Lowell, *supra* note 20, at 35–36.

175. *Id.*

For instance, even under its former worldwide system, the United States allowed deferral on income allocated to subsidiaries in tax havens.¹⁷⁶ Although various outbound regimes (such as controlled foreign corporation rules) and inbound regimes (such as earnings-stripping and thin capitalization rules) have attempted to tax such income, tax competition has also caused countries to rationally tolerate profit shifting.¹⁷⁷ Arguably, the new tax regime instituted by the United States, with BEAT and GILTI, will strengthen taxation of previously untaxed earnings. In previous work, however, I have argued that the new law largely keeps base erosion and profit shifting incentives intact.¹⁷⁸ Indeed, the Congressional Budget Office (CBO) estimates that nearly 80% of profit shifting is maintained under the new regime.¹⁷⁹ The effect on profit shifting is likely even smaller, since CBO does not take into account investor reactions to the instability of the FDII regime in response to WTO challenges, investor reactions to the political instability of the legislation in general, and tax competition from other countries.¹⁸⁰ Furthermore, commentators and treaty partners have critiqued the new provisions for violating the tax treaties.¹⁸¹ As a result, U.S. lawmakers may face future pressures to curtail the regimes on a bilateral basis.

176. See generally JANE G. GRAVELLE, CONG. RESEARCH SERV., R40623, TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION (2015).

177. Alexander Klemm & Li Liu, *The Impact of Profit Shifting on Economic Activity and Tax Competition* (IMF Working Papers 19/287, 2019), <https://www.imf.org/en/Publications/WP/Issues/2019/12/20/The-Impact-of-Profit-Shifting-on-Economic-Activity-and-Tax-Competition-48741> [<https://perma.cc/RWX5-B6JD>].

178. See generally Rebecca M. Kysar, *Critiquing (and Repairing) the New International Tax Regime*, 128 YALE L.J.F. 339 (2018) (highlighting the flaws of the new U.S. international tax regime).

179. CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: 2018–2028, at 124–25, 127 (2018). For instance, AbbVie Inc., a biopharmaceutical company recently reported a tax rate of 9%, decreased from around 22% in years prior to the 2017 tax legislation. See Michael Erman & Tom Bergin, *How U.S. Tax Reform Rewards Companies That Shift Profit to Tax Havens*, REUTERS (June 18, 2018, 6:03 AM), <https://www.reuters.com/article/us-usa-tax-abbvie/how-u-s-tax-reform-rewards-companies-that-shift-profit-to-tax-havens-idUSKBN1JE12Q> [<https://perma.cc/7FXF-95U3>].

180. Kysar, *supra* note 178, at 347 (noting effects the new U.S. international tax regime has on profit sharing).

181. See, e.g., Rosenbloom & Shaheen, *supra* note 3, at 63 (“We believe that the BEAT’s conflicts with the nondiscrimination provision and its reconcilable

Tax treaties, however, do seem to be inching closer to addressing double non-taxation.¹⁸² As stated in the official press release of the new model treaty, the U.S. Treasury has taken the position that tax treaties should eliminate double taxation “without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.”¹⁸³ To further this relatively modest goal, the new model treaty contains somewhat unique “kill-switch” provisions that turn off treaty benefits if income is subject to low or no taxation abroad.¹⁸⁴ For instance, the special tax regime provisions deny treaty benefits on deductible interest or royalties to related persons that face low or no taxation under a preferential tax regime.¹⁸⁵ In this manner, the rules preserve source taxation when the residence country forgoes taxation of the item of income. The treaty also provides that treaty benefits relating to dividends, interest, royalties, and other income may be denied if a treaty partner either (a) reduces its tax rates to below the lesser of 15% or 60% of the general statutory rate or (b) switches to a territorial regime.¹⁸⁶ Other changes to both the U.S. and OECD model treaties attempt to minimize double non-taxation.¹⁸⁷ These changes include addressing exempt permanent establishments, revisions to the limitation on benefits provisions, rules on expatriated entities, and the new general anti-abuse rule adopted in the multilateral instrument.¹⁸⁸

Reuven Avi-Yonah has argued that the international tax regime embraces a principle that income should be taxed once and

inconsistency with the FTC provision of U.S. treaties do not constitute treaty overrides.”).

182. See, e.g., Reuven S. Avi-Yonah & Gianluca Mazzoni, *Are Taxes Converging?* 3 (Univ. of Mich. Law Sch. Pub. Law & Legal Theory Research Paper Series, Paper No. 573, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3059090 (“Despite the existence of many such examples of double non-taxation, it is clear that the tendency in recent years has been for most large countries to support the single tax principle.”).

183. U.S. MODEL TREATY, *supra* note 32, at 1.

184. As Allison Christians has noted, these type of “kill-switch” provisions, whereby treaty benefits are turned off under certain circumstances, are rare but not unprecedented. Christians & Ezenagu, *supra* note 157, at 1059–69.

185. U.S. MODEL TREATY, *supra* note 32, arts. 11(2)(c), at 23, 12(2)(a), at 27, & 21(2)(a), at 40.

186. *Id.* art. 28, at 67.

187. See, e.g., ORG. FOR ECON. CO-OPERATION & DEV., *supra* note 4.

188. *Id.* at 3–5, 9–10, 16.

only once.¹⁸⁹ He has pointed to these recent treaty developments as further indication that the world is converging upon this “single tax principle.”¹⁹⁰ Ample room for double non-taxation under the treaties still exists, however. There is much uncertainty as to the definition of what constitutes a “special tax regime” if such regimes are not explicitly identified during the treaty negotiations. Moreover, if such a regime is implemented through administrative practice, the United States might not be able to detect it if it cannot access taxpayer-specific rulings.¹⁹¹

Finally, it is the treaty regime and its fundamental bargain between source and residence countries that is a primary cause of a great deal of double non-taxation. That treaty partners are now undoing some of the treaties’ contribution to double non-taxation through mechanisms like the unilateral override and anti-abuse provisions cannot be seen as justification for the treaties.

D. FOREIGN DIRECT INVESTMENT

Increased foreign direct investment (FDI) is another cited reason for tax treaties.¹⁹² We would expect foreign direct investment to increase upon entrance into a tax treaty for two reasons. First, if tax treaties really do alleviate double taxation, then we

189. Reuven S. Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of U.S. Treaty Policy*, 59 N.Y. L. SCH. L. REV. 305, 309 (2014) (“The single tax principle states that income should be subject to tax only once, and thus rejects both double taxation and double non-taxation.”); *see also* Hugh J. Ault, *Some Reflections on the OECD and the Sources of International Tax Principles*, 70 TAX NOTES INT’L 1195, 1195 (2013) (noting that the League of Nations advocated a scheme in which income is taxed “once and only once”).

190. Avi-Yonah & Mazzoni, *supra* note 182, at 3. This principle has been controversial both descriptively and as a normative goal. Rosenbloom, *supra* note 163, at 166 (stating that “[i]nvoicing the international tax system does not constitute an explanation, since that system appears to be imaginary”); *see also* SHAVIRO, *supra* note 5, at 21; Graetz, *supra* note 5, at 270 n.29 (citing Rosenbloom, *supra* note 163); Julie Roin, *Taxation Without Coordination*, 31 J. LEGAL STUD. S61, S71 (2002) (same).

191. Christians & Ezenagu, *supra* note 157, at 1075; Ruth Mason, *Identifying Illegal Subsidies*, 69 AM. U. L. REV. 479, 515–16 (2019) (discussing use of secret administrative rulings as a method to confer illegal subsidies to private companies).

192. DAGAN, *supra* note 5, at 108 n.88 (providing an excellent summary of the literature on FDI and tax treaties).

would expect foreign direct investment between the two countries to increase.¹⁹³ Second, the treaties may enhance the treaty country's reputation among the global economy, a benefit that would expand as the country's treaty network expands.¹⁹⁴

Empirical evidence on whether tax treaties bring in foreign direct investment, however, is mixed.¹⁹⁵ Several older studies looked at changes in FDI on a jurisdictional basis as countries entered into tax treaties and concluded that there was no increase in FDI.¹⁹⁶ Newer studies have looked at whether a greater number of tax treaties is correlated with higher FDI and have found a positive relationship between the two.¹⁹⁷ It is difficult to confirm causation, however, "since treaties may precede investment not because they spur the latter but because they may be concluded only when there is an expectation of such investment."¹⁹⁸ In the United States, for instance, this is a built-in feature of treaty policy.¹⁹⁹

193. *Id.*

194. *Id.*

195. See Paul L. Baker, *An Analysis of Double Taxation Treaties and Their Effect on Foreign Direct Investment*, 21 INT'L J. ECON. BUS. 341, 362 (2014) (finding no effect on FDI flows); Bruce A. Blonigen & Ronald B. Davies, *Do Bilateral Tax Treaties Promote Foreign Direct Investment?*, in 2 HANDBOOK OF INTERNATIONAL TRADE: ECONOMIC AND LEGAL ANALYSIS OF LAWS AND INSTITUTIONS 526 (E. Kwan Choi & James C. Hartigan eds., 2005) (finding a positive effect on FDI from old treaties but a slight negative effect from new treaties); Bruce A. Blonigen & Ronald B. Davies, *The Effects of Bilateral Tax Treaties on U.S. FDI Activity*, 11 INT'L TAX & PUB. FIN. 601, 602 (2004) (same); Ronald B. Davies, *Tax Treaties and Foreign Direct Investment: Potential Versus Performance*, 11 INT'L TAX & PUB. FIN. 775, 784 (2004) (finding no effect on FDI from U.S. treaties); Peter Egger et al., *The Impact of Endogenous Tax Treaties on Foreign Direct Investment: Theory and Evidence*, 39 CAN. J. ECON. 901, 902 (2006) (finding a negative effect on FDI); Eric Neumayer, *Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries?*, 43 J. DEV. STUD. 1501, 1502 (2007) (finding some effect in attracting FDI, but only in limited circumstances).

196. See, e.g., Blonigen & Davies, *supra* note 195; Davies, *supra* note 195, at 776; Egger et al., *supra* note 195, at 921–24.

197. Julian di Giovanni, *What Drives Capital Flows? The Case of Cross-Border M&A Activity and Financial Deepening*, 65 J. INT'L ECON. 127, 145 (2005) (demonstrating how "capital tax treaties increase M&A activity"); Neumayer, *supra* note 195, at 1515 (examining how tax treaties "fulfill the purpose of attracting FDI").

198. INT'L MONETARY FUND, *supra* note 77, at 26.

199. *Id.*

One other study has reached both conclusions.²⁰⁰ It finds that the number of treaties that a source country has signed with the United States is positively correlated with FDI from the United States, while also concluding that there is a *negative* correlation between new and existing treaties with the United States and such FDI.²⁰¹ One explanation for this is that a large network of treaties increases profit shifting through the source country by means of treaty shopping.²⁰² On the other hand, new and existing treaties that are renegotiated may reduce FDI and reinvested earnings because of the information sharing and tax cooperation features of tax treaties.²⁰³

The FDI effect is likely to be particularly muted in the case of developed countries like the United States since the treaty is not needed to signal regime stability to investors in that context. Moreover, if tax treaties are increasing FDI because of treaty shopping, developed countries may not benefit from that effect given the relatively higher rates of taxation imposed by such countries.

Furthermore, investment in the United States may also be more inelastic than other jurisdictions. This may be the case if demand for U.S. assets is strong enough to support withholding.²⁰⁴ For instance, although the United States taxes real property, foreign ownership of U.S. real assets remains robust.²⁰⁵ The strong U.S. market for goods and services may mean that foreign demand could support higher withholding rates on outbound flows.²⁰⁶

200. Joseph P. Daniels et al., *Bilateral Tax Treaties and US Foreign Direct Investment Financing Modes*, 22 INT'L TAX & PUB. FIN. 999, 1025–26 (2015).

201. *Id.*

202. *Id.*

203. *Id.* at 1025.

204. Driessen, *supra* note 44, at 749 (“However, investment in the United States may be more inelastic than commonly is perceived—that is, demand by foreign persons for U.S. assets is strong enough that increases in U.S. withholding on outbound flows may not make much difference in a foreign person’s decision to invest.”).

205. *Id.* at 749 n.25 (“FIRPTA does not seem to have curbed the demand by foreign persons for U.S. residential and other real property.”).

206. *Id.* (“[T]he sizable U.S. market for goods and services likely is important enough to [foreign owners] that higher U.S. withholding rates on outbound flows from inbound FDI might not discourage inbound FDI very much.”).

Although the U.S. statutory withholding rate of 30% is quite high,²⁰⁷ the portfolio interest exemption and availability of derivatives drastically reduce the number of taxpayers subject to the tax.²⁰⁸ In this sense, the reduced treaty rates do little work. If treaties did not exist, then surely the domestic withholding rate would be set much lower, thereby alleviating concerns of over-taxation. In all likelihood, the reason that the 30% rate has held so long is that it is a way for the United States to preserve its negotiating position in the treaty context.²⁰⁹ Some would argue that using the domestic rate as leverage is valuable, and thus the treaties allow the United States to tailor their policy-making to their relationship with particular countries. As I explore throughout the Article, however, our monolithic negotiating positions mute this benefit, and, in any case, domestic law could be used to achieve similar results. For instance, the statutory withholding rate could be applicable to certain countries with whom we have diplomatic relationships or that meet other enumerated criteria.²¹⁰

E. COMITY CONSIDERATIONS

Related to the issue of increased foreign direct investment, it is also posited that countries enter into tax treaties for comity reasons.²¹¹ Tax treaties solidify relationships between countries and create communication channels between their taxing authorities.²¹² For developing countries especially, entering into

207. See IRS, WITHHOLDING OF TAX (2020).

208. See David R. Tillinghast, *Tax Treaty Issues*, 50 U. MIAMI L. REV. 455, 456–57 (1996) (noting the impact of exemptions and derivatives on the market).

209. Jones, *supra* note 1, at 3 (“The reason why treaties do not lead to harmonization of tax law is . . . the need to preserve one’s negotiating position.”).

210. For instance, under current law, the foreign tax credit is denied for taxes paid to countries with whom we have severed diplomatic relations. See 26 U.S.C. § 901(j)(2)(a)(ii) (2018) (“This subsection shall apply to any foreign country . . . with respect to which the United States has severed diplomatic relations.”).

211. Christians, *supra* note 1, at 706–07 (“It has been suggested that tax treaties may signal a stable investment and business climate in which treaty partners express their dedication to protecting and fostering foreign investment [T]ax treaties may serve largely to signal that a country is willing to adopt the international norms regarding trade and investment, and hence, that the country is a safe place to invest.” (citations and quotations omitted)).

212. Brauner, *supra* note 90, at 988 (comparing international tax treaties to membership cards that “emphasize their role as comity mechanisms”).

the “club” of tax treaties improves a nation’s standing in the international arena, serving as a “stamp of approval.”²¹³ Signing a tax treaty signals that the country “is willing to adopt the international norms,” which may have positive effects in non-tax areas as well.²¹⁴

Although such benefits might accrue to a developing country attempting to gain a seat at the table, they are less likely to sway the position of the United States, whose existing trade relationships and agreements with other countries dwarf the impact of tax treaties. Moreover, an established tax administration that is willing to robustly enforce tax norms, like the IRS, produces a more effective signaling effect to other nations.²¹⁵ Comity considerations should therefore be relatively minor in factoring into the decision of whether the United States should enter into tax treaties.

F. CERTAINTY AND PREDICTABILITY

Tax treaties are also said to signify a stable and certain legal regime. Many would argue that the current international tax regime is fairly harmonized, and this is partly due to the existence of the treaty network.²¹⁶ The OECD Model has been incredibly influential, and the more than 3000 tax treaties in existence are based upon it.²¹⁷ One scholar has noted that, “[o]ne can pick up any modern tax treaty and immediately find one’s way around, often even down to the article number.”²¹⁸ As a result, tax treaties are quite similar to one another.

To the extent that standardization of international tax rules has occurred, however, we see it outside of the tax treaty context

213. DAGAN, *supra* note 5, at 113.

214. Vann, *supra* note 1, at 726.

215. Brooks & Krever, *supra* note 1, at 167–68 (discussing the importance of “robust legislation” as an important signal to other countries).

216. See, e.g., Reuven S. Avi-Yonah, *Does Customary International Tax Law Exist?* (Univ. of Mich. Law Sch. Pub. Law & Legal Theory Research Paper Series, Paper No. 640, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3382203 (examining the harmonization of the current international tax regime and customary international law).

217. See Yariv Brauner & Pasquale Pistone, *Introduction to BRICS AND THE EMERGENCE OF INTERNATIONAL TAX COORDINATION* 3 n.4 (Yariv Brauner & Pasquale Pistone eds., 2015) (“[The international tax regime] is constructed around the network of bilateral tax treaties, essentially all of which are modelled on the OECD convention.” (citations and quotations omitted)).

218. Jones, *supra* note 1, at 2.

as well—in the domestic laws of nations.²¹⁹ For instance, in the United States, a foreign person will be taxed on U.S. business income if it is “effectively connected” to a “U.S. trade or business.” Tax treaties attempt to clarify and harmonize this concept by narrowing source country jurisdiction over “business profits” that are “attributable to a permanent establishment.”²²⁰ The treaty standard, however, appears to be no clearer than the domestic one, causing many to conclude that it is essentially equivalent to the domestic standard.²²¹ Indeed, some of the U.S. tax treaties explicitly define the term “business profits” in a way that references the domestic law.²²² The Internal Revenue Service has drawn upon domestic law to interpret what constitutes a “permanent establishment,” referencing concepts that are also used to determine the domestic standard.²²³ This is the case for other treaty terms as well.²²⁴

As stated earlier, the treaties generally defer to domestic law to answer vexing and central questions as to the residency of the taxpayer, what type of income is at issue, and the definition of income taxes.²²⁵ Tax treaties are primarily jurisdictional devices and “mostly lack operative provisions of law” that would more meaningfully harmonize the tax regimes of various nations.²²⁶ Even as jurisdictional devices, however, the treaties

219. See Reuven S. Avi-Yonah, *Tax Competition, Tax Arbitrage, and the International Tax Regime*, 61 BULL. INT'L TAX'N, no. 4, 2007, at 130 (contending that a coherent international tax regime exists in both tax treaties and the domestic law of all nations).

220. U.S. MODEL TREATY, *supra* note 32, art. 7, at 15.

221. See, e.g., Lee A. Sheppard, *Why Do We Need Treaties?*, 68 TAX NOTES INT'L 783 (2012); Reuven S. Avi-Yonah & Oz Halabi, *Double or Nothing: A Tax Treaty for the 21st Century* 1–2 (Univ. of Mich. Law Sch. Law & Econ. Working Papers, Paper No. 66, 2012), http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1176&context=law_econ_current.

222. Allison Christians & Yariv Brauner, *United States*, in 7 THE MEANING OF “ENTERPRISE,” “BUSINESS” AND “BUSINESS PROFITS” UNDER TAX TREATIES AND EU TAX LAW 591–93 (Guglielmo Maisto ed., 2011).

223. Kysar, *supra* note 47, at 1413–14.

224. Christians & Brauner, *supra* note 222, at 601 (“In general, the terms ‘business, enterprise, and business profits’ as used in the U.S. tax treaties are not autonomous but derive their meaning from domestic tax law provisions.”).

225. See *supra* Part II.C; see also Kysar, *supra* note 47, at 1411–12 (noting that “specific treaty provisions dictate that domestic law applies when defining a term”).

226. Kysar, *supra* note 47, at 1411.

merely “state general taxing principles” whereas “[c]ode provisions are tailored to specific situations.”²²⁷

The extent to which tax treaties harmonize international law is thus limited. This may be due to various reasons. For one, tax law is an area of law that has to address “nearly all economic activities” and encompasses all business entities and individuals, all while aiming to meet “critical revenue-raising and redistribution functions.”²²⁸ Given the complexities of these tasks, an intricate body of domestic law has arisen. Even still, the statutory text does not often address the specific fact pattern in question and thus reliance upon non-textual sources is necessary to fill interpretive gaps.²²⁹ Plain meaning interpretation also often seems inappropriate in the tax setting given the self-containing nature of tax law, which creates specialized tax terms that do not have analogues in everyday conversation.²³⁰ The highly detailed character of the domestic law means that treatymakers may be unable to incorporate concepts directly; instead, they intentionally leave gaps in the treaty so that domestic law can fill in the details.²³¹

Another reason for the gaps in treaties is “the connection between taxation and state sovereignty.”²³² Treaties often defer to domestic law so that nations can retain some control over tax policy.²³³ Although international law always implicates sovereignty concerns, these issues are particularly strong in the tax context given that taxation implicates the revenue function of a

227. KLAUS VOGEL ET AL., UNITED STATES INCOME TAX TREATIES 26 (1989).

228. Kysar, *supra* note 47, at 1414.

229. See Michael Livingston, *Congress, the Courts, and the Code: Legislative History and the Interpretation of Tax Statutes*, 69 TEX. L. REV. 819, 829–30 (1991) (“[A] complex statute may suggest a broader policy that requires a non-literal, contextual interpretation . . . of the statute.”).

230. *Id.* at 828–29 (“The self-contained nature of tax law makes a plain meaning rule difficult to apply to tax cases.”).

231. Kysar, *supra* note 47, at 1416 (“The highly complex demands upon tax law are one reason for the contemplated gaps in treaty drafting.”).

232. *Id.*

233. *Id.*

nation, which in turns provides public goods and national defense.²³⁴ Taxation is also a key component of a nation's fiscal policy, which allows it to affect growth, prices, and unemployment.²³⁵

It is also important to note that, unlike in the trade context where multilateral cooperation can contribute simultaneously to worldwide and national efficiency, international tax is predominantly a zero-sum game.²³⁶ For all of these reasons, we should expect a significant degree of retention of sovereignty in the tax treaty context. In fact, we do see this, both implicitly, through ambiguity in the treaties, and explicitly, through incorporation of the domestic tax laws.²³⁷ Accordingly, the degree to which tax treaties can provide certainty through the harmonization of tax concepts and terms is limited.

As for stability, the network of more than 3000 treaties provides some benefits in this regard. Indeed, as Tsilly Dagan has noted, the treaty system creates a lock-in effect, which makes transition to a different system more difficult.²³⁸ There is, however, a serious cost to this stability, the dangers of which have become apparent. Long after the system proves useful, it will continue.

G. OTHER GOALS

Tax treaties also may serve ancillary goals such as the prevention of nondiscrimination or the resolution of tax disputes between the governments. Both of these goals can be accomplished via other means, however. Tax treaties require competent authorities to endeavor to resolve cross-border tax disputes and, increasingly, provide for mandatory arbitration.²³⁹ As was the

234. *Id.*; see also Diane M. Ring, *What's at Stake in the Sovereignty Debate?: International Tax and the Nation-State*, 49 VA. J. INT'L L. 155, 157, 167 (2008) (noting the "particular strength to the claims for tax sovereignty").

235. Ring, *supra* note 234, at 168–69.

236. See generally Michael J. Graetz, *The David R. Tillinghast Lecture: Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 TAX L. REV. 261 (2001) (noting that the self-interests of the nation should be served through international tax policy).

237. Kysar, *supra* note 47, at 1417 ("We therefore should expect a greater degree of retention of national policy in the tax treaty context. And we do . . . through reference to domestic tax laws.")

238. Tsilly Dagan, *Tax Treaties as a Network Product*, 41 BROOK. J. INT'L L. 1081, 1101–05 (2016).

239. U.S. MODEL TREATY, *supra* note 32, art. 25, at 57.

case with information exchange, there is no need to couple this goal with the divvying up of taxing jurisdiction.²⁴⁰ Other international agreements, like the approach taken by the European Union, can serve the same purpose.²⁴¹

Tax treaties also are said to accelerate international investment through their nondiscrimination clauses, which require that the treaty partners tax domestic and foreign investors similarly.²⁴² These clauses appear in every U.S. tax treaty in force, as well as the model U.S. and OECD tax treaties.²⁴³ Again, nondiscrimination could also be accomplished without the loss of taxing rights, through stripped-down tax treaties, investment treaties, or domestic legislation.²⁴⁴ Indeed, major multilateral and regional trade agreements already contain mandates against tax discrimination.²⁴⁵ The nondiscrimination principle as articulated in tax treaties was originally intended only to mirror existing obligations under the commercial treaties and was not expected to have a meaningful impact.²⁴⁶

240. See Brooks & Krever, *supra* note 1, at 166–67 (discussing how international tax treaties can “generate information sought by tax authorities”).

241. *Id.* (citing Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises—Final Act—Joint Declarations-Unilateral Declarations 90/436, 1990 O.J. (L 225) 10 (EC); Protocol Amending the Convention of 23 July 1999 on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises, 1999 O.J. (C 202) 1 (EC)).

242. See generally U.S. MODEL TREATY, *supra* note 32, art. 24, at 54 (example of nondiscrimination provision); OECD MODEL TREATY, *supra* note 30, art. 16, at 24–25 (same); Ruth Mason, *Tax Discrimination and Capital Neutrality*, 2 WORLD TAX J. 126 (2010) (comparing nondiscrimination provisions in tax treaties, WTO, and EU law); Ruth Mason & Michael S. Knoll, *What Is Tax Discrimination?*, 121 YALE L.J. 1014 (2012) (analyzing the use of nondiscrimination provisions in tax treaties).

243. See U.S. MODEL TREATY, *supra* note 32, art. 24, at 54; RICHARD E. ANDERSEN, ANALYSIS OF UNITED STATES INCOME TAX TREATIES ¶ 20.01 (2010) (providing an overview of nondiscrimination clauses in all U.S. income tax treaties).

244. Brooks & Krever, *supra* note 1, at 167 (noting the use of nondiscrimination clauses for facilitating international investment).

245. Mason & Knoll, *supra* note 242, at 1018 (“[P]rohibitions of tax discrimination appear in major multilateral and regional trade agreements.”).

246. See, e.g., U.S. DEP’T OF THE TREASURY, TECHNICAL MEMORANDUM OF THE TREASURY DEPARTMENT ON THE CONVENTION WITH GREAT BRITAIN AND NORTHERN IRELAND WITH RESPECT TO TAXES ON INCOME, art. 21 (1945) (“It will be observed that this article extends to all taxes, both Federal and local. Such extension, however, is in keeping with several commercial treaties (such as that with Norway, of 1928, and that with Germany, of 1923) to which the United

Nondiscrimination is a notoriously ambiguous and, at least in U.S. law, narrow concept.²⁴⁷ Under the “nationality paragraph” of Article 24, the treaties bar the source country from taxing foreign enterprises operating in that country in a way that is “more burdensome” than nationals of the source state in “the same circumstances.”²⁴⁸ Its scope is limited since the treaties define “similar circumstances” as excluding U.S. nationals that are taxed on a worldwide basis.²⁴⁹ This preserves the ability of the United States, for instance, to impose gross basis withholding taxes on nonresident aliens since they are not in the same circumstances as a nonresident U.S. citizen (who gets taxed on a net basis).²⁵⁰ In the case of corporations, this carve-out means the nondiscrimination principle has very limited impact in the United States. A corporation that is incorporated abroad is, by definition, not in the same circumstances as a corporation that is incorporated in the U.S.²⁵¹ Other countries may define corporate residency on the basis of other factors, such as place of management, in which case nondiscrimination may have more impact.²⁵²

Under the permanent establishment paragraph of Article 24, a country is prohibited from subjecting the permanent establishment (essentially the fixed place of business) of a resident of the other country to “less favorabl[e]” taxation than its own residents “carrying on the same activities.”²⁵³ The permanent establishment paragraph has no such carve-out for residency, but it is often a struggle for courts and the Internal Revenue Service to determine whether foreign residents are “carrying on the same

States is now a party. It has no practical effect, since our domestic taxation does not discriminate as between United States citizens and British nationals residing in the United States.”); Mary C. Bennett, *The David R. Tillinghast Lecture—Nondiscrimination in International Tax Law: A Concept in Search of a Principle*, 59 TAX L. REV. 439, 444 (2006) (discussing original intentions of nondiscrimination provisions).

247. Mason & Knoll, *supra* note 242, at 1017 (“[J]udges, government officials, and scholars have failed to clearly articulate the . . . values . . . the nondiscrimination provision promotes.”).

248. U.S. MODEL TREATY, *supra* note 32, art. 24, at 54.

249. *Id.*

250. Bennett, *supra* note 246, at 445.

251. *Id.*

252. *Id.* at 446.

253. *Id.* at 447 (discussing the U.S. Model Treaty with respect to the permanent establishment provision); *see also* U.S. MODEL TREATY, *supra* note 32, art. 24(2).

activities” as residents of the permanent establishment country.²⁵⁴ Although one U.S. court has found that a U.S. tax provision violated this paragraph,²⁵⁵ the U.S. Treasury and the Internal Revenue Service have traditionally taken a very narrow view of this phrase.²⁵⁶ For instance, in assessing thin capitalization rules, which deny certain interest deductions for payments to related foreign persons, the position of the United States has been that these rules do not violate nondiscrimination because they also deny deductibility to related domestic tax-exempt entities.²⁵⁷ This defense is arguably unconvincing since the nonresident, for-profit lender should be compared to a resident, for-profit lender.²⁵⁸ European courts, in contrast, have given the paragraph more robust interpretations.²⁵⁹

Given the uncertainty surrounding the nondiscrimination principle and the large divide between countries in interpreting it, query whether it would be more effective to enact it as a domestic provision. These routes may be a more forceful means at ensuring equal treatment of investments. Regardless, it does not appear that the nondiscrimination principle in treaties is providing a great deal of reciprocal protection, and in any case, like other provisions discussed above, nondiscrimination could be incorporated into international agreements that do not cede jurisdiction over the tax base.

Finally, we could see tax treaties as serving as pre-commitment devices, tying Odysseus to the mast lest he fall prey to the sirens’ song. Governments could recognize that they may fail to benefit from taxing inbound capital since, absent market power, the incidence of the tax is likely to fall on locals even if it is paid by foreigners, creating deadweight loss in the system. Nevertheless, governments may be enticed, politically speaking, to enact

254. Bennett, *supra* note 246, at 447.

255. *Id.* (“The opinion states that under the nondiscrimination provision, the [Internal Revenue] Service has no more right to deny interest deductions to an ‘undercapitalized’ branch than it does to an ‘undercapitalized’ domestic bank.” (citing *Nat’l Westminster Bank PLC v. United States*, 58 Fed. Cl. 491 (2003))).

256. *Id.* at 448–49 (explaining it is difficult to predict how courts would rule on this paragraph as compared to the United States Treasury and the Internal Revenue Service because courts have had very few opportunities to do so).

257. H.R. REP. NO. 101-386, at 568 (1989) (Conf. Rep.).

258. See, e.g., AM. LAW INST., *supra* note 77, at 258–59.

259. *Id.*; see *UBS AG v. Revenue & Customs Comm’r* [2005] S.T.C. 589, *aff’d* [2006] EWHC (Ch) 117, [2006] S.T.C. 716 (Eng.).

such a tax since it nominally falls on a nonvoting sector, foreigners. To save themselves from this inefficient outcome, they may bind themselves via international commitments.²⁶⁰

A few responses are warranted. First, this argument is likely to apply only in the passive income context, where local rents are absent (thus justifying non-taxation). Second, a predicate to this argument is that the inbound tax is borne by locals, which may be likely in a small, open economy but highly unlikely in a large, country like the United States, whose policies influence global prices, income, and interest rates.

III. DISADVANTAGES OF TAX TREATIES

The above discussion concludes that the rationales for tax treaties are opaque and ultimately unconvincing. Meanwhile, there are potential disadvantages that they bring to the United States, as this Part explores.

A. A QUESTION OF REVENUES

Scholars have argued that the reciprocal nature of tax treaties disadvantages developing countries by allocating taxing jurisdiction, and hence shifting revenues, from the country where the income is earned, typically the developing country, to the country of the taxpayer's residence, typically the developed country.²⁶¹ This literature points to the asymmetry of the countries' investments flows as the source of the treaty process's unfairness toward developing nations. Proponents of this view also cite economic evidence, discussed above, that tax treaties have no effect, or even a negative effect, on foreign direct investment, meaning that the developing country has sacrificed revenues for little to no advantage in capturing investment.²⁶²

The common account is that treaties between developed nations do not cause similar revenue shifts since the countries are similarly situated. Yet conclusions from the developing country literature can be extended to treaties that the United States enters with other developed nations when the investment flows between those countries differ, as is often the case in the modern era.

260. Thanks to Dan Shaviro for this point.

261. See *supra* note 1 for sources discussing this point.

262. See, e.g., Brooks & Krever, *supra* note 1, at 173–74.

The treaty policy of the United States has remained relatively static since the 1960s, even though the United States has swung from being the world's most important net capital exporter to being a net capital importer due to the massive increase of foreign investment into the United States.²⁶³ The change means that the United States may lose revenue as a result of entering into the treaty whereas before it was likely to gain revenues.²⁶⁴ In spite of the variances of capital flows, both historically and between nations, tax treaties remain markedly similar to one another and to their predecessors.²⁶⁵

This dynamic stands in contrast to the bilateral investment treaty context, where the United States has recognized its status as a capital importer and has taken a more balanced approach towards weighing its investors' interests against state sovereignty rather than protecting just the former.²⁶⁶ One possible explanation for this disparity in approaches is that, under the latter, the United States is often sued as a source country, thus compelling it to reexamine its negotiating stances *ex ante*.²⁶⁷

263. H. David Rosenbloom, *Toward a New Tax Treaty Policy for a New Decade*, 9 AM. J. TAX POL'Y 77, 83–84 (1991).

264. There have been no studies estimating the revenue impact of U.S. tax treaties and how they have changed across time as the United States' capital flows have changed. A Dutch nonprofit has attempted to calculate lost revenue for certain developing countries with regard to treaties entered into with the Netherlands. See ACTIONAID, *MISTREATED: THE TAX TREATIES THAT ARE DEPRIVING THE WORLD'S POOREST COUNTRIES OF VITAL REVENUE* (2016), <http://documents.worldbank.org/curated/en/534391488205311904/pdf/WPS7982.pdf> [<https://perma.cc/3JJS-R663>]. Another working paper attempts to assess the costs and benefits of tax treaties, using Ukraine as a case study. Oleksii Balabushko et al., *The Direct and Indirect Costs of Tax Treaty Policy: Evidence from Ukraine* (World Bank Grp., Policy Research Working Paper No. 7982, 2017), <http://documents.worldbank.org/curated/en/534391488205311904/pdf/WPS7982.pdf> [<https://perma.cc/5Lu3-UCTD>].

265. See, e.g., Reuven S. Avi-Yonah, *Double Tax Treaties: An Introduction*, in *THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT* 99, 99 (Karl P. Sauvant & Lisa E. Sachs eds., 2009) (noting that about 75% of tax treaty terms are identical to one another).

266. Anthea Roberts, *Triangular Treaties: The Extent and Limits of Investment Treaty Rights*, 56 HARV. INT'L L.J. 353, 361 (2015) (stating that early versions of United States bilateral investment treaties heavily favored investor interests).

267. SHAYERAH ILIAS AKHTAR & MARTIN A. WEISS, CONG. RESEARCH SERV., R43052, U.S. INTERNATIONAL INVESTMENT AGREEMENTS: ISSUES FOR CONGRESS 6–8 (2013) (stating that over the past two decades, there has been a substantial increase in treaty-based investment disputes due to the increase in investment flows; ultimately, resulting in countries, including the United States,

It may of course be possible that, although the United States runs a deficit in the aggregate, it runs surpluses with treaty countries. Frustratingly, the Joint Committee of Taxation makes no revenue estimates for tax treaties nor does it include them in the tax expenditure budget.²⁶⁸ This is because the treaties are Article II treaties and bypass the normal budget process.²⁶⁹ The executive branch has also chosen not to provide formal economic analyses of tax treaties.²⁷⁰

Although I do not purport to undertake such a formal analysis here, I have examined a set of data regarding trade, capital, and financial flows in an attempt to shed some modest insight into whether treaties make economic sense for the United States. Scholars have long pointed out that investment flow imbalances cause differences in revenue flows under tax treaties, but, to my knowledge, there has been no attempt to look at those flows in any detail, particularly on a system-wide basis.

First, I surveyed the bilateral balance of payments data from the Bureau of Economic Analysis, which consists of flow data for any given quarter since 2003. Of the sixty-six countries listed on the IRS website as having tax treaties with the United States,²⁷¹ this data included those of sixteen countries.²⁷² Of those sixteen countries, U.S. residents were net borrowers from current, capital account, and financial-account transactions in

to re-evaluate “the balance of rights for investors and other economic and non-economic policy priorities”).

268. See Kysar, *supra* note 2, at 33 (suggesting remedies to create budgetary rules to allow Congress to consider costs and benefits of tax treaties).

269. *Id.* at 32–33.

270. Driessen, *supra* note 44, at 746 (“Executive branch negotiation and Senate consideration of a tax treaty are not subject to any budgetary rules or formal mandated economic analyses . . .”); Kysar, *supra* note 2, at 33. Recently, but sporadically, JCT has added some general economic information regarding trade flows in their explanations of tax treaties but this is by no means comprehensive. See, e.g., J. COMM. ON TAXATION, 112TH CONG., EXPLANATION OF PROPOSED INCOME TAX TREATY BETWEEN THE UNITED STATES AND HUNGARY, JCX-32-11, at 16–19 (2011).

271. *United States Income Tax Treaties – A to Z*, INTERNAL REVENUE SERV., <https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z> [<https://perma.cc/XG2K-Q4Q6>] (last updated Jan. 8, 2020).

272. These countries are Belgium, France, Germany, Italy, Luxembourg, the Netherlands, the United Kingdom, Canada, Mexico, Venezuela, Australia, China, India, Japan, South Korea, and South Africa. See *infra* Appendix, Part A.

thirteen countries over the time span from 2003 to 2017, amounting to net borrowing of approximately \$11 trillion or an average \$735.2 billion per year.²⁷³ They were net lenders in only three countries.²⁷⁴ For financial-account transactions alone over this time span, U.S. residents were net borrowers in eleven and net lenders in five,²⁷⁵ amounting to net lending of approximately \$3.9 trillion or an average \$260.3 billion per year. We could roughly estimate, then, that a supermajority of these sixteen tax treaties are losing revenues.

Second, I studied the U.S. Department of Treasury Annual Survey of Portfolio Holdings, which consists of stock data at particular points in a given year since 2003.²⁷⁶ The Annual Survey lists both the value of foreign holdings of U.S. securities and the value of U.S. portfolio holdings of foreign securities. Of the sixty-six countries listed on the IRS website, two countries did not have sufficient security holdings to list. The remaining sixty-four countries were examined. Notably, the Treasury data revealed the United States had inflows of capital greater than outflows with respect to the tax treaty countries in every year in which data was collected except one (2006).²⁷⁷ From 2003 to 2017, the net flows were negative by \$22.14 trillion or an average of \$1.476 trillion per year.²⁷⁸

I also looked at the relative flows of each country for the year 2017. Of the countries examined, thirty-six had inflows greater than outflows, meaning there were more holdings by that country's residents of U.S. securities than U.S. holdings of those country's securities.²⁷⁹ Twenty-eight countries had outflows greater than inflows, meaning that U.S. investors held more of

273. These countries were France, Germany, Italy, Luxembourg, the United Kingdom, Canada, Mexico, Venezuela, China, India, Japan, South Korea, and South Africa. *See infra* Appendix, Part A.

274. These countries were Belgium, the Netherlands, and Australia. *See infra* Appendix, Part A.

275. The U.S. was a net lender in Belgium, the Netherlands, Mexico, Venezuela, and Australia with respect to financial transactions. It was a net borrower with respect to France, Germany, Italy, Luxembourg, the United Kingdom, Canada, China, India, Japan, South Korea, and South Africa in such transactions. *See infra* Appendix, Part A.

276. U.S. DEP'T OF THE TREASURY ET AL., U.S. PORTFOLIO HOLDINGS OF FOREIGN SECURITIES AS OF DECEMBER 31, 2018 (2019).

277. *See infra* Appendix, Part B.

278. *See infra* Appendix, Part B.

279. *See infra* Appendix, Part C.

those countries' securities than vice versa.²⁸⁰ Notably, the amount of inflows, in total, exceeded outflows by \$4.54 trillion for that year.²⁸¹

Although it is clear that the flow data and stock data paints a picture of the United States as a capital importer with respect to its tax treaty partners, it is nonetheless difficult to conclude with any certainty these findings impact on U.S. revenues. First, any formal revenue analysis should account for increased investment as a result of the treaty. Second, even for the flow data, these are just snapshots in time, reflecting only the current economic position of the United States via its treaty partners. *Because* the treaties are so entrenched, however, one can see the danger of committing to them given the fact that economic flows can reverse rather quickly and dramatically. Third, it is highly likely that the breakdown of flows differs between income types, which is relevant in calculating revenue losses from the treaties. For instance, if the U.S. is a capital exporter for royalties, then perhaps it is gaining overall from the treaties even if it is capital importing with respect to other types of income, like interest. This is because the treaty restricts source country jurisdiction over royalties but generally does not alter the treatment of interest, which is generally exempt under the U.S. portfolio interest rules.²⁸²

Finally, there is a question as to how much of the income that is lightly taxed by the treaties is heavily taxed by the domestic system. The answer could be considerably smaller than the trade flow data suggests because, at least in the investment income context, taxpayers can avoid tax on such income through the portfolio interest exemption and tax planning strategies that include the use of derivatives.²⁸³ Additionally, because the permanent establishment category overlaps so significantly with that of the domestic U.S. trade or business concept, we would expect revenue losses in this category to be marginal. Nonetheless, the degree of asymmetry in the flows suggests that formal revenue analyses of the treaties are warranted.

280. See *infra* Appendix, Part C.

281. See *infra* Appendix, Part C.

282. 26 U.S.C. § 871 (2018).

283. See generally Toby Cozart, *Structuring Foreign Investments in U.S. Corporations Using Portfolio Debt Guaranteed by the Issuer's Foreign Affiliate*, 6 INT'L TAX & BUS. L. 398 (1988) (discussing portfolio interest exemption in detail).

It should also be mentioned that revenue losses can also come about because of the interaction between the domestic law and the treaty or the disparity in tax systems.²⁸⁴ For instance, one could imagine that two similarly situated countries would sign a tax treaty. They may reason that any rate reduction they provide on source income of the other country's residents would be counterbalanced by an increase in domestic taxes through the residual taxation of foreign source income of its own residents. This increase occurs because the domestic residents are also receiving the benefit of lower rates in the other country. If, however, a country does not tax on a worldwide basis, the calculus is different. Its residents may enjoy the lower foreign rate, unencumbered by residual taxation. The territorial regime means that the lower foreign tax treaty rates will not effectuate an increase in domestic revenues. This bargain may still be in the country's interest, but the benefits are flowing to its residents rather than to government coffers.²⁸⁵

The 2017 changes to the U.S. international tax system are likely to complicate the revenue picture of U.S. tax treaties. For one, the partial transition to a territorial system means that the United States is forgoing residual taxation as a residence state on foreign income earned by closely held corporations.²⁸⁶ Yet this is counterbalanced by the new minimum tax regime that is imposed on such income. The reduction of the corporate rate all the way to 21% means that no residual taxation will be paid on foreign income so long as U.S. corporations are taxed at a 13.125% rate abroad.²⁸⁷

This picture is further exacerbated by the fact that the blending of tax credits is allowed to reduce tax liability under residual taxation for individuals and others who do not receive

284. See Roin, *supra* note 77, at 1767 ("Instead of a roughly equivalent revenue exchange, the U.S. Treasury most likely loses more money from forgoing source taxation than it collects in additional residence taxation.")

285. The United States' transition to a partial territorial regime will mean that its treaty agreements may produce less revenue than before, a point that will be revisited below. See *supra* notes 51–65 and accompanying text.

286. See Eric M. Zolt, *Tax Treaties and Developing Countries*, 72 TAX L. REV. (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3248010 [<https://perma.cc/KQ2D-9FWD>] (noting that despite the reduction of source-country revenues through tax treaties, residence countries have been reluctant or unable to capture their share of the lost revenues).

287. See TAX CUTS AND JOBS ACT, H.R. REP. NO. 115-466, at 626 & n.1526 (2017) (Conf. Rep.).

the benefits of territoriality. Treaties allow taxpayers to cross credit income that receives favorable treaty rates with high taxed income, thereby minimizing the limitation on foreign tax credits under U.S. law.²⁸⁸ This dynamic will also occur under the new minimum tax regime, leading to further revenue losses.

To summarize, my data analysis cannot tell us that the United States is losing revenue from the treaty system, but it does cast doubt on the assertion that the United States, as a developed country, stands to gain uniformly from tax treaties. Given the differences in flows between countries and over time, it is problematic that the United States' negotiating position remains constant, and it is puzzling that U.S. tax treaties do not take into account differences in investment flows, disparities in tax systems, and various ways in which the model treaty may diverge from the national interest. Despite the enormous economic and legal changes that have developed since the model tax treaties were first developed, far from becoming more heterogeneous, tax treaties seem to be converging.²⁸⁹ Moreover, despite the fact that Elisabeth Owens called for formal analysis of the costs and benefits of tax treaties nearly sixty years ago, there has been virtually no progress on that front.²⁹⁰ My findings, however, should serve to shift the burden onto treaty proponents to conduct such analyses.

B. STAGNATION OF DOMESTIC POLICY AND INTERNATIONAL TAX NORMS

Another problematic effect of tax treaties is the stagnation of domestic policy and international tax norms. Over two decades ago, John Avery Jones cited the proliferation of treaties as problematically locking in both domestic and treaty policy.²⁹¹

288. See Roin, *supra* note 77, at 1772–75 (explaining this phenomenon under the normal foreign tax credit rules).

289. See Elliott Ash & Omri Y. Marian, *The Making of International Tax Law: Empirical Evidence from Natural Language Processing* (Jan. 11, 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3314310 [<https://perma.cc/4K69-4K77>].

290. Owens, *supra* note 62, at 452–53; see also Roin, *supra* note 77, at 1798 (labeling tax treaties tax expenditures and calling for examination of their costs). I explore possible reasons for these phenomena below. See *infra* Part IV.A and accompanying notes.

291. Avery Jones, *supra* note 1, at 4.

Tax treaties cannot be easily changed because they are so numerous.²⁹² And, unless countries are willing and able to override tax treaties, domestic policy is stymied.²⁹³ The problem has only worsened since Avery Jones raised the issue,²⁹⁴ with the number of treaties having more than doubled since then.

Of course, stagnation may not be a problem if the treaty regime locks in beneficial policy. Although tax treaties may have initially served some valid purposes,²⁹⁵ they more recently have contributed to the breakdown of the international tax system. As discussed above, instead of easing double taxation, treaties have contributed to double non-taxation.²⁹⁶ This is a direct result of the architecture set up by the treaty system, relying on the malleable concepts of source and residence, which are the foundations of the domestic international tax systems around the world.²⁹⁷ This problem has grown exponentially with the rise of digital technology and immensely valuable (and easily shifted) intellectual property. Moreover, their requirements have increasingly come into conflict with possible solutions to the problems plaguing the international tax system. Recent U.S. tax reform has brought this problem into the spotlight.

1. The Destination-Based Cash Flow Tax and Potential Treaty Conflicts

In 2016, Republicans began to set forth their platform to overhaul the international tax provisions.²⁹⁸ Their initial plan was to replace the corporate income tax with a destination-based cash flow tax (DBCFT).²⁹⁹ The DBCFT would have essentially been a modified VAT, with a deduction for wages.³⁰⁰ Like a VAT, the tax would also have been border-adjusted, meaning that it excludes exports and taxes imports without deduction for

292. *Id.*

293. Unlike the United States, not all countries can override international agreements through domestic legislation. Kysar, *supra* note 2, at 36–38.

294. *See* Avery Jones, *supra* note 1.

295. *See supra* Part I.B.

296. *See supra* notes 162–66 and accompanying text.

297. *See supra* notes 23–29 and accompanying text.

298. H. TAX REFORM TASK FORCE, A BETTER WAY: OUR VISION FOR A CONFIDENT AMERICA 6 (2016), https://www.novoco.com/sites/default/files/atoms/files/ryan_a_better_way_policy_paper_062416.pdf [<https://perma.cc/6Z7Z-VP7Y>].

299. *Id.* at 27.

300. *Id.* at 27–29.

costs.³⁰¹ Its features meant that the DBCFT would have treated debt and equity equally, removed taxes on investment returns, and eliminated incentives to profit shift and offshore activities.³⁰² Taxing on a destination basis (where sales occur) offers advantages relative to taxing on an origin basis (where value is created).³⁰³ In general, the residency of customers is more fixed than that of corporations, and thus taxing a business on this basis likely reduces tax avoidance. Additionally, ascertaining where products or services are invented is an economic fiction that has proven impossible to execute, leading to the shifting of profits through transfer pricing games.³⁰⁴

There are reasons to think that a destination-based approach should at least supplement revenue collection given the rise of the multinational corporation. However, the plan was critiqued, in part, for its incompatibility with the tax treaty regime if the DBCFT was considered a “covered tax” under the treaties.³⁰⁵ If so, the treaties’ permanent establishment requirement, which essentially requires a physical presence in the source country before that country can exercise taxing jurisdiction over business profits, would forbid the imposition of a destination-based tax that taxes where goods are sold.³⁰⁶ In short, the very feature that makes the DBCFT attractive is the same trait that makes it incompatible with the treaties—taxing at destination versus origin.

In addition to the conflict with the permanent establishment limitation, the DBCFT also implicated other treaty provisions.³⁰⁷

301. *Id.* at 28.

302. William G. Gale, *Understanding the Republicans’ Corporate Tax Reform*, BROOKINGS INST. (Jan. 10, 2017), <https://www.brookings.edu/opinions/understanding-the-republicans-corporate-tax-reform/> [<https://perma.cc/ZY67-WZF8>].

303. *Id.*

304. See generally Alan J. Auerbach & Douglas Holtz-Eakin, *The Role of Border Adjustments in International Taxation*, AM. ACTION F., Nov. 2016, at 11–12, <https://www.americanactionforum.org/wp-content/uploads/2016/11/The-Role-of-Border-Adjustments-in-International-Taxation.pdf> [<https://perma.cc/LE4K-GY6H>] (discussing transfer pricing with differing valuations of imports and exports).

305. Reuven S. Avi-Yonah & Kimberly Clausing, *Problems with Destination-Based Corporate Taxes and the Ryan Blueprint*, 8 COLUM. J. TAX L. 229, 246 (2017).

306. *Id.*

307. *Id.* (discussing implication of Article 7 (goods and services) and Article 12 (intangibles that produce royalties)).

In order to include all imports, the DBCFT should be levied on intangibles that produce royalties and other types of deductible payments that can substitute for royalties since their exclusion would invite tax abuse.³⁰⁸ If the DBCFT is considered an income tax, however, then such inclusion would constitute a treaty override because it would violate the treaty provisions that forbid withholding on such payments.³⁰⁹ The DBCFT also might arguably violate the nondiscrimination provision of the treaties by advantaging exporters over importers.³¹⁰ Furthermore, if the DBCFT is not an income tax and therefore outside the treaty's scope, treaty partners would be under no obligation to provide foreign tax credits to their residents who pay the tax.³¹¹

A further issue results from the fact that U.S. corporations may no longer be U.S. residents under the treaty because, under the DBCFT, they would no longer be "liable to tax . . . by reason of . . . domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature."³¹² Accordingly, foreign taxpayers may no longer benefit from the treaty provision that reduces withholding on dividends, among other complications.³¹³

Another challenge is that if the United States were to enact the DBCFT, then its treaty partners may no longer have incentives to maintain or renegotiate treaties.³¹⁴ This is because the United States would be giving up its jurisdiction to tax income as the residence country; therefore, why should a source country provide relief from its withholding tax? On the other hand, if the United States was no longer taxing worldwide income, the

308. *Id.* ("[A]llowing royalties and derivatives to escape the tax on imports invites abuse (since there will always be lower tax jurisdictions).").

309. *Id.*

310. *Id.*; see also Reuven S. Avi-Yonah, *From Income to Consumption Tax: Some International Implications*, 33 SAN DIEGO L. REV. 1329, 1343–46 (1996) (discussing impact of tax reform on importers and exporters); Reuven S. Avi-Yonah, *The International Implications of Tax Reform*, 69 TAX NOTES 913, 921–22 (1995).

311. Shaheen, *supra* note 88, at 592.

312. U.S. MODEL TREATY, *supra* note 32, art. 4.

313. Shaheen, *supra* note 88.

314. Avi-Yonah & Clausing, *supra* note 305, at 246; David A. Weisbach, *A Guide to the GOP Tax Plan – The Way to a Better Way*, 8 COLUM. J. TAX L. 171, 214–15 (2017); see also Stephen E. Shay & Victoria P. Summers, *Selected International Aspects of Fundamental Tax Reform Proposals*, 51 U. MIAMI L. REV. 1029, 1074–76 (1997) (outlining various possible responses of foreign countries to the United States tax reform, including pressure to terminate treaties).

source country's reduction of withholding tax would flow to the investor rather than the U.S. Treasury, therefore perhaps strengthening the source country's ability to attract investment.³¹⁵ The source country may also feel increased pressure to reduce its taxation of direct investment income considering the favorable tax treatment U.S. investment would receive.³¹⁶

Another concern would be the potential for tax arbitrage between the DBCFT, which would not tax income, and a treaty partner's income tax system that allows for interest deductions.³¹⁷ This arbitrage opportunity may induce treaty partners to terminate their treaties in order to impose higher withholding taxes on interest and dividends to U.S. residents.³¹⁸ Congress may attempt to stave off such terminations by imposing its own withholding tax on interest and dividends to non-residents, but this may itself violate the nondiscrimination provision since the United States may not be taxing investment income of its own residents.³¹⁹ Even if the provision was upheld, the United States may wish to condition any treaty exemptions of the new discriminatory tax on reciprocal exemption from the treaty partner, a perhaps undesirable bargain for a country with reciprocal trade flows with the United States and a large tax base.³²⁰

In short, the enactment of the DBCFT would cause chaos in the international tax community. The myriad issues presented by the tax have caused some to predict that its enactment could lead to the collapse of the treaty regime.³²¹ Moreover, this problem is not specific to the DBCFT. Other significant new taxes in other countries pose classification challenges for tax treaties. In the past few years, the Indian Equalization Levy, the UK Diverted Profits Tax, the Australian Diverted Profits Tax, the Netherlands Excessive Severance Tax, and the Belgian Fairness Tax are all hybrid taxes of some nature, and serious questions have arisen over their relationship with the treaty system.³²² Together, these taxes and the U.S. reforms, discussed below, are

315. Shay & Summers, *supra* note 314, at 1075.

316. *Id.*

317. *Id.*

318. *Id.*

319. *Id.* at 1075–76.

320. *Id.* at 1076.

321. Avi-Yonah & Clausing, *supra* note 305, at 246–47.

322. Roland Ismer & Christoph Jescheck, *The Substantive Scope of Tax Treaties in a Post-BEPS World: Article 2 OECD MC (Taxes Covered) and the Rise of New Taxes*, in 45 *INTERTAX* 382, 386–89 (Fred C. De Hosson ed., 2017)

part of a larger debate over taxing on a destination basis versus an origin basis.³²³

More recently, France levied a tax on the digital revenues, which U.S. technology companies have argued unfairly targets them.³²⁴ Other countries are exploring similar digital taxes.³²⁵ The digitalization of the economy poses a significant problem to international taxation. Since digitalization allows value to be created without physical presence, countries have increasingly become frustrated by the treaties' requirement that physical presence is required for taxing jurisdiction.³²⁶ Nonetheless, a prior OECD effort to relax the permanent establishment concept to encompass digital activities failed.³²⁷

The new digital services taxes attempt to avoid this constraint by being structured as an equalization levy on a gross basis.³²⁸ Since traditional withholding taxes are also on a gross

(evaluating similarities between new taxes); see also M. Tenore, "Taxes Covered": *The OECD Model (2010) Versus EU Directives*, 66 BULL. FOR INT'L TAX'N 162 (2012).

323. Itai Grinberg, *The Future of Corporate Taxation in a Digital World*, AM. ENTER. INST. (Apr. 19, 2018), <http://www.aei.org/events/the-future-of-corporate-taxation-in-a-digital-world/>.

324. Hadas Gold, *U.S. and France Reach Compromise on Digital Tax*, CNN (Aug. 26, 2019), <https://www.cnn.com/2019/08/26/business/digital-tax-france-us/index.html> [<https://perma.cc/8YLD-VEUM>] (stating that Amazon said "it will pass along the costs of the French digital tax to its third-party sellers beginning October 1").

325. William Horobin & Aoife White, *How Europe's 'Digital Tax' Plans Will Hit U.S. Tech Companies*, WASH. POST (July 19, 2018, 7:36 PM), https://www.washingtonpost.com/business/how-europes-digital-tax-plans-will-hit-us-tech-companies/2019/07/19/1177baba-aa03-11e9-8733-48c87235f396_story.html [<https://perma.cc/XAQ8-RNRY>] (naming the United Kingdom, Austria, Italy, Spain, and Belgium as countries considering digital taxes).

326. Joe Kennedy, *Digital Services Taxes: A Bad Idea Whose Time Should Never Come*, INFO. TECH. & INNOVATION FOUND. (May 13, 2019), <https://itif.org/publications/2019/05/13/digital-services-taxes-bad-idea-whose-time-should-never-come> [<https://perma.cc/S2XS-8G23>] ("[F]rustration stems from the fact that digitalization has made it possible for companies to export more goods and services into a country without subjecting themselves to that country's [corporate income tax].").

327. See generally ORG. FOR ECON. CO-OPERATION & DEV., TAX CHALLENGES OF DIGITALISATION: COMMENTS RECEIVED ON THE REQUEST FOR INPUT—PART II, at 6 (2017), <https://www.oecd.org/tax/beps/tax-challenges-digitalisation-part-2-comments-on-request-for-input-2017.pdf> [<https://perma.cc/K8WV-SWT6>].

328. See, e.g., Ashok K. Lahiri et al., *Equalisation Levy* (Brookings Inst. India Ctr., Working Paper No. 01, 2017), <https://www.brookings.edu/wp-content/>

basis and are still “covered taxes” under the treaties, it is unclear whether this approach will pass muster. The EU Council Legal Service issued an opinion that the European Commission’s proposed digital services tax is not an indirect tax,³²⁹ which also makes it harder to contend that tax treaties are not in conflict with it since tax treaties demand certain requirements of direct taxes.

Moreover, there is reason to think that the presence of the treaties affects the design of these equalization taxes to their detriment. Gross taxes, although sometimes required for administrative purposes, violate ability to pay principles.³³⁰ Moreover, the new equalization taxes have been fairly narrow in application, applying to certain industries and not others, thereby creating efficiency concerns. Arguably, this narrowness stems, in part, from being hamstrung by the treaty architecture. Without a multilateral solution to deal with taxation of the digital economy—in fact, the bilateral treaties stand in its way—the proposals have understandably evolved in a piecemeal fashion. Moreover, justifying these taxes by using the notoriously vague concept of value creation, which comes from the treaties, problematically sets no reliable guidepost.³³¹ Although the OECD

uploads/2017/01/workingpapertax_march2017_final.pdf (discussing India’s equalisation levy).

329. Mehreen Khan, *EU Lawyers Question Brussels Digital Tax Plan*, FIN. TIMES (Oct. 9, 2018), <https://www.ft.com/content/88e0a81a-cbf0-11e8-b276-b9069bde0956> [<https://perma.cc/E7G7-S5QT>]. In contrast, Wei Cui argues that countries should be able to freely design digital taxes so that they fall outside the scope of the treaty. Cui reasons that a treaty is a contractual agreement and parties can choose its scope. Cui also argues that, even if double taxation is an important goal (of which he is skeptical), tax treaties cannot be successful at this goal if they generate allocations that are in tension with countries’ desires. Wei Cui, *The Digital Services Tax: A Conceptual Defense at 20* (Jan. 2020) (unpublished manuscript), https://commons.allard.ubc.ca/cgi/viewcontent.cgi?article=1469&context=fac_pubs [<https://perma.cc/6B6R-8UBW>].

330. See generally J. Clifton Fleming, Jr. et al., *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income*, 5 FLA. TAX REV. 299, 306–11 (2001) (discussing ability-to-pay principles).

331. Michael Devereux, *The Digital Services ‘Sutton’ Tax*, SAID BUS. SCH. (Oct. 23, 2018), http://business-taxation.sbsblogs.co.uk/2018/10/23/the-digital-services-sutton-tax/?dm_i=17AR,5XL76,ELTIXU,N8496,1 [<https://perma.cc/HTM3-6QT2>] (“[T]he problem with the DST . . . is that their proponents claim that the tax has different purposes [I]t seems likely that the design of any DST will reflect the obfuscation offered by its advocates as to why it should be introduced.”).

countries will likely revisit the definition of “permanent establishment,” it is unclear that stretching this concept to the point of disbelief will provide any useful parameters for taxing jurisdiction.

We might search for a procedural solution to all of this. If the DBCFT presents difficulties of treaty interpretation, and was clearly not contemplated in the treaty’s design, then the states should endeavor to resolve the issue by mutual agreement. Going forward, a clause could be inserted in Article 2 of the treaties to cover significant new taxes if the parties reach a mutual agreement to this effect. The hybrid nature of these taxes requires further clarification from the treaty partners, and asking courts and arbitrators to fill these significant gaps may be beyond their institutional capacity. Yet even if an administrative solution was achievable, the complexities resulting from the mapping of these taxes onto the treaty system expose the latter’s rigidity. International movement towards destination-based taxes or increased taxation at source may be preferable, but this is antithetical to the fundamental deal cut in tax treaties. As a result, the substance of the proposals has suffered, and the treaty regime makes the likelihood of such a shift more remote.

The new recommendations of the OECD/G20 in revising nexus and profit allocation rules necessitates a dramatic reworking of the tax treaty system. For instance, BEPS 2.0 proposes a reworking of the permanent establishment concept to allow for nexus if there is “remote yet sustained and significant involvement in the economy.”³³² As an alternative, BEPS 2.0 contemplates a standalone provision that gives market jurisdictions “a taxing right over the measure of profits allocated to them under the new profit allocation rules.”³³³ These proposals would require a reworking of the arm’s length standard of Article 9 and the resolution of contentious factors such as the definition of “sustained and significant involvement” or, alternatively, how profits should be allocated.

2. The BEAT

Although Republicans abandoned the DBCFT, the 2017 tax legislation that was enacted also poses significant challenges to the tax treaty system. Among the changes to the tax law is the new inbound base erosion regime, which is designed to prevent

332. OECD, INCLUSIVE FRAMEWORK *supra* note 6, at 22–23.

333. *Id.*

earnings stripping from companies that have been able to erode the base by making deductible payments to related foreign parties.³³⁴

The originally proposed inbound regime was the House excise tax.³³⁵ The excise tax subjected income from deductible items, including royalties and cost of goods sold, to an excise tax, which was designed to prompt taxpayers to elect to treat such payments as effectively connected income.³³⁶ The Ways and Means committee report made clear that the new tax was necessary to supplement transfer pricing principles, which were insufficient to stop inbound base erosion.³³⁷

There is a strong argument that the proposed House excise tax would have breached treaty obligations because the tax was designed to hit multinationals without a permanent establishment, in violation of Article 7 of the treaty.³³⁸ The excise tax also was vulnerable to the criticism that it was an indirect way to impose withholding taxes on royalties, contrary to Article 12 of the treaties.³³⁹ Additionally, the tax also arguably violated the arm's length standard of Article 9 of the treaties because it would have applied to cost of goods sold between the related parties regardless of what parties dealing at arm's length would have agreed to do.³⁴⁰

The end result of the excise tax would have also been to tax foreign-earned income, with no foreign tax credit or double tax relief.³⁴¹ Such criticism forced the House to revise the proposal to allow a partial foreign tax credit.³⁴² This was the case even

334. See generally *U.S. Tax Reform Has a Profound Impact on Inbound Investment*, ORRICK (Mar. 9, 2018), <https://www.orrick.com/ja-JP/Insights/2018/03/US-Tax-Reform-Has-a-Profound-Impact-on-Inbound-Investment> [<https://perma.cc/D9G2-38SE>] (explaining inbound investments and lowering of U.S. corporation tax rate by deductions).

335. Tax Cuts and Jobs Act, H.R. 1, 115th Cong. § 4303 (2017).

336. *Id.*

337. H.R. COMM. ON WAYS & MEANS, TAX CUTS AND JOBS ACT, H.R. REP. NO. 115-409, at 400 (2017).

338. Reuven S. Avi-Yonah, *Guilty as Charged: Reflections on TRA 17*, 157 TAX NOTES 1131, 1134–35 (2017).

339. *Id.* at 1135.

340. *Id.*

341. *Id.* (“[Trading partners] are likely to retaliate by imposing tax on the royalties, interest, or cost of goods sold without a credit for the BEMT [base erosion minimum tax], and that will result in double taxation because there is no reverse FTC provision in TRA 17S . . .”).

342. *Id.*

though the United States would have been crediting residence country taxes as the source country, when traditionally foreign tax credits are offered by the residence country for source country taxes.³⁴³ This revision reduced the revenue estimate of the proposal.³⁴⁴

In part because of its tension with the tax treaties, Congress abandoned the House excise tax, instead enacting the BEAT, a new and separate tax.³⁴⁵ The BEAT functions as an alternative minimum tax, adding back in certain deductible payments to foreign-related parties (but not U.S.-related parties) to constitute a “modified taxable income” base.³⁴⁶ The BEAT liability is the excess of 10% of that base over the taxpayer’s regular tax liability. Notably, although it functions like the now repealed corporate alternative minimum tax, the BEAT does not allow foreign tax credits in the calculation of the base.³⁴⁷

Importantly, the BEAT also allows parties to circumvent it because it exempts cost of goods sold, including imbedded royalties.³⁴⁸ In contrast, the House excise tax would have left less room for circumvention because it would have applied to cost of goods sold. Unfortunately, *because* the House tax applied to cost of goods sold, it likely would have violated the arm’s length principle of the treaties.

Even still, the BEAT as enacted may be in tension with existing tax treaties. The alternative minimum tax structure of the BEAT is an attempt to accommodate tax treaties, but a group of EU Ministers asserted that the BEAT regime could be viewed as discriminating against foreign companies in violation of bilateral

343. *Id.*

344. The original revenue estimate for the excise tax was \$154.5 million over the budget window period. J. COMM. ON TAXATION, ESTIMATED REVENUE EFFECTS OF H.R. 1, THE “TAX CUTS AND JOBS ACT,” SCHEDULED FOR MARKUP BY THE COMMITTEE ON WAYS AND MEANS ON NOVEMBER 6, 2017, H.R. REP. NO. JCX-46-17 (2017), <https://www.jct.gov/publications.html?func=startdown&id=5026> [<https://perma.cc/KXE7-NVKK>]. This was revised to \$94.5 million after revisions to the excise tax, including the provision for foreign tax credits. J. COMM. ON TAXATION, ESTIMATED REVENUE EFFECTS OF H.R. 1, THE “TAX CUTS AND JOBS ACT,” AS ORDERED REPORTED BY THE COMMITTEE ON WAYS AND MEANS ON NOVEMBER 9, 2017, H.R. REP. NO. JCX-54-17 (2017), <https://www.jct.gov/publications.html?func=startdown&id=5034> [<https://perma.cc/QUP2-5GTE>].

345. Rosenbloom & Shaheen, *supra* note 3, at 53.

346. 26 U.S.C. § 59A (2018).

347. The corporate AMT limited foreign tax credits instead of disallowing them completely. *Id.*

348. Kysar, *supra* note 178, at 357.

tax treaties.³⁴⁹ Article 24(5) of our double tax treaties provides that treaty partners cannot tax residents of the other treaty country more heavily than its own residents.³⁵⁰ Arguably, the BEAT violates this nondiscrimination clause because a foreign-owned U.S. entity will be subject to the BEAT regime whereas a U.S.-owned U.S. entity will not be. One counter-argument is that the BEAT applies regardless of who *ultimately* owns the corporation.³⁵¹ Thus, the BEAT applies to payments from a U.S. entity to a foreign entity that is owned by the U.S. entity (a CFC), which indicates that the intent was to protect the U.S. tax base rather than to discriminate against foreign-owned U.S. parties.³⁵²

Another arguable path to treaty violation is Article 24(4), which commands that foreign residents be entitled to deductions “under the same conditions” as U.S. residents.³⁵³ The BEAT regime, however, is arguably not equivalent to the denial of a deduction, and interest, royalties, and other items remain fully deductible. Instead, the BEAT merely subjects the tax benefit conferred by such deductions to the 10% tax; denying a tax deduction would increase the tax on the item by 21%, not 10%.³⁵⁴ Additionally, the base erosion rules are perhaps sanctioned un-

349. Stephanie Soong Johnston, *EU Finance Ministers Fire Warning Shot on U.S. Tax Reform*, 157 TAX NOTES 1704, 1704 (2017).

350. The model tax treaty provides:

Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith that is more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned Contracting State are or may be subjected.

U.S. MODEL TREATY, *supra* note 32, art. 24(5).

351. Although a harsher result applies to foreign companies that were formerly U.S. companies, such disparate treatment is likely within the savings clause of the treaties, which allows the United States to tax its residents, and former residents, under its own domestic law. *Id.* arts. 1(4), 4(1); *see also* Bret Wells, *Get with The BEAT*, 158 TAX NOTES 1023, 1029 (2018) (arguing the BEAT is nondiscriminatory).

352. Reuven S. Avi-Yonah, *Beat It: Tax Reform and Tax Treaties* (Univ. of Mich. Law Sch. Pub. Law & Legal Theory Research Paper Series, Paper No. 587, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3096879 [<https://perma.cc/9MCL-GSXD>].

353. U.S. MODEL TREATY, *supra* note 32, art. 24(4).

354. Avi-Yonah, *supra* note 352, at 1026.

der Article 24(4) because they are necessary to arrive at an appropriate arm's length result within the meaning of Article 9 of the treaties, although this argument seems less forceful since the BEAT applies even when arm's length prices are charged.³⁵⁵

The BEAT may also violate Article 23, which requires treaty partners to grant a foreign tax credit for income tax of the treaty partner "[i]n accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof)."³⁵⁶ Since the BEAT offers no foreign tax credit, it may be inconsistent with the "general principle" of Article 23.³⁵⁷ It is possible, however, that the BEAT is not a "covered tax" under Article 2 of the treaty and therefore not subject to the requirements of Article 23 (although still subject to Article 24).³⁵⁸ If the BEAT did not fall within this category of "covered taxes," then a treaty partner could not object to the disallowance of foreign tax credits.

As discussed above, what constitutes a covered tax is a difficult question, and the status of many new taxes is in doubt.³⁵⁹ Relevant to the BEAT context, however, is that the United States has previously taken the position that the AMT was covered by the treaties and the two taxes are structurally similar.³⁶⁰ Another counter to the argument that the BEAT falls outside the treaties' scope is that Congress chose to enact it as part of subtitle A (income taxes) of the Code.³⁶¹ In favor of BEAT's non-coverage, however, is the fact that it denies deductions for payments to related foreign persons, therefore falling outside the definition of an "income" tax.³⁶²

C. TAX ABUSE OPPORTUNITIES

A third disadvantage of tax treaties is that they encourage tax avoidance as a result of the ceding of taxing jurisdiction and

355. Wells, *supra* note 351.

356. U.S. MODEL TREATY, *supra* note 32, art. 23.

357. *Id.*

358. *Id.* art. 2.

359. See Ismer & Jescheck, *supra* note 322, at 386–87; *supra* note 88 and accompanying text.

360. Rosenbloom & Shaheen, *supra* note 3, at 54.

361. *Id.* at 56.

362. *Id.* at 55.

the interface between the treaties and domestic provisions.³⁶³ Since this was discussed in the context of whether tax treaties fulfill their promise of achieving double non-taxation, I will not discuss it here. But it is a significant downside and one that loses revenue.

IV. WHY DOES U.S. TREATY POLICY REMAIN IN THE PAST?

If tax treaties have these negative effects and also fail to fulfill their purposes, why has U.S. tax treaty policy remained stagnant for decades? This Part will explore possible answers to this mystery. It begins with a discussion of how tax treaties suffer from a deficiency in process. It then explores the lock-in effect that occurs from having a proliferation of treaties. It then posits that a race-to-the-bottom dynamic is occurring between some countries seeking foreign direct investment, thus explaining entrance into the treaties.

A. PROCESS DEFICIENCIES AND POLITICAL ECONOMY

Because tax treaties are Article II treaties, the House is entirely cut out of the tax treaty process despite its long constitutional pedigree as the initiator of tax policy on the domestic side.³⁶⁴ Somewhat puzzlingly, this stands in contrast to trade treaties, with which the House has remained involved through congressional executive agreements.³⁶⁵ The House's participation in the trade treaty context has been justified, in part, because of its traditional role over revenues, as set forth in the Origination Clause.³⁶⁶

363. Julie Roin has argued that avoidance as a result of treaty rates is of no concern because the residual taxation of the residence country offsets the reduction of source country tax. Julie A. Roin, *Adding Insult to Injury: The "Enhancement" of § 163(j) and the Tax Treatment of Foreign Investors in the United States*, 49 TAX L. REV. 269, 285 (1994). This view, however, does not take into account the fact that the residence country may fail to tax the income. Driessen, *supra* note 44, at 749 n.22.

364. Kysar, *supra* note 2, at 23 n.149.

365. JANE M. SMITH ET AL., CONG. RESEARCH SERV., 7-5700, WHY CERTAIN TRADE AGREEMENTS ARE APPROVED AS CONGRESSIONAL-EXECUTIVE AGREEMENTS RATHER THAN TREATIES 2 (2013).

366. Bruce Ackerman & David Golove, *Is NAFTA Constitutional?*, 108 HARV. L. REV. 799, 923 (1995) (noting that the Origination Clause may strengthen the argument that NAFTA is constitutional); Laurence H. Tribe, *Taking Text and*

The treaty process often flies under the radar. Most of the treaty negotiating process happens behind closed doors, with multinational corporations strategically communicating their policy positions to negotiators.³⁶⁷ It is not surprising that the paucity in process benefits special interests like these corporations. Each step in the legislative process can potentially derail any proposal. The more robust process means the greater potential for policy failure. When the context is bestowing benefits to special interests, as opposed to the public, a less robust process will accrue to their benefit.³⁶⁸ Tax treaties reduce the tax bills of multinational corporations and do not increase taxes. Therefore, their relatively easy path to enactment favors such constituents at the expense of the public. Additionally, the resultant lobbying power of the corporations helps to explain why tax treaties exist in their current form—to benefit industry. The lack of process generally benefits policy that would otherwise be controversial in the legislative process.

Thus, a nefarious explanation for why tax treaties look the way they do is that they are simply a less visible way to funnel U.S. revenues to multinational corporations. Seen as tax incentives that do not have the scrutiny of the legislative or budget processes, they are invisible and against the public interest.³⁶⁹ Perhaps then it is not so puzzling that the United States would remain in treaties that are antithetical to its interest—to be able to deliver benefits to powerful constituencies without some kind of reckoning.

Groups that might normally be opposed to funneling benefits to multinational corporations, such as labor unions, are absent from the tax treaty process, in spite of their engagement over the reach of our international tax system as implemented through domestic law.³⁷⁰ Domestic policy disfavoring outbound

Structure Seriously: Reflections on Free-Form Method in Constitutional Interpretation, 108 HARV. L. REV. 1221, 1261 n.133 (1995) (noting that the Origination Clause may place limits on treaties involving revenues but disagreeing with Ackerman and Golove that House participation justifies the use of congressional-executive agreements).

367. Driessen, *supra* note 44, at 745.

368. Kysar, *supra* note 2, at 35 (noting bicameralism could minimize the influence of special interests by making their preferences more difficult to enact).

369. See Kysar, *supra* note 2, at 33–39; Zolt, *supra* note 286, at 10 (noting greater transparency weighs in favor of a country using domestic legislation over tax treaties to establish rules for cross-border taxation).

370. Driessen, *supra* note 44, at 751.

investment is in direct conflict with the lowering of withholding rates through the treaty, yet public debate only focuses on the former. These advocacy groups may overlook tax treaties because the process forecloses open and vigorous deliberation. In fact, their significant participation in trade treaties suggest this might be the case since such treaties, as congressional-executive agreements, are subject to greater process than tax treaties.³⁷¹

The other major deficiency in process is the lack of revenue estimates of tax treaties, or any formal studies undertaken by the U.S. Treasury that might justify entrance into particular tax treaties.³⁷² The lack of consensus on whether tax treaties increase foreign direct investment and the reversal of trade flows that the United States has experienced over the past few decades, which almost certainly impacts the revenue picture of the treaties, makes the omission from the budget process especially troubling.³⁷³

Not only are there no revenue estimates when the United States enters into treaties, the benefits they funnel to taxpayers also do not show up on the tax expenditure budget,³⁷⁴ which the Joint Committee on Taxation (JCT) publishes to account for revenue losses from special tax benefits. Many decades ago, Stanley Surrey famously concluded that such preferences should be highlighted as equivalent to government spending since they constituted revenue losses.³⁷⁵ Among such preferences Surrey highlighted were certain tax benefits provided by tax treaties.³⁷⁶ The absence of tax treaties from the tax expenditure budget allows for an easier path to treaty conclusion.³⁷⁷

One might try to justify omission of tax treaties from the tax expenditure budget as reflecting difficulties in defining the appropriate baseline. Surrey and McDaniel argued, for instance,

371. Oona A. Hathaway, *Treaties' End: The Past, Present, and Future of International Lawmaking in the United States*, 117 YALE L.J. 1236, 1274, 1307–16 (2008).

372. Driessen, *supra* note 44, at 749–50.

373. See *supra* note 264 and accompanying text.

374. Steven A. Dean, *The Tax Expenditure Budget Is a Zombie Accountant*, 46 U.C. DAVIS L. REV. 265, 306–07 (2012).

375. *Id.*

376. PAUL R. MCDANIEL & STANLEY S. SURREY, INTERNATIONAL ASPECTS OF TAX EXPENDITURES: A COMPARATIVE STUDY 59 (1985); STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES 168–70 (1985) [hereinafter SURREY & MCDANIEL, TAX EXPENDITURES].

377. Dean, *supra* note 374, at 290 n.117.

that reduction in gross withholding taxes are not tax expenditures because they reflect an approximation of the tax burden if it were applied on a net basis.³⁷⁸ If the rate was very low or zero, as is the case for certain types of income under the treaties, then such justification for omission from the budget would not be applicable. Another justification for omission might be that the exercise would prove too challenging for the estimators.³⁷⁹ Presumably, however, JCT could attempt to produce average tax rates applicable to net investment income on the domestic front and use this as an approximate baseline. A more straightforward alternative, however, is to simply follow the CBO revenue baseline, acknowledging that tax expenditure analysis need not be precise in detailing costs while still providing the useful function that such costs exist.

Moreover, this line of argument does not extend to the regular budget process. In estimating revenues for purposes of the enactment process, if such revenue estimates were produced, the proper baseline is not a normative one but generally follows current law with some prescribed modifications.³⁸⁰ In that context, the proper revenue baseline should be the 30% withholding rate applicable to net investment income earned by non-U.S. residents.³⁸¹

The paucity in process might also have several other ramifications. As discussed above, treaties do not seem to fulfill their stated or unstated purposes. Enhanced deliberation might help clarify the objectives of tax treaties, or expose the lack thereof.³⁸² Additionally, the process problem might also help explain why tax treaties are surprisingly uniform in nature, a suboptimal result given the variances in relative flows of the U.S. and its tax

378. SURREY & MCDANIEL, *TAX EXPENDITURES*, *supra* note 376, at 168.

379. Dean, *supra* note 374, at 290 n.117

380. David Kamin, *Basing Budget Baselines*, 57 WM. & MARY L. REV. 143, 188–90 (2015); David Kamin & Rebecca Kysar, *Temporary Tax Laws and the Budget Baseline*, 157 TAX NOTES 125, 126 (2017).

381. Note, however, that if revenue estimates were undertaken on treaty revisions, then these would often be scored as revenue increases. The relevant baseline would be the existing treaty, and many recent revisions limit treaty benefits to address problems of base erosion and profit shifting. Thus, the true cost of the treaty, on a standalone basis, would not be reflected in the estimates. It could, however, be captured by the tax expenditure budget, which need not follow current law.

382. Driessen, *supra* note 44, at 748. Misstated purposes also risk misleading the judiciary in their interpretation of the treaty.

treaty partners.³⁸³ More robust process might help to create heterogeneity among the treaties, tailoring them to various national interests.

Finally, although powerful constituencies shape U.S. treaty policy as a matter of political economy, there is reason to be hopeful that there is some room for reform of the process. Although tax treaties have historically been approved as a matter of course, the politically charged environment has made this less likely.³⁸⁴ Although opponents of tax treaties have blocked them for reasons unrelated to the problems discussed here,³⁸⁵ perhaps this controversy will shift the burden to proponents to analyze and justify their costs.

B. THE LOCK-IN EFFECT

Another obstacle to treaty innovation is the fact that the international tax system is comprised of thousands of bilateral treaties. Any changes must generally be made treaty-by-treaty. As discussed above, the proliferation of the treaties has created a “network effect,” whereby the global community disapproves of deviations from the script.³⁸⁶ Tax treaties are based on a common standard that provides more and more benefits the greater the number of adopters.³⁸⁷ The OECD treaties have positive network externalities along the dimensions of predictability of legal content, enforcement, and the signaling of a credible commitment to a stable regime.³⁸⁸ But as the network grows, so do its costs.

First, the initiators can exploit the network to extract “cartelistic gains from potential competitors and monopolistic rents from its own users.”³⁸⁹ Second, there is a strong lock-in effect; the treaty remains in force even when the standard becomes undesirable because it becomes difficult for users to establish a new network. This is because any purveyors of a new standard will

383. See *supra* note 265 and accompanying text.

384. See Ring, *supra* note 155, at 1198–203.

385. *Id.*

386. DAGAN, *supra* note 5, at 170; Dagan, *supra* note 238, at 1081; see also Eduardo Baistrocchi, *The Structure of the Asymmetric Tax Treaty Network: Theory and Implications* 10–11 (Bepress Legal Servs. Working Paper No. 1991, Feb. 8, 2007), <http://law.bepress.com/cgi/viewcontent.cgi?article=9408&context=expresso> [<https://perma.cc/5FF7-L66T>].

387. DAGAN, *supra* note 5, at 170; Dagan, *supra* note 238, at 1082.

388. See Baistrocchi, *supra* note 386, at 32–34 (describing five examples of positive network externalities of the tax treaty network).

389. DAGAN, *supra* note 5, at 173.

have a difficult time recruiting other states to join the new network without a critical mass that can reduce risk and transition costs.³⁹⁰ At one time, the United States and other developed nations may have rationally preferred the treaties' tilt towards the residence country when they were capital-exporting, but they are now locked into that position long after it no longer makes sense. As a result, the status quo reigns.

C. RACE TO THE BOTTOM

Nations may also enter into tax treaties with countries in which trade flows are obviously and persistently asymmetrical in order to receive legitimacy on the international level, although this is unlikely to be the case with established countries like the United States. They may hope to increase foreign direct investment through the reduction in tax burden, even though the evidence on this is mixed.³⁹¹ Countries could be engaging in a race to the bottom, whereby one country chooses the sub-optimal option of joining the treaty network because it fears others will do so as well, thereby crowding it out of the investment environment.

In particular, source countries may assent to the regime in spite of its favoring residence countries because of a prisoner's dilemma scenario.³⁹² If all source countries are competing to attract foreign direct investment, they could be in a better position to agree to not sign treaties and maintain their revenues. Anticipating defection, however, a source country may choose to enter into a treaty because they may be better off if the other source country does not sign the treaty, although still worse off than in a world where the source countries all agreed not to participate in the treaty regime. They also will be better off than if they are the fool who did not sign the treaty when the other one did.

Under this scenario, the countries are worse off if all join the treaty network since there is a perhaps only modest possibility of increasing investment with a certainty of fewer revenues. Yet, this is the likely outcome given that a worse outcome would be if one country joins the treaty network and the other one is left out. Coordination problems thus may explain why countries with divergent interests enter into tax treaties.³⁹³

390. *Id.* at 176.

391. *See supra* notes 192–200 and accompanying text.

392. *See* Baistrocchi, *supra* note 386, at 11.

393. *But see* Yariv Brauner, *An International Tax Regime in Crystallization*,

Finally, the world is changing, and developing countries do not seem as eager to sign double tax treaties as they once were.³⁹⁴ As I mentioned above, even developed countries have started to contemplate self-help regimes around the treaties.³⁹⁵ Consequently, just because tax treaties have evolved as the building blocks of the international tax regime does not mean they will continue to serve that function.

V. UNRAVELING THE TAX TREATY

In light of the foregoing discussion, how might we reconceptualize the tax treaty? The world seems to be moving away from the prioritization of residence country taxation. The recent U.S. international reform, and proposed and enacted taxes in Europe, can be seen as strengthening taxation by the “source” country.³⁹⁶ Furthermore, the double tax treaties have recently been under attack by developing countries, who now question whether it is in their interest to sign them.³⁹⁷ The pressure that globalization, stateless income, and technology have placed on the antiquated international tax system may cause other countries to doubt the relevance of tax treaties. As a result, the bargains long reached in the tax treaties may very well be finally upended.

This is because the international tax system, based on artificial concepts of source and residence, is fundamentally at odds with the nature of today’s world economy. Geopolitical, technological, and economic forces, as well as the phenomenon of stateless income, will require policy innovation that is in tension with the bargains reached long ago in tax treaties. The allocation of

56 TAX L. REV. 259 (2003) (“Developing countries have benefited from the current bilateral tax treaty practice They have never been forced, nor have they claimed to have been forced, into concluding a bilateral treaty with a developed country. In fact, in many cases the developing countries wish to conclude treaties with the developed countries, which often reject their . . . overtures.”).

394. DAGAN, *supra* note 5, at 181 (“Over the course of the last decade, the developed countries that were represented by the OECD have been losing some of their clout as a group.”).

395. *See supra* note 384 and accompanying text.

396. Although destination-based taxes forgo the concept of origin of income, and hence “source” countries, their practical effect will often be greater source country taxation.

397. *See* Martin Henson, *When Do Developing Countries Negotiate Away Their Corporate Tax Base*, 30 J. INT’L DEV. 233, 251 (2018) (concluding developing countries should revisit their existing tax treaty networks as their understanding of fiscal costs grows).

taxing rights no longer makes sense for many countries, both developed and developing, but instead serves small but powerful constituencies.

The new international tax system will likely contain more destination-based rules, as a response to the ability of multinational corporations to more easily game origin-based rules. So far, tax treaties have served to thwart such innovation, but the desperate need for revenues may eventually require it. Another possible innovation is to preserve origin-based taxation through a move to formulary apportionment or global unitary taxation. The current incarnation of the treaty system is ill-suited to accommodate either type of change. Indeed, the treaty system hits the United States particularly hard, because, unlike other countries, politics have prevented the United States from adopting the type of destination-based tax that clearly falls outside the treaty system—a VAT.

Thus, it seems that we should seriously consider jettisoning, or at least scaling down, the tax treaty provisions that allocate taxing jurisdiction. Some of the treaty provisions that do not relate to the allocation of income, however, should be retained, or at least could be kept with little cost. For instance, any shift to destination-based taxation is likely to be incremental. As a result, the rules regarding transfer price enforcement will likely be useful in the interim. The recent shift towards binding arbitration in the treaties makes this treaty function more valuable. The information exchange provisions are less useful with the rise of other international agreements in the area and should yield to those. Their retention does little harm, however, unlike the allocation of income provisions.

Nondiscrimination is a useful concept in theory but has had little practical effect. Given the flexible interpretation U.S. courts have given nondiscrimination, its inclusion in the treaties does not stand in the way of tax reform. Even if the concept was strengthened, however, it would provide normatively appealing constraints on tax reform.

Other functions, like the avoidance of double taxation, are somewhat incoherent, likely unnecessary due to domestic law provisions, and could also be refined. Revisiting the chart from above, we can summarize which features of the treaty should be maintained and which should be abandoned or altered, as follows:

	Main Treaty Features	Article Number	Harm	Outcome
1.	Residency Rules, Including Limitation on Benefits	Articles 4, 22	Neutral/ Helpful	Maintain, Although Less Necessary Without Jurisdictional Provisions
2.	Permanent Establishment Requirement (Jurisdictional Provision)	Articles 5, 7	Harmful	Abandon or Scale Down
3.	Limit Source Country Withholding Tax on Investment Income (Jurisdictional Provision)	Articles 10–13	Harmful	Abandon or Scale Down
4.	Alleviation of Double Tax Requirements	Article 23	Neutral/ Perhaps Unnecessary	Maintain, with Refinement
5.	Non-Discrimination Provisions	Article 24	Helpful	Maintain, with Clarification
6.	Transfer Pricing/ Dispute Resolution	Article 25	Helpful	Maintain, with Focus on Binding Arbitration
7.	Information Exchange Provisions	Article 26	Neutral/ Helpful	Maintain, Although Perhaps Unnecessary Due to Other Agreements

As discussed above, the OECD has completed a multinational instrument that aims to create a streamlined mechanism by which countries can amend their existing tax treaties to include BEPS measures, subject to domestic ratification procedures.³⁹⁸ The aim is to allow countries to update their treaties without the need for treaty-by-treaty negotiating. This effort is,

398. See *supra* note 42 and accompanying text.

in some ways, not as ambitious as it first appears. It primarily relates to proposals, like the limitation on benefits and mandatory arbitration provisions, that can be found in existing treaties entered into by the United States. In general, the BEPS process leaves in place treaty rules dividing the tax base between the two countries and does little to update those concepts. Treaties are also only amended if there is a two-sided “match” between treaty partners in choosing which of the new provisions to adopt. Still, one could imagine that the multilateral instrument may eventually extend beyond the BEPS project, inducing the United States to sign on to it.³⁹⁹ Somewhat paradoxically, the multilateral instrument, which was designed to breathe new life into the double tax treaty regime, could be used to scale it down. Specifically, the multilateral instrument could be used to opt out of those aspects of the tax treaties that reallocate taxing jurisdiction while maintaining the still useful features such as dispute resolution mechanisms and nondiscrimination provisions. This would allow countries to examine where it is in their interest to give up source-based taxation and where it is not. Essentially, rather than countries signing on to a system of treaties that are identical to one another, the multilateral instrument could be used to tailor treaties to the particular needs of a set of countries, creating a heterogeneous international tax system.⁴⁰⁰

This new heterogeneity of the tax treaties, although disruptive in many respects, could more fairly reflect the incongruity of trade flows between countries, differences in the elasticities of taxing foreign income between nations, variances in revenue needs, and divergence in gains from comity and reputation. Although this diversification could occur unilaterally, the multilateral instrument provides a mechanism to do so without jettisoning the treaty framework altogether or taking the controversial move of treaty termination. It would also obviate the need for painstaking treaty-by-treaty negotiation, although this would certainly still be a possibility. Moreover, it provides a mechanism

399. Yariv Brauner, for instance, has argued that it is difficult to imagine that the multilateral instrument will be abandoned after the BEPS treaty norms have been implemented. Brauner, *supra* note 90, at 1030.

400. This prescription is similar to that suggested by Victor Thuronyi with regard to developing nations signing “skinny treaties” that do not yield taxing rights, although my recommendation is broader than his since it applies to developed nations as well. See Victor Thuronyi, *Tax Treaties and Developing Countries*, in *TAX TREATIES: BUILDING BRIDGES BETWEEN LAW AND ECONOMICS* 441, 445 (Michael Lang et al. eds., 2010).

to automatically update treaties as the circumstances of a nation change.

Leveraging the multilateral instrument would also allow for intermediate options that a nation could opt into. Instead of abandoning the low treaty rates on withholding, for instance, they could be raised somewhat in between the current treaty rates and the statutory rates. Nations could even specify a range that they would tolerate, and if the treaty partner's range also matches, then the treaty rates could be adjusted to the mid-point of overlap.

Another more moderate option would be to expand upon the permanent establishment concept, allowing for taxation at source without a physical presence as is contemplated as a possibility in BEPS 2.0.⁴⁰¹ This would provide much-needed certainty of legality for the incremental taxes that have thus far been implemented in various countries. Reforming the concept of permanent establishment could also make source country jurisdiction contingent upon administrative capacity of the source country.⁴⁰² Since a country without the ability to collect source country taxes is arguably not losing anything from residence country taxation, treaty partners may decide this is an efficient allocation of taxing jurisdiction.

An important aspect of this approach is flexibility. Currently, the multilateral instrument goes a long way in this regard by allowing countries to opt in and out of proposals. Even the minimum standards, which signatories to the instrument are required to meet, can be fulfilled in a variety of manners. Since the multilateral instrument allows nations to pick and choose which treaties are subject to which new provisions, this would allow countries with asymmetric trade flows or different tax systems to opt out of the tax allocation provisions when it is not in their interest. One treaty partner's opting out, however, will likely negatively impact the other from a revenue standpoint. Once the other country sees that withdrawal is imminent, however, it may be in their interest to acquiesce to the unilateral withdrawal rather than risk the termination of the entire treaty. The countries may also decide to come to an agreement to scale up source-based taxation. Moreover, the multilateral instrument could provide a means to revisit the treaties if a country's economic circumstances changed.

401. OECD, INCLUSIVE FRAMEWORK, *supra* note 6.

402. Brooks & Krever, *supra* note 1, at 170.

Rather than the 3000 tax treaties that are nearly identical to one another, we could have a system of bilateral tax treaties that are better calibrated to national interests. Moreover, by deemphasizing residence-based jurisdiction, this type of system may help to solve the stateless income problem. Finally, because the pared down treaty system would necessarily give way to more domestic solutions, international tax could respond more readily to current economic conditions and tax planning maneuvers. Although some might critique this solution as causing chaos in the international tax sphere, I would argue that we are at least on the precipice of that point already, and an ordered unwinding of the system is preferable to unilateral moves by individual nations that we are beginning to see.

Another advantage of this proposal is that it would give nations the space and flexibility to experiment with new ways to tax cross-border income. As countries have struggled with various methods of taxing stateless income it has become apparent that fitting such new taxes into the old tax treaty model is a fool's errand. Moreover, the time to explore novel approaches to cross-border taxation is now, as the E.U. state aid controversy and other developments have suddenly cast doubt upon the longstanding status quo of preventing double taxation as the sole focus of the international tax system.⁴⁰³

If tax treaties are at least partially unraveled, we might ask how and when the new system should be rebuilt. It is my view that even if true multilateral coordination of the tax base is not achieved, abandonment of or scaling down aspects of the current bilateral system is still worthwhile given their harmful effects. Ideally, however, a new system could be put into place as the older treaties are being unraveled. The best solution would be for nations to come together to decide on new principles that can accommodate our changing world.⁴⁰⁴ This could, for instance,

403. See Steven A. Dean, *A Constitutional Moment for Cross-Border Taxation* (Jan. 30, 2020) (unpublished manuscript) (on file with author) (likening the current political environment in cross-border taxation to a potentially transformative constitutional moment).

404. Optimistically, the BEPS 2.0 efforts are indicia that such coordinated innovation is beginning to occur. OECD, INCLUSIVE FRAMEWORK, *supra* note 6, at 22–23. Although a consensus has not yet been reached, the OECD/G20 has begun to seriously consider the expansion of market jurisdiction taxing rights, a minimum tax regime, and inbound base erosion rules. *Public Consultation Document: Secretariat Proposal for a “Unified Approach” Under Pillar One*, ORG. FOR ECON. CO-OPERATION & DEV. 4 (2019), <https://www.oecd.org/tax/>

mean engaging in a true substantive multilateral treaty in order to design profit allocation rules. Such principles must extend beyond the EU's current sectorial focus of digital taxation and the geographic focus on large U.S. corporations. Multilateral solutions should also strengthen source-based taxation in instances where the residence country is not taxing the income. To the extent an initial allocation of taxing jurisdiction is retained, the multilateral instrument could, for instance, pursue provisions that "throw-back" the tax to a state if the state of initial apportionment does not tax the item.⁴⁰⁵

More modestly, the multilateral instrument could be used to resolve problems of inconsistent tax treatment. For instance, countries could agree to harmonize their tax rules in certain areas or to make adjustments to their domestic rules in order to achieve consistent tax treatment.⁴⁰⁶ It could also be used to refine source rules to incorporate more destination-based concepts such as customer base.⁴⁰⁷ Domestic double-tax relief systems could then function in a better manner. Likewise, other problems

beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf [https://perma.cc/S9G6-8Z57]; *Public Consultation Document: Global Anti-Base Erosion Proposal ("Globe")—Pillar Two*, ORG. FOR ECON. CO-OPERATION & DEV. 5 (2019), <https://www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf> [https://perma.cc/9RYW-J67N].

405. Wells & Lowell, *supra* note 20, at 38 n.181. Such a system would replicate the "throw-back rules" adopted by several states in the United States. See Walter Hellerstein, *The Quest for 'Full Accountability' of Corporate Income*, 63 ST. TAX NOTES 627 (2011).

406. See Victor Thuronyi, *International Tax Cooperation and a Multilateral Treaty*, 26 BROOK. J. INT'L L. 1641, 1652 (2001). Some multilateral proposals seek to simply replicate the OECD bilateral model treaty on a multilateral basis. See Michael Lang et al., *Draft for a Multilateral Treaty*, in MULTILATERAL TAX TREATIES: NEW DEVELOPMENTS IN INTERNATIONAL TAX LAW (Michael Lang et al. eds., 1998). Tsilly Dagan has also argued for greater coherence in harmonizing the international tax system through focus on such rules, although not through a treaty or instrument per se. DAGAN, *supra* note 5, at 311–12. Harmonization of tax rules has been done on a small, although not legally binding, scale. See *Recommendation of the Council on the Tax Deductibility of Bribes to Foreign Public Officials*, ORG. FOR ECON. CO-OPERATION & DEV. (Apr. 11, 1996) (representing a political commitment by OECD countries to deny a deduction for bribes).

407. See Paul Oosterhuis & Amanda Parsons, *Destination-Based Income Taxation: Neither Principled nor Practical?*, 71 TAX L. REV. 515, 515–23 (2017).

of cross-border arbitrage could be addressed by the multilateral instrument.⁴⁰⁸

If multilateral solutions are not found, domestic law could step in to serve as a coordination device. For instance, domestic law could impart some of the give and take in foreign relations by premising code provisions on reciprocity. This would allow nations to have more control over their revenue policy while also partially tying tax systems together. This would also address one potential objection to ceding more authority to individual nations—that control over international relations would be lost because nations would no longer have the *quid pro quo* negotiation that the treaty system imparts.

It would also remove some of the arbitrariness in applying different policies to treaty and nontreaty countries, even if the economics or politics of the situation call for uniform treatment between the two. A reciprocal code provision would instead tie foreign relations policy to the desired criteria. For instance, a code provision could reallocate profits from a foreign related party to a domestic-related party if the foreign profits were not subject to meaningful taxation abroad. This would be similar to the new kill-switch provisions in the 2016 U.S. Model Treaty but would have the advantages that unilateral decision-making brings.⁴⁰⁹ After all, precisely those countries that are reluctant to tax such income may also be reluctant to implement these new treaty provisions. Other destination-based statutory solutions, like destination-based taxes or experimental source rules, could also be utilized to preserve taxation of business income.⁴¹⁰ As these rules are enacted by a powerful country like the United States, other nations may follow suit, creating harmonization without multilateral action.

Another significant advantage domestic law has over treaties is, at least in the United States, greater democratic process and transparency. With regard to statutory changes, both houses of Congress are involved, there is greater opportunity for

408. On a more ambitious level, proponents of formulary apportionment may wish to use the multilateral instrument to shift to such a system.

409. See U.S. MODEL TREATY, *supra* note 32, arts. 11, para. (2)(c), 12, para. (2)(a), & 21, para. (2)(a).

410. Such solutions need not wholly embrace destination-based taxation but could instead utilize some of its principles alongside the existing system. This incremental approach would allow for experimentation with a new form of taxation on a platform less risky than, say, the destination-based cash flow tax that would have replaced the corporate income tax.

deliberation, and any changes would be subject to the normal budget process.⁴¹¹ This has the advantage of bringing scrutiny over policies that benefit multinational corporations at perhaps great cost to the fisc. Although one can make the case that tax treaties allow countries to strategically enact different tax systems for foreign and domestic investors,⁴¹² such differentiation would still be attainable in, and would benefit from, a robust legislative process. Such a solution would also lend itself to greater policy innovation and fiscal flexibility.

CONCLUSION

To conclude, this Article finds fault with the traditional justifications offered in favor of bilateral tax treaties. Most criticism towards these treaties has been done on behalf of developing nations, but countries like the United States also stand to lose from the status quo. Rather than accommodating tax reform or reflecting differences in tax systems or trade flows, the treaties, by and large, are entrenched and follow a single model. At a minimum, formal revenue and economic analyses of double income tax treaties should be undertaken to explore whether the treaties are in the interest of the United States. Further, this Article argues that the most damaging aspects of the tax treaties are those provisions that allocate taxing jurisdiction. Countries should abandon or scale back these provisions, leveraging the new multilateral instrument as a possible means to do so. The hope is that this process paves the way toward a more dynamic and heterogenous tax treaty and the rebuilding of a more rational international tax system. Gone are the days where nations are able to invoke some notion of economic neutrality to justify a uniform international tax system. Instead, the system must do its best to coordinate within a world of competing national interests.

411. See Kysar, *supra* note 2, at 33.

412. See Zolt, *supra* note 286, at 14.

APPENDIX

A. BUREAU OF ECONOMIC ANALYSIS DATA 2003–2017
(MILLIONS OF DOLLARS)⁴¹³

Country	Net Lending (+) or Net Borrowing (-) from Current, Capital, & Financial Account Transactions	Net Lending (+) or Net Borrowing (-) from Financial Account Transactions
Belgium	921,88	170,508
France	-669,771	-509,618
Germany	-1,508,415	-616,350
Italy	-311,887	-2259
Luxembourg	-126,115	-149,878
Netherlands	1,273,415	300,870
United Kingdom	-651,997	-863,954
Canada	-284,902	-226,364
Mexico	-943,492	82,432
Venezuela	-212,379	25,799
Australia	785,465	305,549
China	-5,745,479	-1,435,305
India	-344,510	-26,552
Japan	-2,009,670	-759,504
Republic of Korea	-366,308	-199,994
South Africa	-4448	-612
Total	-11,028,305	-3,905,232

413. See Table 1.3. *U.S. International Transactions*, BUREAU OF ECON. ANALYSIS: INTERACTIVE DATA, <https://apps.bea.gov/iTable/iTable.cfm?ReqID=62&step=1> (follow “International Transactions (ITA)”; then follow “Table 1.3. U.S. International Transactions, Expanded Detail by Area and Country”).

B. U.S. DEPARTMENT OF TREASURY ANNUAL SURVEY OF PORTFOLIO HOLDINGS, 2003–2017 (MILLIONS OF DOLLARS)⁴¹⁴

Second, I studied the U.S. Department of Treasury Annual Survey of Portfolio Holdings, which consists of stock data at particular points in a given year since 2003. The Annual Survey lists both the value of foreign holdings of U.S. securities and the value of U.S. portfolio holdings of foreign securities. Of the sixty-six countries listed on the IRS website, two countries did not have sufficient security holdings to list. The rest were examined. Notably, the Treasury data revealed the U.S. had inflows of capital greater than outflows with respect to the tax treaty countries in every year in which data was collected except one (2006). From 2003 to 2017, the net flows were negative by \$22.14 trillion or an average of \$1.476 trillion per year.

Year	Tax Treaty Country Holdings of U.S. Securities at End of June of Year Shown	Market Value of U.S. Holdings of Tax Treaty Country Securities at End of the Year Shown	Net Flows
2017	13,462,660	12,408,946	-1,053,714
2016	12,580,491	9,891,264	-2,689,227
2015	12,563,446	9,454,779	-3,108,667
2014	12,080,917	9,604,305	-2,476,612
2013	10,564,471	9,130,409	-1,434,062
2012	9,659,592	7,958,388	-1,701,204
2011	9,212,767	6,840,849	-2,371,918
2010	7,893,465	6,763,362	-1,130,103
2009	7,167,285	5,976,711	-1,190,574
2008	7,646,906	4,291,407	-3,355,499

414. See *Foreign Holdings of U.S. Securities at the End of the Period Shown*, DEPT. OF THE TREASURY/FED. RESERVE BD.: TREASURY INT'L CAPITAL SYS. (Apr. 30, 2019), <https://www.treasury.gov/resource-center/data-chart-center/tic/Pages/index.aspx> [<https://perma.cc/H56D-ZZJ9>]; *Market Value of U.S. Holdings of Foreign Securities at the End of the Year Shown*, DEPT. OF THE TREASURY/FED. RESERVE BD.: TREASURY INT'L CAPITAL SYS. (Oct. 31, 2019), <https://www.treasury.gov/resource-center/data-chart-center/tic/Pages/index.aspx> [<https://perma.cc/Q3DD-EEYG>].

2020]	<i>UNRAVELING THE TAX TREATY</i>		1835
2007	7,307,148	7,219,707	-87,441
2006	5,842,935	5,990,896	147,961
2005	5,164,573	4,609,105	-555,468
2004	4,505,334	3,786,635	-718,699
2003	3,571,856	3,152,282	-419,574
Total Net Flows			-22,144,801
Average Net Flows Per Year			-1,476,320

C. U.S. DEPARTMENT OF TREASURY DATA BY COUNTRY, 2017
(MILLIONS OF DOLLARS)⁴¹⁵

Countries and Regions	Value of Foreign Hold- ings of U.S. Se- curities as of June 20, 2017	Value of U.S Portfolio Holdings of Foreign Securities as of Dec. 31, 2017	Net Flows
Armenia (11)	622	284	-338
Australia	270,762	354,873	84,111
Austria	19,934	32,061	12,127
Azerbaijan (11)	7,361	1,629	-5732
Bangladesh	1,005	924	-81
Barbados	23,793	2,352	-21,441
Belarus (11)	151	1,012	861
Belgium and Luxembourg (5)	NA	NA	NA
Belgium (5)	690,855	72,481	-618,374
Bulgaria	169	202	33
Canada	1,060,832	995,893	-64,939
China (21)	1,540,549	162,282	-1,378,267
Cyprus	620	2,115	1495
Czech Republic (10)	23,507	4,764	-18,743
Denmark	124,571	110,150	-14,421

415. See *Foreign Holdings of U.S. Securities at the End of the Period Shown*, supra note 414; *Market Value of U.S. Holdings of Foreign Securities at the End of the Year Shown*, supra note 414.

Egypt	8,548	8,093	-455
Estonia (11)	457	214	-243
Finland	45,098	47,152	2054
France	291,810	604,774	312,964
Georgia (11)	74	953	879
Germany	427,172	494,275	67,103
Greece	3,935	9,988	6053
Hungary	2,557	12,632	10,075
Iceland	3,395	2,600	-795
India	133,423	194,444	61,021
Indonesia	33,974	73,228	39,254
Ireland	1,068,048	495,403	-572,645
Israel	87,640	66,211	-21,429
Italy	78,187	140,214	62,027
Jamaica	976	1,059	83
Japan	1,998,329	1,132,251	-866,078
Kazakhstan (11)	28,523	5,688	-22,835
Korea, South	281,754	263,113	-18,641
Kyrgyzstan (11)	NA	0	NA
Latvia (11)	2,095	219	-1876
Lithuania (11)	281	1,444	1163
Luxembourg (5)	1,397,779	145,873	-1,251,906
Malta	1,499	1,260	-239
Mexico	97,115	162,693	65,578
Morocco	1,811	0	-1811
Mozambique	355	2,249	1894
Netherlands	397,974	537,731	139,757
Netherlands Antilles (22)	NA	NA	NA
New Zealand	26,582	20,468	-6114
Norway	340,323	71,188	-269,135
Pakistan	3,830	3,430	-400
Philippines	42,703	27,545	-15,158
Poland	36,035	26,669	-9366
Portugal	8,358	14,924	6566
Romania	3,374	4,196	822
Russia (11)	103,403	69,191	-34,212

2020]	<i>UNRAVELING THE TAX TREATY</i>		1837
Slovakia (10)	314	386	72
Slovenia (6)	2,176	1,706	-470
South Africa	22,393	115,362	92,969
Spain	59,953	158,215	98,262
Sri Lanka	1,039	4,461	3422
Sweden	180,244	172,330	-7914
Switzerland	823,897	505,951	-317,946
Tajikistan (11)	1	47	46
Thailand	79,193	51,056	-28,137
Trinidad and Tobago	9,748	677	-9071
Tunisia	1,089	1,842	753
Turkey	59,367	39,814	-19,553
Turkmenistan (11)		0	
Ukraine (11)	2,270	8,978	6708
United Kingdom	1,493,215	1,473,490	-19,725
Uzbekistan (11)	4	0	-4
Venezuela	5,609	3,014	-2595
Total	13,462,660	8,919,723	-4,542,937
