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Purism and Contextualism within International Tax Law Analysis: How Traditional Analysis Fails Developing Countries

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Abstract

There are two broad approaches to the study of international tax law. Purists adopt a traditional approach, emphasizing conceptually pure tax solutions based on efficiency interests. Contextualists combine economic analysis with political, historical, social, institutional and other perspectives. It is argued that the Purist approach is overly-reliant on international tax economics which, in turn, is challenged by significant theoretical, empirical, and behavioral uncertainty. The Purist analysis nevertheless can be effective in respect of situations in which there are relatively balanced capital flows between countries with developed economies. Developing countries, however, are generally capital importing nations and their interests tend to be downplayed under the Purist approach. In an increasingly integrated global economy, the Contextualist perspective is more effective at taking account of the interests and needs of developing countries and, in so doing, promotes the long-term economic and security interests of developed countries.

I. INTRODUCTION

The roots of the modern international tax regime are often traced back to the work of the famed group of four economists who helped to design it.[1] Since that time, economic thought has played a significant, possibly dominant, role in international tax law analysis. Under the traditional approach, legal analysts look to guiding principles that are typically broken down into efficiency and equity categories.[2] Efficiency concerns include the need to promote capital export and/or import neutrality, low compliance costs for multinational companies and ease of enforcement for tax authorities. Equity concerns typically surround the need to promote 'fairness' in the division of tax revenues from international transactions and the preservation of

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[1] See Professors Bruins, Enaudi, Seligman and Sir Josiah Stamp, *Report on Double Taxation Submitted to the Financial Committee* (League of Nations, 1923) [Group of Experts].

[2] For a discussion, see, e.g., Nancy H. Kaufman, 'Fairness and the Taxation of International Income' (1998) 29 *Law and Policy in International Business* 145.

vertical and horizontal equity between taxpayers with domestic sources of income and taxpayers with international sources of income.

Under traditional legal analysis, the efficiency concerns tend to dominate in part because there is very little agreement on the normative foundations for the equity issues.[3] As a result, this analysis often circumvents what is arguably the central policy concern of international tax law—how can countries share in a fair manner the international income tax base?[4] Legal scholars who emphasize conceptually pure solutions based on efficiency premises can be characterized as Purists.[5]

As many observers have noted, a lack of attention to equity concerns poses few problems when inflows and outflows of capital are relatively balanced as the two countries will collect roughly equal amounts from the source-based and residence-based components of their international tax rules. The main losers under the traditional approach may be developing countries which tend to be capital importers. Moreover, the emphasis on efficiency concerns downplays the historical/institutional/political/social and/or other context that determines the path of international tax law.[6]

An alternative approach—deployed by analysts who could be characterized as Contextualists—takes into account the interplay between efficiency interests and these other factors to promote a better understanding of the ways that tax reform can promote optimal policy solutions. In particular, Contextualists generally view a fair sharing of the international income tax base as complementary with efficiency concerns because countries that feel that they are not sharing in their entitlement to

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[3] See, e.g., Klaus Vogel, 'World vs. Source Taxation of Income – A Review and Re-evaluation of Arguments (Part III)' (1988) 11 *Intertax* 393, 393(noting that equity is an interpretive concept that can only be explained, not defined); Michael J. Graetz, 'Taxing International Income: Inadequate Principles, Outdated concepts and Unsatisfactory Policies' (2001) 26 *Brooklyn Journal of International Law* 1357, 1362 (arguing that traditional international tax principles may inhibit sound policy analysis); Stephen E. Shay, J. Clifton Fleming, Jr. & Robert J. Peroni, 'The David R. Tillinghast Lecture "What's Source Got to Do With It?" Source Rules and U.S. International Taxation' (2002) 56 *Tax Law Review* 81, 83-84 (noting the lack of normative foundation and arbitrariness of the design of existing rules).

[4] See Jinyan Li, Arthur Cockfield and Scott Wilkie, *International Taxation in Canada: Practices and Principles* (2006) 375-377.

[5] For a few works that emphasize the Purist approach see Paul R. McDaniel, 'Formulary Taxation in the North American Free Trade Zone' (1994) 49 *Tax Law Review* 691; Daniel Shaviro, 'Some Observations Concerning Multijurisdictional Tax Competition' in Daniel Esty and Damien Geradin (eds.) *Regulatory Competition and Economic Integration: Comparative Perspectives* (2001) 49; Jinyan Li, *International Taxation in the Age of Electronic Commerce: A Comparative Study* (2003)(advocating, in part, global formulary apportionment); Ewen McCann and Tim Edgar, 'The International Income Taxation of Portfolio Debt in the Presence of Bi-Directional Capital Flows' (2006) 4(1) *eJournal of Tax Research* 5. I have also at times analyzed efficiency interests without examining broader interests. See, e.g., Arthur J. Cockfield, 'The Law and Economics of Digital Taxation: Challenging Traditional Tax Law and Principles' (2002) 56 *Bulletin for International Fiscal Documentation* 606. Under one view, economics can reveal insights not available to other social sciences. See, e.g., Edward Lazear, 'Economic Imperialism' (2000) 115(1) *The Quarterly Journal of Economics* 99. This paper can be seen as part of the literature that criticizes an over-emphasis on efficiency concerns within certain legal analysis. See, e.g., Arthur Allen Leff, 'Economic Analysis of Law: Some Realism about Nominalism,' (1974) 60 *Virginia Law Review* 451; James Boyd White, 'Economics and Law: Two Cultures in Tension' (1987) 54 *Tennessee Law Review* 161.

[6] See Richard L. Doernberg, 'Electronic Commerce and International Tax Sharing' (1998) 16 *Tax Notes Int'l* 1013 (claiming that the desire for conceptual purity may frustrate progress towards more effective sharing of revenues among nations).

revenues will be less cooperative, potentially leading to international tax disputes, international double taxation and the inhibition of international trade and investment.[7] In other words, in an increasingly integrated global economy, the emphasis on efficiency concerns at the expense of a fuller exploration of equity concerns may be also harming the long-term economic interests (and possibly security interests) of developed countries.

At the outset, it is important to recognize that the division of international tax law analysts into Purist/Contextualist categories is, at least to a certain extent, an artificially concocted dichotomy.[8] While there is an overarching emphasis on efficiency or integration in these different approaches, there is often an attempt to recognize the potential and pitfalls associated with either approach.[9] Accordingly, the slotting of analysts into Purist/Contextualist camps is an admittedly reductionist interpretation of complex schools of thought. Nevertheless, the division will be helpful to illustrate the limitations associated with an emphasis on Purism as well as the potential for more non-traditional analysis employed by Contextualists.

Part II discusses some of the limitations with the traditional legal analytical approach that emphasizes efficiency concerns. The potential utility of international tax economics with respect to international tax law analysis is reduced by at least three sources of uncertainties: (a) a lack of clear benchmarks and theoretical uncertainty concerning optimal international tax policy, at least when compared to other areas such as domestic tax economics and international trade; (b) a lack of empirical work to confirm theoretical perspectives; and (c) a behavioral disconnect between efficiency prescriptions and international tax reform efforts pursued by government officials. These limitations are generally apparent to economists, but may be less well understood by international tax law scholars. As a result of the limitations associated with the Purist approach, the Part concludes by claiming that international tax law analysis needs to make greater resort of other analytical tools to complement the economic analysis. In particular, the approach deployed by Purists has tended to downplay the interests of developing countries by promoting tax reform efforts that favor the interests of capital exporting nations.

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[7] For discussion, see Arthur J. Cockfield, 'Balancing National Interests in the Taxation of Electronic Commerce Business Profits' (1999) 74 *Tulane Law Review* 133, 164-167; Joseph H. Guttentag, 'Key Issues and Options in International Taxation: Taxation in an Interdependent World' (2001) *Bulletin for International Fiscal Documentation* 546.

[8] I touched on these different analytical approaches in an earlier Commentary. See Arthur Cockfield, 'Commentary, Formulary Taxation versus the Arm's Length Principle: The Battle among Doubting Thomases, Purists and Pragmatists' (2004) 52(1) *Canadian Tax Journal* 114. I have changed the word 'Pragmatists' to 'Contextualists' as the former term was considered somewhat misleading by certain commentators.

[9] Economists also try to recognize the limitations surrounding an exclusive focus on efficiency concerns. See, e.g., Robin Boadway, 'Income Tax Reform for a Globalized World: The Case for a Dual Income Tax' (2005) 16 *Journal of Asian Economics* 910, 913 (2005)(noting that theoretical considerations must be tempered by the feasibility of applying the principles in practice); Charles E. McLure, Jr., 'Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Law' (1997) 52 *Tax Law Review* 269 (discussing historical developments that drove efficiency and equity concerns); Richard M. Bird and Pierre-Pascal Gendron, *The VAT in Developing and Transitional Countries* (2007)(using case studies to examine the effectiveness of VAT regimes in certain developing countries); Richard A. Musgrave, *Fiscal Systems* (1969) 243-252 (discussing the compatibility of efficiency and equity concerns).

Part III discusses how the Contextualists' use of broader contextual analysis that emphasizes historical, political, institutional, social or other developments could provide a deeper understanding of potential reform efforts and focus attention back on one of the central issues of international tax law—how to share the international tax base in a fair manner. The approach in particular would seek to understand how international tax reform actually takes place by examining the pragmatic concerns of governments and their constituents who collectively determine the path of international tax law. Pragmatic tax solutions that encourage cooperation will benefit developed countries by ensuring that tax barriers to foreign investment in developing countries are reduced while encouraging more revenue flows to the latter countries as they become wealthier and require a larger role for governments.[10] Moreover, the Contextualist approach avoids the 'one size fits all' perspective evident in much Purism analysis so that tax policy prescriptions can address the specific cultural, political, and economic needs and realities of developing countries.

The Part also provides a case study to show how the Contextualist approach could shed insight into global tax reform efforts. The case study involves a review of the OECD's e-commerce taxation reform process, which shows the potential for 'soft law' and loyalty to this reform process to encourage the adoption of uniform cross-border tax rules and practices. In particular, the reform process showed that enhanced formal outreach mechanisms (with a particular focus on building up local expertise in tax administration) promote cooperation with and 'buy in' by developing countries with respect to international tax rules and practices. Moreover, the institutions deployed by the OECD can be portrayed as 'adaptively efficient' as these institutions were perceived to be productive, stable, fair, and broadly accepted by OECD countries and, to a certain extent, non-OECD countries. An OECD outreach program that provides permanent 'Tier II' membership within the Committee on Fiscal Affairs is proposed to provide more opportunities for developing countries to deliberate and participate in reform efforts.

II. THE LIMITATIONS ON TRADITIONAL EMPHASIS ON EFFICIENCY CONCERNS

A. The Roots of Purism

As mentioned at the outset, views by economists have played an important role in shaping the modern international tax regime. The desire by many of these economists for conceptually pure solutions based on efficiency concerns can be seen in the well-known report authored by Professors Bruin, Einaudi, Seligman and Sir Josiah Stamp (the "Group of Experts").[11] In 1921, the Financial Committee of the League of Nations was concerned with discovering ways to "remove the evil consequences" of international double taxation that was thought to be inhibiting international trade and

[10] The analysis is primarily directed at showing how different analytical approaches can generate different ways about thinking about international tax rules and principles. The paper avoids discussion of the most efficient or equitable tax regimes for developed or developing countries. Some observers maintain, for example, that a dual income tax regime is preferable over a comprehensive income tax from an international policy perspective for all countries, and that the case for such a system, mainly on efficiency and administrative grounds, is even stronger for developing countries. See Boadway, above n 9; Eric M. Zolt and Richard M. Bird, 'Redistribution via Taxation: The Limited Role of the Personal Income Tax in Developing Countries' (UCLA Law and Economics Research Paper no. 05-22, 2005) 65-69.

[11] Group of Experts Report, above n 1.

investment.[12] The Financial Committee provided the Group of Experts with a number of terms of reference to assist in the framing of their work, including "What are the economic consequences of double taxation from the point of view: (a) of the equitable distribution of burdens; [and] (b) of the interference with economic intercourse and with the free flow of capital?"[13]

In 1923, the Group of Experts presented their masterful report, which ultimately played an important role in laying the foundation for the subsequent debate surrounding the design of optimal international tax rules and bilateral agreements. In particular, the report played a great influence on the now-accepted differential cross-border tax treatment of different categories of income: income streams generated by land or commercial establishments ("corporeal wealth") should be taxed at their source while primary taxing jurisdiction for interest, dividends, and professional services ("intangible wealth") would be assigned to the residence jurisdiction.[14]

The Group of Experts acknowledged that governments historically emphasized that they have the primary right to tax income generated within their borders, which was considered to be the "*main* instinctive principle."[15][their emphasis] They noted that the residence or source country may both claim tax jurisdiction over different income streams under entitlement theories (such as the theory of economic allegiance developed by the Group of Experts where "a part of the total sum paid according to the ability of a person ought to reach the competing authorities according to his economic interest under each authority") and hence they accepted that any geographic divisions in the tax base will be somewhat arbitrary.[16] For this reason, they did not dwell extensively on the first part of the question posed by the Financial Committee concerning the 'equitable division' of tax revenues.

The economists emphasized the need to promote taxation on a residence-basis in part because of the desire to ensure that progressive individual income taxes could be applied to world-wide income streams on the basis of a taxpayer's ability to pay taxes. They considered a number of options to relieve international double taxation and ultimately recommended the 'method of exemption for income going abroad' whereby source countries would exempt all non-residents from taxation on income from sources within their borders.[17] The method of exemption was primarily justified on efficiency grounds in that it was considered to be the most straight-forward solution to prevent international double taxation.

The Group of Experts noted that where capital flows are fairly equal between countries, the solution would promote "rough justice" as both countries would enjoy the benefit of collecting similar revenue streams. They recognized that this solution may not appeal to capital importing countries because "it does violence to what are at

[12] Ibid at 3.
[13] Ibid.
[14] Ibid at 39. This classification system already existed in certain tax treaties of the era, but the Group of Experts provided an economic justification for the regime.
[15] Ibid at 40.
[16] Vogel discusses how the late 19th Century scholarship of Georg von Schanz similarly agreed that both source and residence state had legitimate tax claims over cross-border transactions on the grounds of services provided. In Schanz' view, the source state, however, typically provides more services and hence should be entitled to share in a greater amount of the income tax base. See Vogel, above n 3, 395.
[17] See Group of Experts, above n 1, 48, 51.

present their instinctive ideas as to their rights to origin [i.e., source] taxation."[18] Nevertheless, they thought that capital importing and developing countries might be amenable to this approach because: (a) it would encourage more investment in these countries; (b) mechanisms could be created to give them a residual right to tax certain streams of income at the source; (c) government fiscs could negotiate end-of-year transfers to make up for revenue losses; and (d) as developing nations became more industrialized the capital flows would become more balanced.[19]

In 1925, a group of technical experts reviewed the Group of Experts' report to determine how the League of Nations should proceed with respect to the development of international tax agreements.[20] These experts noted that the most common mechanism already employed by countries (including the first multilateral tax treaty—the Rome Convention—signed in 1921) was the 'method of classification and assignment of sources.'[21] Moreover, the technical experts asserted that certain types of source taxation such as that of interest might in fact be the most efficient and administratively feasible because the tax is imposed on the payor of the interest.[22] Rejecting the Group of Experts's main recommendation, the experts proposed a system based more in line with existing mechanisms whereby real property and commercial establishments would be subjected only to source-based taxation through 'impersonal taxes' (or *impot réels*) while individual non-residents should be exclusively taxed by the resident country through their 'personal taxes' which may have progressive rates.[23]

In 1928, the League of Nations published its first model tax convention that was based in part on the views of the Group of Experts as well as the more recent work by the technical experts. In 1933, the Fiscal Committee of the League of Nations proposed another model tax treaty on the allocation of business income that enshrined many of the principles apparent in today's model treaties:[24] source countries were provided with primary jurisdiction to tax business profits attributable to permanent establishments and dependent agents (an interesting side note is that this model treaty proposed the separate accounting arm's length rule to divide profits among related permanent establishments, but also envisioned formulary taxation—and not transactional profit split methods—as a back-stop rule in the event that the arm's length method was inapplicable.). In other words, the Group of Experts' main recommendation was rejected in favor of tweaking the *status quo* that had been previously found to be acceptable by governments.

As discussed in Part III, the path of international tax law is likely determined by an integration of efficiency concerns with other factors such as historical, institutional, political and/or social interests. This may be the case because policymakers recognize the limitations associated with prescriptions based primarily or exclusively on efficiency concerns. The following discussion overviews these limitations.

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[18] Ibid 49.
[19] Ibid 42, 49, 51.
[20] See Technical Experts to the Financial Committee of the League of Nations, *Double Taxation and Tax Evasion: Report and Resolutions* (League of Nations, Geneva, 1925).[Technical Experts]
[21] Ibid 14.
[22] Ibid 17.
[23] Ibid 31-33.
[24] See League of Nations Fiscal Committee, *Report to the Council on the Fourth Session of the Committee* (League of Nations, June 26, 1933).

B. Theoretical Uncertainty

i. Lack of Benchmarks

Unlike certain areas such as international trade, international tax economics struggles with the fact that there is little agreement on the appropriate benchmarks to gauge the efficacy of policy prescriptions. For example, under neoclassical trade theory a country that unilaterally reduces its tariffs will be better off as its importers will be able to access international services and products at a reduced price, which should enhance their own efficiencies.[25] In the long term, countries should unilaterally or collectively move toward free trade, which will enhance national and international efficiency, lead to a better allocation of cross-border resources and increase standards of living. For these reasons, the consensus view among economists supports a reduction of tariffs along with free trade. While there remain a number of challenges to assumptions underlying trade theory such as perfect information, perfect competition, and so on, the basic insight that reduced barriers to trade enhances welfare is generally accepted.

In contrast, there is less theoretical agreement on optimal international tax solutions.[26] Taxes imposed on cross-border transactions will almost always carry efficiency costs at the national and international level.[27] A country that offers tax rate and/or base incentives for international investments may improve its domestic welfare potentially at the expense of international efficiency concerns. For example, a country could offer a generous research and development tax credit to both domestic and foreign firms that conduct these activities within its borders. This move could lead to a misallocation of resources as multinational firms start-up or relocate their research and development departments because the after-tax cost of engaging in these activities has now been reduced (hence increasing the returns on engaging in these activities). From an international efficiency perspective, the misallocation of mobile factors of production is thought to be undesired because it reduces capital productivity, which is ultimately thought to lower world-wide standards of living (i.e., the misallocation may lead to an overall diminishment of global per capita income). Moreover, these sorts of misallocation of resources for tax reasons may be inhibiting the efficiency of regionally integrated free trade areas or customs unions and reduce their competitiveness vis à vis other competitor trade blocs or nations.

From a national interest perspective, however, it may make economic sense to promote these sorts of tax incentives for both domestic and foreign businesses: to the extent that the incentives actually work they arguably generate new economic activities that in turn may raise additional revenues (to offset the losses resulting from the credit) or perform some other function deemed necessary for national economic success such as attracting or retaining a highly-skilled workforce.

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[25] A classic work in this area is P.A. Samuelson, *The Foundations of Economic Analysis* (1947). For a discussion of trade and tax issues, see, e.g., Joel Slemrod, 'Tax Cacophony and the Benefits of Free Trade' in Jandish Bhagwhati and Robert E. Hudec (eds.) *Fair Trade and harmonization: Prerequisites for Free Trade?* (1996) 283.

[26] But see Michael Keen and David Wildasin (2004) 'Pareto-Efficient International Taxation' 94:1 The American Economic Review 259 (attempting to derive the conditions for efficient international tax rules).

[27] For a more comprehensive discussion of these issues, see Arthur J. Cockfield, *NAFTA Tax Law and Policy: Resolving the Conflict between Sovereignty and Economic Interests* (Toronto: University of Toronto Press, 2005) [NAFTA Tax Law and Policy] 15-21, 145-150.

As long as national interest and international interests differ and compete, it is difficult to foresee how the problems associated with a lack of benchmarks can be resolved.

This lack of benchmarks also presents challenges to theoretical perspectives concerning whether tax competition promotes positive or negative results. Literature in this area initially focused on local (i.e., municipal) and subnational (i.e., provincial or state) competition with more recent efforts directed at the issue of international tax competition.[28] Despite these efforts, there remain a number of areas of uncertainty. To date, theoretical perspectives, depending on the assumptions made and the methodologies employed, appear to confirm both 'race to the bottom' (e.g., revenue losses and an increased focus on less mobile factors such as labor leading to a more regressive tax system) and 'race to the top' (e.g, the taming of Leviathan governments as well as efficiency gains associated with maintaining the flexibility to develop innovative tax rules) scenarios.[29] As such, the literature provides limited guidance upon which to base the design of international tax rules.

In addition, the literature on local/subnational taxation is far more extensive when compared to international tax economics.[30] Certain observers have questioned the extension of earlier models to the international arena as international tax competition differs from local/subnational tax competition in that:[31] (a) the benefit principle (i.e., tax payments match the benefits taxpayers receive) that is thought to promote optimal outcomes is less apparent in the international tax sphere; (b) there are more non-tax obstacles to international trade and investment; (c) information concerning tax and other investment costs is less available to taxpayers at the international level; and (d) federal and subnational governments have more sticks (e.g., threat of federal pre-emption of state taxing powers in the United States) and carrots (e.g., redistribution of income tax revenues among provinces in Canada) that can encourage cooperation to reach at least potentially efficient outcomes.

Economists recognize the need for more empirical work in this area as well as a better accounting of non-efficiency interests such as political needs to "incorporate reasonable political processes into tax competition models, leading to sharper distinctions between good and bad tax competition."[32] Consider, for example,

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[28] See Charles Tiebout, 'A Pure Theory of Local Expenditures' (1956) 64 *Journal of Political Economy* 416 (concluding that tax competition for labor by municipal governments may promote an efficient provision of public goods); Wallace E. Oates, *Fiscal Federalism* (1972)(asserting that tax competition may lead to reduced revenues and an inability to fund needed government services).

[29] For a recent literature review, see Kenneth J. McKenzie, 'A Race to the Bottom in Provincial Business Taxation in Canada?' in Kathryn Harrison (ed.) *Racing to the Bottom? Provincial Interdependence in the Canadian Federation* (2006) 25, 36 ("[F]rom a theoretical perspective, it is impossible to conclude whether tax competition results in taxes that are too high, too low, or just right."); Wilson and Wildasin, below n 32 (discussing how models predict both welfare-improving and welfare-reducing effects associated with tax competition).

[30] See NAFTA Tax Law and Policy, above n 27, 160-163.

[31] See, e.g., Peggy B. Musgrave & Richard A. Musgrave, 'Fiscal Coordination and Competition in an International Setting, in Influence of Tax Differentials on International Competitiveness' in Klaus Vogel (ed.) *Proceedings of the VIIIth Munich Symposium on International Taxation* (1990) 61, 63-70 (arguing that the forces of competition cannot secure an efficient or equitable allocation of resources in the international arena).

[32] See John D. Wilson and David E. Wildasin, 'Capital Tax Competition: Bane or Boon' (2003) 88(6) *Journal of Public Economics* 1063, 1078.

potential tax competition between two countries: Smaller Economy receives the bulk of its foreign direct investment (FDI) from Larger Economy, which receives a small portion of its FDI from the other country. A game theory model can be developed whereby each country enjoys utility gains through the preservation of tax sovereignty as both governments wish to maintain their ability to design their own international tax rules to promote perceived self-interested goals.[33] Moreover, each country enjoys utility gains through the attraction of FDI.

Smaller Economy may be willing to engage in tax competition as the utility gains associated with attracting FDI outweigh its political concerns. In contrast, Larger Economy may be indifferent to the moves by Smaller Economy because the utility gains associated with attracting FDI from Smaller Economy are outweighed by the utility gained through the preservation of tax sovereignty. Because tax sovereignty concerns act as a constraint on Larger Economy's willingness to engage in tax competition, Smaller Economy is presented with an opportunity to undercut tax burdens on capital without facing the risk of retaliation from Larger Economy that could trigger a race to the bottom. Consistent with the Contextualist approach discussed below, by introducing realistic political concerns into the models, researchers may be able to derive a more accurate assessment of the possible outcomes associated with international tax competition.

ii. Lack of Agreement on Guiding Principles

Moreover, there are ongoing debates within the literature concerning more narrow efficiency concerns and their impact on national and international welfare. Consider the debate about whether international tax policy should promote capital export or import neutrality. Under capital export neutrality, tax policy should be designed so that domestic firms will not have a tax incentive to invest in foreign countries—the decision to invest at home or abroad should be neutral from a tax perspective. On the other hand, capital import neutrality maintains that firms should be able to compete on a level tax playing field with their competitors in foreign countries: under this view, tax rules should be structured so that taxpayers investing in foreign countries will be subject to roughly the same tax burdens as taxpayers from source countries.

The pursuit of either goal can lead to different and opposing policy proposals. To promote capital export neutrality, countries should adopt residence-based tax systems and provide foreign tax credits for foreign taxes paid (as well as tax refunds when the foreign tax exceeds the local tax, which no country has chosen to adopt). To promote capital import neutrality, countries should adopt source-based tax rules and a territorial tax system that does not strive to tax foreign earnings by resident taxpayers. Proponents of capital export neutrality and capital import neutrality both claim that their approaches would maximize global and/or national welfare: the former approach may enhance international welfare by encouraging firms to place their investments with the highest pre-tax returns while the latter approach would provide the same tax burden for investors on a given investment irrespective of where they reside and would also enable firms to compete on an even tax playing field. As noted by the Group of Experts in their 1923 report, because cross-border income is derived from multiple sources, it is a somewhat arbitrary exercise to assign income to a single

[33] See NAFTA Tax Law and Policy, above n 27, 166-174.

source.[34] Theoretical perspectives tend to support both sides of the capital import/capital export neutrality debate.[35]

The theoretical uncertainty surrounding guiding principles can be traced to the different national and international efficiency concerns noted previously. At the national level, institutional factors such as courts, tax authorities, and legislative bodies encourage consensus surrounding guiding principles that drive the formulation of tax laws. If necessary, the highest court in the land can pronounce on a particular issue that affects national and subnational tax concerns. Consider the ongoing dilemma surrounding the imposition of U.S. state and local sales and use taxes on out-of-state purchases: state governments want to extend their sales tax jurisdiction over out-of-state companies that sell goods (and in limited cases services) into their states while the federal government is concerned that burdensome compliance costs could inhibit inter-state commerce. In a series of cases, the U.S. Supreme Court developed a 'bright line' test where a state can only extend its tax jurisdiction over an out-of-state company if this company maintains a physical presence within the state (similar to the permanent establishment requirement in bilateral tax treaties for cross-border income tax purposes).[36]

Similarly, national legislators or, in certain cases, supranational institutions can encourage consensus. With respect to the former institution, for instance, the United States Congress passed the *Tax Reform Act of 1986* that broadened the income tax base and reduced tax rates in a manner that was generally compatible with many theoretical perspectives. With respect to the latter institution, for example, the European Union's Commission can promulgate Directives that bind the EU member states who must pass complimentary tax laws. For instance, in 2002, the Commission issued a VAT Directive that requires all non-EU companies to assess, withhold and remit VAT on cross-border sales of e-commerce goods and services to EU residents.[37] These EU efforts were based on the EU consensus view that the location of consumption for cross-border business-to-consumer VAT supplies is the jurisdiction in which the recipient has his or her usual residence.[38] Tax reform efforts will likely never escape controversy, but centralized institutions can nevertheless encourage consensus on guiding principles. At the international level, there are no formal mechanisms—no world tax authority or world tax court—to generate this consensus or act as the final arbiter.[39]

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[34] See also Hugh J. Ault and David Bradford, 'Taxing International Income: An Analysis of the U.S. System and its Economic Premises' in Assaf Razin and Joel Slemrod (eds.) *Taxation in the Global Economy* (1990) 11, 30-31.

[35] For arguments in favor of promoting capital export neutrality, see Sijbren Cnossen, 'Reform and Harmonization of Company Tax Systems in the European Union' (Erasmus University Rotterdam: Research Centre for Economic Policy Research Memorandum 9604, 1996)(noting that the consensus view among economists is that capital export neutrality maximizes global welfare). For arguments that capital import neutrality leads to the most efficient outcome from a national welfare perspective, see Vogel, above n 3.

[36] See National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967)(U.S. Supreme Court); Quill Corp. v. North Dakota, 504 U.S. 298 (1992)(U.S. Supreme Court).

[37] Council Directive 2002/38/EC of 9 May 2002, 2002 O.J. (L 128) 41.

[38] Importantly, the OECD member states came to the same consensus view as part of e-commerce reform efforts in 1998. See Ottawa Taxation Framework, below n 67.

[39] Certain taxes on goods and services are governed by the World Trade Organization and can be subjected to tribunal review. Similarly, NAFTA tribunals and bodies under other regional trade

In summary, theoretical uncertainty surrounding optimal international tax rules as well as the guiding principles that could guide the formulation of these rules reduces the utility of international tax economics with respect to international tax legal/policy analysis. Because national and international tax interests differ and there are not any international institutional bodies that can reconcile these differing interests, it is difficult to foresee a near-term resolution of the problems associated with this theoretical uncertainty. As noted by two economists, "Over time, less through the systemic or normative application of international tax principles than by the incremental evolution of rules deemed to be both roughly fair and roughly feasible, a regime that acknowledges and accommodates competing claims developed, for the most part with substantial international agreement as to both the underlying objectives and the means to achieve them."[40]

C. Empirical Uncertainty

Another area that bedevils international tax economics is a lack of empirical research that confirms theoretical perspectives. This can be attributed in part to the difficulties in conducting comparative analysis among different national tax regimes.

Consider, for example, some of the challenges facing attempts to estimate the impact of taxes on cross-border investment decision-making through the use of comparative marginal effective tax rate (METR) studies.[41] METR studies try to measure the impact of taxes on the marginal or last unit of investment activity.[42] A marginal investment is a project that is expected to earn a rate of return that is just sufficient to persuade investors that the project is worth investing in. Economists attempt to calculate how taxes reduce the pre-corporate rate of return and the post-personal rate of return for this investment.

For example, Joe knows that he can earn a 4% after-tax return by investing in a risk-free asset such as a government bond. Joe will only invest his money with a company if he believes he will be provided a return of at least 4% after-tax. Accordingly, a company will need to pay Joe dividends and/or capital gains of at least say 7% to give him his needed 4% return. The difference in these last two figures represents the amount Joe pays in individual income taxes. In addition, the company must earn a pre-corporate income tax return of say 11% to pay out the dividend of 7%: the difference between the two returns represents the amounts paid in corporate income taxes. In the example, the tax burden creates a difference of 7% between the original return on the investment to Joe of 4% and the return earned by the company before taxes of 11%. Economists attempt to calculate how taxes imposed on individuals and businesses reduce the return from 11 to 4% to generate the effective tax rate. Once the impact of these taxes can be identified, comparative analysis is conducted to show how the taxes of a particular country offer incentives or disincentives for local investment vis à vis competitor nations.

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agreements can rule on certain taxes on goods and services. The technical experts to the League of Nations similarly recognized in their 1925 report that a truly global tax system would only be workable if an international body could settle disputes surrounding the interpretation and application of a tax treaty. See Technical Experts, above n 20, 29.

[40] See Richard Bird and Jack Mintz, 'Sharing the International Tax Base in a Changing World' in Sijbren Cnossen and Hans-Werner Sinn (eds.) *Public Finance and Public Policy in the New Century* (2003) 405, 406.

[41] For more discussion, see NAFTA Tax Law and Policy, above n 27, 73-80.

[42] For discussion, see Robin Boadway, 'The Theory and Measurement of Effective Tax Rates', in Jack M. Mintz and Douglas D. Purvis (eds.) *The Impact Of Taxation on Business Activity* (1985).

While these studies are considered to be the most sophisticated way of estimating the influence of taxes on investment decision-making, economists recognize a number of drawbacks that reduce their utility with respect to policy analysis. First, economists deploy different methodologies (typically based on the King and Fullerton method[43] or some variation) to calculate METRs, which can generate very different results.[44] Second, the studies involve the use of assumptions that can lead to greatly varying results. For example, most of the models incorporate an assumption of full loss offsetting for losses suffered by taxpayers over the course of the year. If this unrealistic assumption is varied to include the fact that most tax laws only permit partial loss offsetting with time limits for loss carry-forwards and carry-backwards then the METRs may change in a significant manner.[45]

In fact, each model necessarily incorporates a number of assumptions, each one potentially controversial, along with a corresponding chance to skew the results obtained. These assumptions include: whether to lump all economic activity into certain broad industry categories such as manufacturing, construction or retail trade; whether to choose average individual income tax rates, the highest marginal individual/corporate tax rate or some other rate; the need to assume a certain portion of investment activity will be tax-free or tax-deferred as a result of preferential tax treatment for say pension income; the need to divide asset investments into certain categories such as industrial buildings, machines and inventories; the ways that companies raise fund through debt, new equity or retained earnings (while generally ignoring more complex financial instruments); whether to ignore the reality that multinational firms deploy tax planning through, for example, related-party loans or hybrid financial instruments to lower their global tax liabilities; whether to use current inflation rates or expected inflation rates; the need to ignore certain taxes such as wealth taxes, tax incentives, taxes on foreign exchange gains or losses, and payroll taxes; whether tax compliance levels, which ultimately affects the amount of tax paid by firms and individuals, should be taken into account; and whether the investment takes place in a risk-free environment or whether capital risk and income risk should be taken into account.

Many of the assumptions are driven by the need to maintain the manageability of the study and the results will reflect this incompleteness. In short, the assumptions made to simplify the comparative analysis may ultimately have a material impact on the METR. According to one view, "One comes away from this recipe book with the

[43] See Mervyn A. King and Don Fullerton, *The Taxation of Income from Capital: A Comparative Study of the United States, the United Kingdom, Sweden and West Germany* (1984).

[44] See Kenneth J. McKenzie & Aileen J. Thompson, 'Taxes, the Cost of Capital, and Investment: A Comparison of Canada and the United States' (Technical Committee on Business Taxation Working Paper 97-3, 1997); John Shoven and Michael Topper (1992) 'The Cost of Capital in Canada, the United States, and Japan', in John B. Shoven and John Whalley (eds.) *Canada-U.S. Tax Comparisons* 217(modifying the traditional approach to take into greater consideration risk premia demanded by investors); K. J. McKenzie, J. M. Mintz and K.A. Scharf (1997) "Measuring Effective Tax Rates in the Presence of Multiple Inputs: A Production Based Approach", International Tax and Public Finance 4(3): 337-359 (generating an effective tax rate on marginal costs that is a function of the METR on both labour and capital inputs).

[45] See Kenneth J. McKenzie and Jack M. Mintz, 'Tax Effects of the Cost of Capital', in John B. Shoven and John Whalley (eds.) *Canada-U.S. Tax Comparisons* (1992) 199. For efforts to quantify the impact of imperfect loss offsetting into METR calculations, see Jack M. Mintz, 'An Empirical Estimate of Corporate Tax Refundability and Effective Tax Rates' (1988) *The Quarterly Journal of Economics* 225.

distinct feeling that effective tax rates, like sausage, are best enjoyed in their final form, and that one can quickly lose one's appetite by looking too carefully at the details of preparation."[46] Economists are aware of the limitations involving METR studies although these limitations are rarely voiced within the actual study that a legal analyst may draw from. A more sophisticated critique, beyond the scope of this paper, might assert that METRs should be downplayed in favor of some other approach such as the use of cash-flow studies that simulate the amount of taxes (including income tax, capital tax, payroll tax and property tax) paid to tax authorities.[47] This approach, which generates average tax rates, is theoretically offensive to most economists because average rates include marginal and infra-marginal decisions of the firm.[48]

As touched on in the next section, METR studies are often used as the basis for policy prescriptions. Taking into consideration the problems noted above, METRs can be viewed as a rough measure of the potential influence of taxation on cross-border investment decisions. Yet the studies do not attempt to estimate the actual welfare losses associated with maintaining different national tax regimes. Such an attempt would be problematic in any event, in part because different empirical studies continue to question whether tax plays a significant influence on foreign direct investment flows.[49] Moreover, as touched on previously, empirical work has thus far failed to confirm theoretical perspectives regarding tax competition: "The study of tax competition is characterized by a marked imbalance between theory and evidence, with the former dominating."[50]

D. Behavioral Uncertainty

The over-emphasis on economic analysis also suffers from the fact that efficiency concerns are only one of a number of factors that drive the actual design of international tax rules. In other words, there is often a disconnect between policy prescriptions based on efficiency concerns and the actual policies implemented by policymakers within national governments or supranational institutions. This occurs because the premise of much Purist analysis—that government officials act like rational economic agents who seek to maximize wealth-creation for their constituents—is false. Consider the example of European Union (EU) reform efforts with respect to cross-border income taxation. The Treaty of Rome generally requires

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[46] See Laurence J. Kotlikoff, 'Comment' in Jack M. Mintz & Douglas D. Purvis (eds.) *The Impact of Taxation on Business Activity* (1985) 102.

[47] For studies that deploy the cash-flow approach or generate average tax rates by reviewing financial statements, see Mahmood Iqbal, *A Tax Comparison of Large Manufacturing Industries in Canada, the United States and Mexico* (Conference Board of Canada, 1994); Julie H. Collins and Douglas A. Shackelford, 'Using Financial Statement Information to Compare the Corporate Income Tax Systems of Canada, Japan, the United Kingdom and the United States' (1994) 94 *TNI* 63-22.

[48] But see David G. Hartman, 'Comment' in Assaf Razin and Joel Slemrod (eds.) *Taxation in a Global Economy* (1990) 118 (claiming that average tax rates are more relevant when an investor buys an existing company or asset).

[49] See, e.g., Alan J. Auerbach & Kevin Hassett, 'Taxation and Foreign Direct Investment in the United States: A Reconsideration of the Evidence', in Alberto Giovannini, R. Glenn Hubbard & Joel Slemrod (eds.) *Studies in International Taxation* (1993) 119 (indicating that attributing most of the increase in FDI in the United States after the mid-1980s to the *Tax Reform Act* (TRA86) is likely incorrect); Joel Slemrod, 'The Impact of the Tax Reform Act of 1986 on Foreign Direct Investment to and from the United States', in Joel Slemrod (ed.) *Do Taxes Matter?* (1990) 169, 192 (concluding that FDI flows were significantly affected by TRA86 tax incentives).

[50] See McKenzie, above n 29, 27.

unanimous approval for direct tax issues (unlike cross-border consumption taxes where the Treaty of Rome permits a majority of EU member states to dictate policy). As a result, the Commission is unable to mandate a particular reform path in this area and must seek approval from the EU member states (although the European Court of Justice plays an important and arguably increasing role in the design of EU international income tax rules).

Since the adoption of the Treaty of Rome in 1957, the Commission has struck a number of expert groups to advise it on tax policy reforms options.[51] A review of these efforts shows how efficiency concerns may not be persuasive to many government officials.[52] In 1962, a committee of tax experts—the so-called Neumark committee—recommended a number of centralized tax solutions for cross-border business income taxes, but these solutions were never implemented. In 1967, 1975, and 1980, the Commission proposed similar recommendations to harmonize corporate income tax rates and/or bases. Again, none of the proposals were ratified or implemented by the governments of the EU member states. In part based on METR studies that indicated 'harmful' tax competition may be taking place, in 1992 another committee of tax experts, chaired by former Dutch finance minister Onno Ruding, also recommended the partial harmonization of corporate income tax rates as well as other ambitious centralized linkages, but the recommendations were never implemented.

Nevertheless, incremental progress has been made on EU direct taxation issues—the arbitration Convention, the Directives on mergers and acquisitions, parent/subsidiary dividends, royalties and interest—but these deals represented political compromises. In 2001, the Commission announced yet another round of discussion concerning cross-border business income tax reform. To assist with the reform, METR studies were conducted to try to measure the potential distortions promoted by EU member state business tax regimes. The studies generally showed that corporate income tax rates were the main cause of locational distortions, and that the adoption of a common tax base could result in an even greater dispersion of METRs among the different countries, potentially leading to even greater resource misallocation.[53]

In spite of this finding, the Commission continues to support movement towards a consolidated corporate income tax base. Unlike full-blown harmonization, most of the proposals in this direction would permit some base consolidation such as a common base for firms with EU-wide activities while permitting each state to maintain its corporate tax regime for firms that do not have cross-border activities. This approach may prove to be problematic as it permits in many instances differential tax treatment for substantively similar economic activities (e.g., a firm that sells widgets within the UK only will be taxed one way but a firm based in France that sells widgets to UK consumers may be taxed in a different manner). As a shorter term solution, the Commission has begun to emphasize the more politically-feasible option of improving

[51] See Alex Easson, 'Harmonization of Direct Taxation in the European Community: From Neumark to Ruding' (1992) 40 *Canadian Tax Journal* 600, 615.
[52] See NAFTA Tax Law and Policy, above n 27, 108-114.
[53] See European Commission, 'Towards an Internal Market without Tax Obstacles' COM (2001) 582, 35-36.

the coordination among the different European Union tax systems in areas such as exit taxes and cross-border loss relief.[54]

There are a number of reasons that could explain the gap between prescriptions based on efficiency considerations and the actual policies implemented by government officials. For instance, the fact that policy analysis often ignores or downplays political concerns over a potential loss of tax sovereignty may be inhibiting sound policy analysis.[55] Moreover, there may be a disconnect between the tax reform discourse and recommendations offered by policy experts and the needs perceived by policymakers in other countries, particularly developing or transitional governments.[56]

E. Summary

Three sources of uncertainty—theoretical, empirical, and behavioural—reduce the utility of international tax economics with respect to international tax law policy analysis. Developing countries in particular may suffer from an over-emphasis on efficiency concerns largely because of their imbalance in capital flows with developed countries. Because the interests between developing and developed countries diverge with respect to international tax rules, they often find themselves on the short end of the stick. The next section claims that greater resort to other analytical tools is needed to complement the economic analysis to promote reform efforts that take more fully into account the interests of developing countries, which in turn will benefit the interests of developed countries.

III. CONTEXTUALISM AND INTERNATIONAL TAX LAW ANALYSIS

A. What Is Contextualism?

As explored in the previous Part, international tax law analysis often draws to a significant extent from international tax economics. The emphasis on efficiency concerns leads to a corresponding emphasis on the efficient division of the international tax base along with downplaying equity considerations. To a certain extent, the approach of these Purists avoids one of the central issues of international tax law: what is a fair division of the international tax base? In fact, as noted by the Financial Committee of the League of Nations who in 1921 commissioned the work of the Group of Experts, the efficiency and fairness concerns should be seen as closely related: the Financial Committee asked how the 'equitable' division of tax revenues impacts on the issue of international double taxation. For example, if a country feels that it is not enjoying its entitlement to a 'fair' share of the international income tax base then it is more likely to try to assert its jurisdiction over cross-border transactions, potentially leading to international tax disputes, international double taxation and a reduction in global trade and investment.

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[54] European Commission Communication, Direct Taxation: The European Commission proposes an EU co-ordinated approach of national direct tax systems, IP/06/1827 (Dec. 19, 2006).

[55] See Julie Roin, 'Taxation Without Coordination', 31 *Journal of Legal Studies* 61 (2002) (discussing how political realities are often ignored); Luc Hinnekens, 'Territoriality-Based Taxation in an Increasingly Common Market and Globalization Economy: Nightmare and Challenge of International Taxation in the New Age' (1992) 1 *EC Tax Review* 70, 71 (noting it is unhelpful to ignore political constraints on tax reform). To address this concern, researchers sometimes conduct interviews with government tax policymakers to discern what drives international tax reform efforts. See, e.g., Geoffrey Hale, *The Politics of Taxation in Canada* (2002).

[56] See Miranda Stewart (2003), 'Global Trajectories of Tax Reform: The Discourse of Tax Reform in Developing and Transition Countries', 44 *Harvard International Law Journal* 139.

To overcome these problems, certain legal analysts deploy other analytical tools often in integration with economic analysis. These tools sometimes draw from different academic disciplines apart from economics or in integration with economic theories that take into account broader interests (e.g., institutional economics or political economy). These analysts can be characterized as Contextualists as their works emphasize the need to study international tax law reform within its political, social, historical, institutional or other context.[57]

Underlying this argument is the view that a fuller understanding of the political/historical/institutional or other factors that drive the adoption of international tax rules could promote insights into ways to promote the adoption of optimal tax laws and cooperative cross-border tax agreements. Interestingly, both the Contextualist and the Purist approaches are widely deployed in domestic tax law policy analysis while Contextualism is arguably downplayed by international tax law analysts. Yet, as discussed in Part II, international tax economics likely suffers from more sources of uncertainty when compared to domestic tax economics. If this view is accurate then the Contextualt approach is called for to an even greater extent in international tax law analysis when compared to its domestic counterpart.

As discussed, as long as countries share roughly balanced capital flows, the emphasis on efficiency concerns may not create undue problems. But, as many observers have noted, to the extent that these flows differ as occurs with developing and developed countries then more contentious issues appear.[58] The Indian government, for instance, has complained in the past that traditional international tax principles and practices, based to a large extent on the OECD model tax treaty, do not result in a fair sharing on

[57] A literature review of works that arguably fall within the Pragmatist school is outside the scope of this paper. A sample of a few works could include Reuven S. Avi-Yonah, 'The Rise and Fall of Arm's Length: a Study in the Evolution of U.S. International Taxation' (1995) 15 *Virginia Tax Review* 89; H. David Rosenbloom, 'Sovereignty and the Regulation of International Business in the Tax Area' (1994) 20 *Canada-United States Law Journal* 267; Robert A. Green, 'Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes' (1998) 23 *Yale International Law Journal* 79 (employing international relations theory to promote understanding of international tax cooperation mechanisms); Alex Easson, 'Harmful Tax Competition: An Evaluation of the OECD Initiative', (2004) 34 *Tax Notes International* 1037 (discussing some of the political problems associated with OECD reform efforts); Arthur J. Cockfield, 'Tax Integration under NAFTA: Resolving the Conflict between Economic and Sovereignty Interests' (1998) 34 *Stanford Journal of International Law* 39 (integrating international relations literature into international tax law analysis); Diane M. Ring, *International Tax Relations: Theory and Implications* (Boston College Law School Legal Studies Research Paper 97, 2006)(noting that relatively little attention has been devoted to understanding how a variety of different forces, including political needs and multinational lobbying, shape international tax policy); Michael J. Graetz and Michael M. O'Hear, 'The "Original Intent" of U.S. International Taxation', (1997) 46 *Duke Law Journal* 1021 (discussing the historical forces that shaped U.S. international tax policy); Walter Hellerstein, 'Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective' (2003) 38 *Georgia Law Review* 1 (discussing the need to ensure that a government's enforcement jurisdiction is aligned with its powers to impose tax on transactions that have a relationship to economic actors within the state).

[58] Importantly, there is evidence that capital flows from certain developing countries, especially international portfolio investments, to developed countries has increased in recent years. See, e.g., E. Prasa, R. Rajan and A. Subraminian (2006) 'Patterns of International Capital Flows and their Implications for Economic Development' (IMF Research Paper, Sept. 2006); J.B. DeLong (2004) 'Should We Still Support Untrammelled International Capital Mobility? Or are Capital Controls Less Evil than We Once Believed?' 1(1) *The Economist's Voice* 1.

the international income tax base.[59] There is at least anecdotal evidence that India may be becoming more aggressive in assessing non-resident investors to increase revenues from India-based operations.[60]

The Contextualist approach would seem to be particularly helpful to ensure that the interests of developing countries are taken into account which, as mentioned, is in the long term interests of developed countries where the bulk of multinational firms are based. In particular, Contextualism avoids the 'one size fits all' prescriptions sometimes offered by Purists who seek comprehensive tax solutions in an effort to maximize global economic welfare.

For example, in recent decades international organizations such as the International Monetary Fund encouraged many developing countries to eliminate their customs tariffs in favor of the introduction of VATs, which are thought to promote domestic and international efficiencies in part by focusing taxation on consumption: revenues from the new VATs, it was thought, would replace or exceed revenue losses associated with eliminating tariffs. In fact, recent research shows that, for certain developing countries, VAT revenues did not make up for the tariff losses, in part because of significant grey or black market economic activity within these countries where businesses and consumers did not comply with the new VAT rules.[61] In another example, the OECD has often promoted a reduction or elimination in tax treaty withholding taxes for its member states, which include developing countries such as Turkey and Mexico, under the view that this move would encourage more efficient international capital flows (e.g., withholding taxes can sometimes lead to double taxation if they are not fully creditable).[62] Yet this perspective does not take into account that withholding taxes may be the only administratively feasible taxes for many developing countries that lack human, legal and administrative resources to enforce source-based net income taxes: multinational firms, on the other hand, typically have the necessary resources to comply with their legal obligation to assess, withhold and remit the appropriate withholding tax on cross-border payments.

Instead of looking at the developing world as an amorphous indistinct blob, Contextualists address the specific cultural (e.g., levels of government corruption and taxpayer views on compliance), political (e.g., totalitarian states versus quasi-democracies), and economic (e.g., failed states versus transitional economies) needs and realities of developing countries. If the interests of these developing countries are

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[59] *See, e.g.,* Ministry of Finance (India), *Report of the High Powered Committee on E-Commerce and Taxation* (2001) 20-21 ("The Committee … supports the view that the concept of PE [permanent establishment] should be abandoned and a serious attempt should be made within the OECD or the UN to find an alternative to the concept of PE.").

[60] In a recent work, I conducted a survey of national government responses to e-commerce challenges, which revealed a number of areas of contention involving Indian tax authorities. See OECD as Informal World Tax Organization, below n 65, 153-155, and accompanying notes.

[61] For a view that trade liberalization may actually harm the interests of developing countries by reducing revenue collection opportunities, see Thomas Baunsgaard and Michael Keen, 'Tax Revenue and (or?) Trade Liberalization' (June 2005) *IMF Working Paper No.* 05/112. For a view that replacing tariffs with VATs is not helpful for developing countries due to the prevalence of an informal economy, see M. Shahe Emran and Joseph E. Stigliz, (2005) 'On Selective Indirect Tax Reform in Developing Countries' 89 *Journal of Public Economics* 599**.**

[62] For example, the OECD model tax treaty has eliminated withholding taxes for cross-border royalty payments under the principle of exclusive taxation of royalties by the country where the beneficial owner of the royalty resides. See OECD model tax treaty, Commentary on Article 12, par. 3.

more fully taken into account, the countries may become more vested in ensuring the international tax regime remains stable and tenable in the long run. This view brings us full-circle to efficiency interests as global tax consistency and uniformity in terms of rules and practices is thought to promote international welfare by reducing the risk that tax will act as a barrier to international trade and investment.

Finally, it is important to note that heightened international law cooperative efforts with developing countries, including an extension of true free trade in agricultural and textile products, should be seen as a critical component in the war on international terrorism. Under one view, enhanced free trade, increased tax revenues and concomitant higher levels of per capita income for developing countries will reduce the risk that these countries will serve as a base to foment ideological hatred of individuals within developed countries.[63] Moreover, heightened information sharing with tax authorities from developing nations may inhibit terrorist financing schemes. In other words, increased tax cooperation and sharing of revenues with developing countries can be portrayed as a part of broader international law efforts to promote global security, including security for residents living in OECD member states.

As explored below, the Contextualist approach tends to (with many exceptions) call for policy prescriptions that seek incremental and politically-feasible solutions.[64]

B. Case Study: OECD E-commerce Reform Efforts

The Contextualist approach may help to promote a greater understanding of the legal and institutional framework and process that should govern international tax reform efforts. In fact, there are several central (and arguably under-explored) legal/institutional questions that this approach could assist in answering:

- should traditional international law mechanisms (e.g., binding international tax agreements) or non-traditional law mechanisms (e.g., soft law via model treaties) serve as the starting point for negotiating cross-border tax rules?
- what are the costs associated with changing international tax rules on an incremental or radical basis?
- on what basis should membership be granted to promote optimal international tax policy: regional (e.g., European Union or NAFTA), international (e.g., United Nations), broad common interests (such as shared-values concerning capitalism and democratic values within OECD countries), narrower common interests such as economic interests only (e.g., the G-8) or values only (e.g., Commonwealth countries)?

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[63] For discussion, see Aaron Schwabach and Arthur J. Cockfield, 'The Role of International Law and Institutions', in *Knowledge for Sustainable Development: An Insight into the Encyclopedia of Life Support Systems* (vol. 3, Oxford: UNESCO, 2002) 611 (discussing international law mechanisms in light of international terrorism developments along with the need for a stricter adherence to the values of liberalism within international law); Arthur J. Cockfield, 'Who Watches the Watchers? A Law and Technology Perspective on Government and Private Sector Surveillance' (2003) *Queen's Law Journal*. 364 (discussing privacy concerns with respect to cross-border information sharing practices to combat terrorism).

[64] Of course, the Contextualist approach, to the extent that it makes a fuller accounting of developing country interests, could also lead to more radical reform suggestions to address these interests. See, e.g., Reuven S. Avi-Yonah, 'Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State', 113 *Harvard Law Review* 1573 (2000)(proposing to re-introduce withholding taxes on portfolio interest and advocating cross-border income taxation on the basis of consumption) .

- how should outreach program with developing countries be structured to encourage buy-in and adoption of uniform rules and practices by these countries?

i. Overview OECD E-commerce Tax Reform Process

In another work, I examined OECD reform processes directed at cross-border e-commerce tax issues and surveyed government responses to these efforts.[65] The goal of the paper in part was to generate insights into the efficacy of existing reform paths to see whether they are effective at encouraging the adoption of uniform rules by governments and their national tax authorities.[66] The following discussion draws from this earlier work.

In 1997, the OECD began a reform process to try to address perceived challenges to the international tax regime presented by global e-commerce. After its initial meeting in Turku, Finland, the OECD held a Ministerial Meeting in Ottawa, Canada in October 1998. The OECD invited representatives from both OECD and non-OECD member states to attend the meeting and, after a few days of discussion and deliberation, the OECD members signed onto two important documents. The so-called Ottawa Taxation Framework Conditions set out the consensus view on the guidelines that would drive any subsequent reform efforts (e.g., traditional international tax policies and principles should be applied to cross-border e-commerce).[67] The Joint Declaration of Business and Government Representatives similarly included guidelines to assist with policy reform efforts in the area of international e-commerce.[68]

A survey of national responses revealed that governments were generally content to follow the OECD lead and its adoption of certain changes to the Commentary to the OECD model tax treaty.[69] In fact, the OECD's e-commerce reform process arguably represented unprecedented international tax cooperation by generating a series of 'firsts':[70]

> (a) it was the first time that countries engaged in multilateral discussions that led to agreement on principles-the Ottawa Taxation Framework-that would guide the subsequent formulation of international tax rules;
>
> (b) it was the first time that the OECD joined with members of industry to agree to a framework—the Joint Declaration of Business and Government Representatives—to guide the development of new rules;

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[65] See Arthur J. Cockfield, 'The Rise of the OECD as Informal 'world tax authority' through National Responses to E-commerce Taxation', (2006) 8 *Yale Journal of Law and Technology* 136 [OECD as Informal World Tax Authority].

[66] The approach is related to efforts by researchers in New Institutional Economics who seek to understand how economic performance is determined by the kind and quality of institutions that support markets. See, e.g., Douglas C. North, *Understanding the Process of Economic Change* (2005).

[67] *See* OECD Committee on Fiscal Affairs, *Electronic Commerce: Taxation Framework Conditions* (1998)[Ottawa Taxation Framework Conditions].

[68] See OECD, *Joint Declaration of Business and Government Representatives: Government/Business Dialogue on Taxation and Electronic Commerce* (Oct. 7, 1998), available at http://www.oecd.org/dataoecd/62/60/1932547.pdf.

[69] More specifically, the survey uncovered seventeen administrative pronouncements by national tax authorities; five cases and two tax laws passed to address international e-commerce matters. The only area of clear disagreement surrounded the new server/permanent establishment rule in the Commentary to the OECD model tax treaty. See OECD as Informal World Tax Authority, above n 62, 149-161.

[70] Ibid 168-169. See also Duncan Bentley, 'International Constraints on National Tax Policy' (2003) 30 *Tax Notes International* 1127, 1140.

> (c) it was the first time that the OECD analyzed policy options in an extensive way through the publication of multiple discussion drafts of reports (that sometimes included both majority and minority viewpoints) from Technical Advisory Groups and Working Parties consisting of tax experts drawn from national tax authorities, industry and academics;
>
> (d) it was the first time that non-OECD countries were permitted to be part of ongoing deliberations along with the development of policy options through the appointment of representatives from non-OECD governments to Technical Advisory Groups; and
>
> (e) it was the first time that OECD member states engaged in extensive discussions with respect to cross-border Value-Added Tax (VAT) issues, and attempted to promote consensus-driven reform efforts in this area.

Analysis of the lessons learned through this reform process could assist in answering the questions outlined at the outset of this section.

ii. What Processes Encourage Cooperative Efforts?

The OECD's e-commerce tax reform process did not involve any institutions that can bind the tax policy of its member countries in any way. The Working Parties and other expert groups served as fora to explore different policy alternatives, but cannot enact any changes without broad support and consensus by OECD members. The OECD model tax treaty or its Commentary are not binding, and members are permitted to insert reservations and observations that set out dissenting views, which they did in several instances (e.g., Spain and Portugal inserted reservations concerning the new server/permanent establishment rule).

A more detailed discussion concerning one aspect of the non-binding negotiating processes, first put in place during the e-commerce reform efforts, may help to illustrate how the OECD negotiation process attracted support from its member states. In the late 1990s, different OECD Working Parties decided to delegate certain tasks to Technical Advisory Groups (TAGs) that were co-chaired by a government delegate and an industry representative.[71] The co-chairs subsequently advised and reported on their work to the relevant Working Party. The TAGs were composed of roughly equal numbers of members drawn from industry and government (and, as noted previously, additionally included academics and representatives from non-OECD member countries). In 2001, certain TAGs also developed smaller Task Teams, typically comprised of roughly a half dozen individuals (again, generally split equally between government and business representatives) to draft in a collaborative manner any reports so that concerns could be addressed in a non-confrontational manner. The drafting of reports and guidelines by the Task Teams proved to be effective at generating consensus views as any drafts would eventually need to be approved by the TAGs as well the Working Parties: the process hence promoted progress while ensuring that there would be a number of different opportunities to discuss and evaluate any potential reforms.

[71] With respect to e-commerce tax reform efforts, the OECD set up the following Technical Advisory Groups: (1) Technology TAG (to monitor and evaluate Internet technology developments); (2) Consumption Tax TAG (to examine collection systems for digital transactions); (3) Professional Data Assessment TAG (to examine how tax professionals and tax administrations are using information technologies); (4) Business Profits TAG (to examine how current treaty rules should apply for cross-border e-commerce profits); and (5) Treaty Characterization TAG (to examine cross-border characterization issues).

Moreover, this process appears to have gathered support with respect to subsequent reform efforts. For example, in June 2007 Working Party No. 9 on Consumption Taxes met in Paris to discuss the drafting of VAT/GST Guidelines with respect to customer location and place of performance for supplies of services and intangibles. Building on the guiding principles set out in the Ottawa Taxation Framework Conditions put in place at the OECD Ministerial Conference on Global E-commerce in 1998, the government delegates had previously accepted certain general principles such as the place of supply should be the jurisdiction where consumption takes place. To overcome remaining hurdles, the Working Party agreed at the June meeting to create a new TAG and Task Team developed along similar lines to the ones in the OECD earlier e-commerce reform process.[72] The Task Team was then charged with the drafting of the specific sections of the VAT/GST Guidelines.

The OECD approach of encouraging discussion, study, and non-binding reform efforts resembles the phenomenon of 'soft law' or 'soft institutions.' Soft institutions are said to be more informal processes employed to achieve consensus by providing a forum for actors to negotiate non-binding rules and principles, instead of binding conventions.[73] The OECD approach is also consistent with emerging views in international relations theory that "government networks" (e.g., relatively informal arrangements among government officials in the same agencies) may be best at addressing global challenges.[74] Informally coordinated and networked action by governments, it is thought, may lead to a new form of international law- and policy-making that addresses these challenges without imposing undue restrictions on national sovereignty.

Similarly, the use of non-binding institutions promotes the interests of the OECD members by reducing tax obstacles to international trade and investment (thus encouraging national economic growth) while protecting tax sovereignty to the greatest extent possible. The OECD process more closely resembles customary international law, which is perhaps best understood as a set of normative expectations developed through observation of the actions of states. As is the case in other areas of customary international law, peer pressure and the need to promote business certainty (again to promote national economic welfare) encourages the OECD member states to follow the consensus views once they have been adopted into the OECD model tax treaty. In contrast, conventional international law typically involves the use of treaties that, once entered into, create continuing obligations, unlike the OECD model tax treaty.

Through the use of informal mechanisms, the OECD mediates and manages the expectations of its member states in an attempt to generate politically acceptable (and hopefully effective) international tax policy. Under one view within New Institutional Economics, economic developments depend largely on "adaptive efficiency," which is

[72] The only significant difference is that, for purposes of the earlier e-commerce reform efforts, the OECD had initially set up a Sub-Group on E-commerce constituted only by government representatives that in turn set up TAGs: the more recent efforts do not include a Sub-Group so the TAG now directly reports to Working Party No. 9.

[73] For a discussion on the potential for soft law within international tax reform efforts, see Charles McLure Jr., *Legislative, Judicial, and Soft Law Approaches to Harmonizing Corporate Income Taxes in the US and the EU* (draft, forthcoming, 2007).

[74] *See, e.g.,* Anne-Marie Slaughter, *A New World Order* (2004); Daniel C. Esty, 'Good Governance at the Supranational Scale: Globalizing Administrative Law', (2006) 115 *Yale Law Journal* 1490.

a society's or group of societies effectiveness in creating institutions that are productive, stable, fair, and broadly accepted and flexible enough to be changed or replaced in response to political and economic feedback.[75] The OECD's e-commerce reform process along with subsequent developments generally appears to have deployed institutions that meet the requirements for adaptive efficiency.

iii. What Are Transition Costs Associated with Different Reform Alternatives?

The OECD's apparent success with e-commerce can also be attributed to the loyalty to its reform process that has been underway since 1960. Moreover, the OECD member states have accepted the OECD model treaty as the basis for negotiating their own bilateral tax treaties since its formation in 1963. The OECD model was based on models developed by its predecessor entity, the Organization for European Economic Cooperation, which in turn were based on the League of Nations model treaties dating back to the post-World War I era (see the discussion in Part I). Moreover, the OECD is active in non-tax areas such as cross-border privacy and consumer protection, which has encouraged decades of cooperative government actions.

Loyalty to the OECD process is arguably deserved. It has been noted, for instance, that the vast majority of the over 1,500 tax treaties throughout the world exhibit significant uniformity with the provisions set out in the OECD model tax treaty.[76] The courts of many countries such as the United States and Canada have accepted the OECD model tax treaty and its Commentary as secondary sources of authority by acting as helpful guides in the interpretation of tax treaty provisions.[77] The uniformity in terms of rules and their interpretation has encouraged tax certainty and likely ensured that tax has not acted as a significant inhibitor of international trade and investment since the widespread deployment of treaties based on the OECD model treaty.

An under-examined issue is the (legal) costs associated with moving to another reform process or radical reform of the model treaty approach. Consider some of the implications that radical change might have on international tax jurisprudence in common law countries. The common law evolves by integrating past judicial

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[75] See North, supra note 66.

[76] *See* Victor Thuronyi, 'Tax Cooperation and a Multilateral Tax Treaty', (2001) 26 *Brooklyn Journal of International Law* 1641, 1641.

[77] *See, e.g., Nat'l Westminster Bank, P.L.C. v. United States*, 58 Fed. Cl. 491, 498 (U.S. Ct. Fed. Claims, 2003) ("[b]oth this court and others have recognized that the [OECD tax treaty and its Commentary] serve as a meaningful guide in interpreting treaties that are based on its provisions."); *Att'y Gen. of Can. v. R.J. Reynolds Tobacco Holdings, Inc.*, 268 F.3d 103, 119 n.15 (2d Cir., 2001) *cert. denied*: 2002 U.S.LEXIS 8081 (Nov. 4, 2002) ("[i]n the realm of international taxation, the OECD's model convention 'has almost acquired the status of a multilateral instrument' because of the reliance placed on it by many countries in negotiating bilateral tax conventions. . . .") *citing* American Law Institute, International Aspects of United states Income Taxation II: United States Income tax Treaties (1992) 3; *The Queen v. Crown Forest Industries*, 2 S.C.R. 802, at 827 (Supreme Ct. of Can., 1995) (indicating that the OECD model tax treaty is of "high persuasive value" in defining the parameters of the U.S.-Canada tax treaty). Moreover, OECD views within the Commentary may be increasingly influenced by European Court of Justice jurisprudence, especially with respect to the non-discrimination clause, potentially promoting more consistency with the interpretation of model treaties with the European Union countries. For discussion, see Michael J. Graetz and Alvin Warren Jr., 'Income Tax Discrimination and the Political and Economic Integration of Europe' (2006) 115 *Yale Law Journal* 1186 (describing how the ECJ interpretation may also conflict with provisions in certain U.S. tax treaties).

perspectives and adopting them to new fact patterns: "The life of the law has not been logic: it has been experience… In order to know what [the law] is, we must know what is has been, and what it tends to become."[78] If the OECD model treaty was jettisoned in favor of some other approach it might undermine the common law principle of *stare decisis* as old decisions would now be less helpful as precedents for present or future cases. It would make it harder for tax lawyers to provide certainty with respect to their legal advice concerning cross-border transactions.

In short, radical change would encourage potentially significant costs that, at least in the short term, could result in adverse outcomes such as a reduction in international trade and investment. Instead, loyalty to the OECD reform process may signal readiness on the part of the OECD member states (and potentially non-OECD member states) to continue to work towards cooperative tax solutions, including in (arguably modest) areas such as enhanced information sharing as well as uniform transfer pricing documentation requirements and advanced pricing agreement procedures.

iv. Who Should Participate in Reform Efforts?

The OECD is constituted by thirty member countries, which generally possess similar technology- and service-oriented economies (with exceptions such as Mexico and Turkey). Moreover, the OECD countries control the bulk of the world's capital and serve as the base for most of world's large multinational firms. Many of the OECD member states are also net capital exporters. For these reasons, the OECD countries often have similar economic interests to promote. Importantly, OECD countries are also, in the OECD's own words, 'like-minded' in the sense that they possess shared values concerning the need to maintain market-base economies, democratic principles and a commitment to human rights.[79] The attainment of consensus on international tax reform efforts is likely facilitated by the fact that the economic and non-economic interests of the OECD countries are aligned in many circumstances.

A reform process involving more countries with a greater divergence of interests could act as a barrier to the development of any reforms. A historical example may help to illustrate this point. During the World War II era, a League of Nations subcommittee mainly constituted by developing countries tried to reform the model treaty to promote heightened source taxation of business profits (e.g., the proposed model would entitle a source country to tax business profits that were not derived from "isolated or occasional transactions" even if there was not a permanent establishment located within the source country).[80] The so-called Mexico model treaty was subsequently proven to be unacceptable to capital exporting nations and was never adopted.

In 1980, the United Nations model treaty was formed in part to provide an alternative to OECD model tax treaty, which is thought to favor the interests of capital exporting nations (e.g., in contrast to the OECD model tax treaty, the United Nations model expands source-based taxation by, *inter alia*, promoting a restricted force of attraction rule for cross-border business profits, ensuring that independent contractors constitute permanent establishments in certain circumstances, and applying a withholding tax to

[78] See Oliver Wendell Holmes, Jr., *The Common Law* (1881, Dover Publications ed. 1991) 1.
[79] See OECD, Chair of the Heads of Delegation, *A Strategy for Enlargement and Outreach* (2004) 16-17.
[80] See Fiscal Committee to the League of Nations, *London and Mexico Model Tax Conventions: Commentary and Text* (C.88.M.88.1946.II.A., Geneva, Nov. 1946) 60.

cross-border royalty payments).[81] The United Nations model treaty is frequently used by developing countries as the starting point of their treaty negotiation process, which has enabled like-minded OECD countries to reach consensus through their own reform process that focuses on their own interests. As such, this two-track process likely encouraged progress to be made as evidenced by the fact that developed and developing countries have significantly expanded their tax treaty networks since the 1960s. As explored in the next section, the fact that international tax reform is driven in large by a group of mainly elite countries—a "rich countries' club"—is increasingly seen as a drawback for attempts to generate effective international tax reform.[82]

v. What Structural Changes Can Encourage Developing Country 'Buy-in'?

The fact that the OECD engaged in its most significant outreach effort with developing countries within its e-commerce reform process likely contributed to the overall success of the project. The consulted developing countries had a chance to deliberate reform efforts, and voice their concerns as members of Technical Advisory Groups and Working Parties. Providing enhanced voice to developing countries may have encouraged them to 'buy in' to the rule changes adopted into the Commentary of the OECD model tax treaty. The cross-country survey revealed that many non-OECD member countries agreed to adopt the OECD's proposed solutions or, in certain cases, produced reports that set out modest departures from the OECD's proposals. The general success of these efforts should encourage more outreach by the OECD's Committee on Fiscal Affairs.[83]

In addition to the e-commerce reform efforts, the OECD has initiated a series of programs to improve its relationship with non-OECD members and developing countries including: (i) in 1997, the OECD began including the positions of certain non-member countries in the OECD model tax treaty; (ii) in 2002, the OECD, the International Monetary Fund, and the World Bank formed the International Tax Dialogue to, inter alia, provide a forum for input from developing countries; (iii) the OECD has sponsored multilateral tax centers in certain countries to hold meetings with representatives from non-member tax authorities; and (iv) the OECD provides a Global Tax Forum that seeks input from representatives from non-member countries. Importantly and consistent with the Contextualist view that specific national political and social concerns often drive tax reform, the OECD efforts are increasingly focusing on helping build local expertise among foreign tax authorities and administrators; the local experts may be most effective at promoting tax policy changes that will address the differing needs of developing countries.

These outreach efforts have likely assisted in promoting uniformity in terms of the provisions and practices of non-OECD national tax authorities vis à vis the OECD model treaty. Enhanced outreach efforts could promote even more beneficent outcomes. It may not be politically feasible in the near term to permit non-OECD

[81] See *United Nations Model Double Taxation Convention between Developed and Developing Countries*, Jan. 1, 1980.

[82] See, e.g., Reuven S. Avi-Yonah, 'Bridging the North/South Divide: International Redistribution and Tax Competition' (2004) 26 *Michigan Journal of International Law* 371, 383-385 (discussing the advantages and disadvantages regarding the OECD's role in international tax reform efforts and noting that the World Trade Organization may make a more suitable candidate for a world tax organization).

[83] Enhanced outreach to developing countries is also part of the mandate of Group of Experts on International Cooperation in Tax Matters, which became a permanent United Nations Committee under the Economic and Social Council in 2004.

member states to vote on policy changes or to enlarge OECD membership to any significant degree. Under the Contextualist approach, a feasible and incremental solution could involve extending permanent membership to the OECD's Committee on Fiscal Affairs (CFA) to developing countries who wish to participate in the deliberation of potential reform efforts through a simplified and expanded outreach program.[84] This initial step might go a long way toward encouraging further buy-in by developing countries as it would give them a formal platform to provide ongoing input into the design of international tax rules. The OECD already permits certain governments—China, Chile, India, South Africa, Argentina and Russia—to act as Observers in the CFA: representative from these countries are permitted to sit it on and provide input during, for example, Working Party meetings that discuss specific areas targeted for reform. As such, the reform effort may be acceptable to OECD members as it effectively only amounts to creating a host of new permanent Observers to the CFA, which should not unduly upset the *status quo*. A draw-back of the current approach is that it does not extend Observership status to more than a handful of countries, potentially creating the perception that the OECD only 'cares' about the bigger players and transitional economies while ignoring the plights of countries with smaller or failing economies.

To improve the situation, under this proposal only OECD member states (i.e., Tier I members) acting through the CFA will continue to have a vote on the ultimate direction of this reform. Non-voting membership (i.e., Tier II membership) will be extended to any non-OECD member who wishes to participate in CFA processes. A lack of true representation will be obviously problematic for many developing countries, but it may be the only politically feasible way of expanding outreach in the tax area, at least in the short term. In the longer term, extension of a 'vote' or even full membership within the CFA may become feasible. As discussed in Part I, enhanced global economic interdependence likely requires increased cooperation among national tax authorities to reduce the risk that tax will inhibit cross-border trade and investment. If the OECD continues to evolve into a kind of informal (lower-case) world tax organization, it will ultimately be better suited to attract global consensus to deal with emerging and vexing challenges such as profit attribution to permanent establishments, cross-border hybrid securities and hybrid business entities, enhanced remote sales, double non-taxation via tax planning, and entity isolation strategies for intellectual property assets.

IV. CONCLUSION

International tax law analysts who emphasize efficiency concerns can be characterized as Purists as they often seek conceptually pure tax solutions to promote national or international welfare. Yet international tax economics analysis suffers from several

[84] The OECD's outreach program has already been formalized to a certain extent through the Board for Co-operation with Non-OECD Economies (a subsidiary body of the Committee on Fiscal Affairs) and the Advisory Group on Co-operation with Non-OECD Economies, which administers the outreach programs and advises the Board. *See* Centre for Tax Policy and Administration, *Handbook: Developing Partnerships with Non-OECD Economies* (2004) 4, 10. By 2007, the structure appears to have been changed slightly so that a Unit for Co-operation with Non-OECD Economies within the OECD's Centre for Tax Policy and Administration (CETPA), headed up by Richard Parry, has been provided with the day-to-day management of the outreach program. Moreover, the CEPTA's Tax Treaty, Transfer Pricing and Financial Transactions Division now includes two permanent outreach officials in the areas of tax treaties (David Partington) and transfer pricing (Wolgang Büttner).

sources of uncertainty—theoretical, empirical and behavioral—that may limit the utility of the Purist perspective. In contrast to the Purist approach, Contextualists deploy other analytical tools to complement the economic analysis by examining international tax law reform processes within their political, historical, social and/or institutional context.

The Contextualist approach may permit a fuller exploration of the relevant policy issues to guide the adoption of effective international tax rules and practices. Moreover, the Contextualist approach could do a better job of taking into account the unique interests of different developing countries as the efficiency analysis is less helpful when there exists an imbalance in capital flows (and possibly other flows like technology transfers) between developing and developed countries. As the world becomes increasingly economically integrated, the needs and interests of developing countries should be addressed to ensure that tax does not unduly inhibit global trade and investment.

For these reasons, the Contextualist approach better serves the interest of developed countries who seek tax solutions that promote opportunities for enhanced global trade and investment with developing countries and other non-OECD countries. In addition, enhanced global tax cooperation can be portrayed as a component of broader international law efforts to combat international terrorism. The extension of formal 'Tier II' membership within the Committee on Fiscal Affairs to any desiring non-OECD country, along with opportunities to participate and deliberate reform options, would provide a modest and incremental Contextual solution to promote more cooperative efforts.