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DEMOCRACY, SOVEREIGNTY AND TAX COMPETITION: THE ROLE OF TAX SOVEREIGNTY IN SHAPING TAX COOPERATION

by

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Virtually all efforts to confront and curb tax competition effectively require some measure of cooperation among nation-states. Regardless of the precise amount and type of competition deemed acceptable, the cooperation question arises. Only for those who would advocate a complete acceptance of all forms of “tax competition” would cooperation seem irrelevant, although even for those pro-competition advocates, some joint advocacy on the part of the “competing” nations has formed an important part of their efforts to maintain competitive practices.¹ Assuming we envision a world in which there is some notable commitment by a number of nations to tackle the problem of “harmful” tax competition, what will their solution look like? The prospect of tax cooperation inevitably raises questions regarding the plausibility of such cooperation, the scope and best context for such cooperation and the normative principles upon which it rests. Yet attempting to resolve these broad questions can be daunting.

This paper contends that sovereignty shapes both the *problem* of tax competition and the *solution* of cooperation. Understanding the functional and normative goals underlying nation-states’ claims for tax sovereignty can enable us to assess, predict and influence prospects for tax cooperation. As I have argued elsewhere,² claims of tax sovereignty are proffered in a variety of situations, by a variety of actors, with a variety of motives, but there are nonetheless several core goals that are at risk when a nation-state makes the decision to surrender some measure of its tax power. An understanding of these goals and principles helps highlight unresolved issues in tax competition conversations, fruitful avenues for cooperation efforts, and the connections among inter-nation equity (which presumes sovereignty), inter-individual equity, and competition.

1. Many of the tax havens joined together in an effort to resist the OECD harmful tax competition project. See, e.g., Free-Market Activists Ask Cayman Islands to Rescind OECD Commitment, 22 Tax Notes Int’l 2971 (Jun. 11, 2001) (noting a May 2001 presentation at the Cayman Islands Chamber of Commerce meeting to encourage the Cayman Islands to rethink its commitment to comply with the OECD tax competition recommendations).

2. Diane Ring, What’s at Stake in the Sovereignty Debate?: International Tax and the Nation-State, 49 Virginia J. of Int’l L. 155 (2008).

This paper does not seek to establish whether and when tax competition is good or bad. That is a distinct question reflecting assessments of government action, the market, externalities, and behavioral predictions. Instead, this paper assumes that some subset of countries will contend that certain tax competition is undesirable. From that baseline, the paper considers the question of how sovereignty shapes arguments over the merits of tax competition and how sovereignty influences the design of responses to tax competition. Part I provides a basic overview of sovereignty concepts, in particular their relevance to a nation-state desirous of control over tax policy. Part II defines tax competition, identifies the different kinds of states involved, reviews the emergence of the OECD project to limit harmful tax competition, and traces the EU experience with tax competition. Part III explores the normative grounds for challenging tax competition and the role of sovereignty in shaping and limiting these challenges. Finally, Part IV, working from the practical and theoretical baselines established in Part III, considers how an appreciation of sovereignty claims can facilitate the design of plausible cooperation strategies for states trying to limit tax competition.

I. THE SOVEREIGNTY BACKDROP

The consideration of tax competition, and the corresponding prospects for cooperation take place against the backdrop of a world in which sovereign nation-states are the dominant actors in promulgating tax rules and collecting (and using) tax revenues.³ Sovereignty bears no single definition, but a reasonable starting point envisions a sovereign state as one which possesses three core elements: “territory, people, and a government.”⁴ In possessing these elements, a sovereign state should display internal control and supremacy, along with external independence from other states.⁵ As the 20th century has come to a close, the sovereign state stands as more than a nation with internal control and external independence regarding

3. This paper takes as a premise that the global system we currently see is one in which “sovereign” states play a key role. This premise is not undermined by acknowledging that the definition of a sovereign state faces controversy, nor by the recognition that many non-state actors play a vital role (including international organizations and multinational enterprises). The identification of our global system as one based on sovereign states does *not* imply a claim that these states are all powerful, exclusive, or monolithic actors. Rather it asserts that they continue to have a central organizing and decision making role. Moreover, the prospect that the “degree” of sovereignty may be shifting (i.e. that for example, international organizations are gaining more power) is *not* inconsistent with the paper’s premise.

4. Ring, *supra* note 2 at 160 note 9 (quoting Michael Ross Fowler & Julie Marie Bunck, *Law, Power and the Sovereign State* 33 (1995)).

5. See, e.g., Hendrik Spruyt, *The Sovereign State and its Competitors* 38-39 (1994); Fowler & Bunck, *supra* note 4 at 37.

people, territory and government (i.e. the possessor of a series of rights to exclude and control). The sovereign is also the locus of a duty and an obligation to protect and promote the welfare of its citizens.⁶ Sovereign responsibilities now accompany those sovereign rights.

What does “sovereignty” not presume or promise? It does not presume equality of situation. Most considerations of sovereignty and a world system based on sovereign states anticipate that states will vary significantly in their resources and power,⁷ and that the exercise of such power is not inconsistent with the premises of the sovereign state system. In sharp contrast, the “unprovoked” invasion of the territorial sanctity of another state would likely violate the principles and shared expectations of the sovereign state system.

Of course the existence of the sovereign state system and the ability to define it are not the same as a seal of approval. Even if the current world political order takes sovereign states as the primary decision makers (a positive observation),⁸ is that normatively desirable? The “desirability” of

6. See, e.g., Fowler & Bunck, *supra* note 4 at 6, 73; Kathryn Sikkink, Human Rights, Principled Issue-Networks, and Sovereignty in Latin America, 47 *Int'l Org.* 411, 413 (1993) (“[U]ntil World War II, in the widest range of issues, the treatment of subjects remained within the discretion of the state”).

7. “Historically, one or the other of the major principles associated with sovereignty has always been under challenge. . . . Only a very few states have actually possessed all of the major attributes that are associated with sovereignty – territoriality, autonomy, recognition, and effective control – the United States being the most obvious case. . . . Hence, in some sense, almost all of the states of the world have been semi-sovereign.” Stephen D. Krasner, *Pervasive Not Perverse: Semi-Sovereigns as the Global Norm*, 30 *Cornell Int'l L.J.* 651, 652 (1977). Although the reality of widely differing sovereign states is accepted, we find, deeper within the interstices of sovereignty theory, conflict over how states differ. The debate questions whether it is more accurate to see sovereign states as beginning with a uniform package of sovereign state rights and powers, some of which they may lose in the rough and tumble world of power, resources, strategy and luck – or whether some states become sovereigns without the rights and expectations that other states may possess. See, e.g., Fowler & Bunck, *supra* note 4 at 29, 42, 63-68; cf. Abram Chayes & Antonia Handler Chayes, *The New Sovereignty* 27 (1995) (“[s]maller and poorer states are almost entirely dependent on the international economic and political system for nearly everything they need to maintain themselves as functioning societies.”).

8. Some observers have argued that sovereignty is dead or dying, although this is an empirical point. Ring, *supra* note 2 at 165 (considering claims that the sovereign state system is in decline). Whether the system is dead or dying (which some seriously challenge) tells us nothing about whether this would be good or bad as a normative matter. *Id.* at 165-166 (examining the competing view that interprets recent changes in the role of international organizations as affirming and supporting the sovereign state system).

sovereign states raises a series of deeper questions regarding society, justice, human nature, and political science. Can we envision the alternative to the sovereign state system (e.g., a single global state, or states based not on territory but on “people” or “religion”⁹) and what are its weaknesses? Although this paper does not aim to resolve the normative question of whether a sovereign state system is good, Part III pursues one strand of this inquiry (theories of cosmopolitan justice) because an assessment of sovereignty’s impact on the tax competition debate requires consideration of how advocates press their claims. At present, it is useful to make one observation and one assertion. The observation is that the sovereign state system is sufficiently healthy and active, as a positive matter, to require that any serious tax competition discussion confront the reality of sovereign states. The assertion, argued by the author elsewhere,¹⁰ is that one important “right” of the sovereign state – tax sovereignty – carries meaningful content. States’ anxiety over tax sovereignty can be legitimate (although it can also be a smokescreen for less palatable or reputable goals). The ability to control tax policy enables a state to meet its functional duties (revenue raising and fiscal policy design) and support its two important democratic norms – democratic accountability and democratic legitimacy.¹¹ Recognizing this role of tax sovereignty for a democratic sovereign state becomes important as we explore how we might further clarify and expand the duties and obligations between and among sovereign states on the subject of tax competition.¹²

Obviously states do not exercise unimpeded control over tax policy choices – they are influenced and constrained by the political economy within their own domestic system (e.g., pressure from powerful taxpayers) and by the need to account for the implications of their tax rules globally (e.g., will the state’s new tax be deemed a creditable foreign tax by other countries). However, the lack of absolute control does not render a state’s interest in maintaining substantial control an implausible or irrational

9. A world (such as ours) in which international organizations and multinational enterprises influence and shape outcomes is not an alternative to a sovereign state system. It is a version of such a system.

10. Ring, *supra* note 2 at 170, 232.

11. Control over tax policy by the states supports goals of democratic accountability and legitimacy because the nation-state (in contrast to certain global structures) provides a closer connection between decision maker and voter, and because the nation-state is more likely to constitute a *demos* – a certain type of political community considered valuable to true democratic legitimacy in government rule. Ring, *supra* note 2 at 172-77, 213-14; *infra* Part III.C.2.a.

12. This assertion could be interpreted as a normative claim of the paper. However, even for readers who may challenge the *value* of these elements of tax sovereignty – as a descriptive matter they form the foundation for states’ interest in tax sovereignty.

position. Furthermore, an expression of interest in retaining more control over tax policy does not translate into a blanket unwillingness to cooperate.

Beyond establishing a descriptive understanding of sovereignty and an appreciation for the most persuasive normative claims to tax sovereignty, it will also be important to identify the positive role tax sovereignty plays in rhetoric and national decision making. Although not wholly independent of the functional and normative roles for tax sovereignty referenced above, the broadly characterized right of a nation to sovereignty over tax matters has proven a potent tool of rhetoric (often without extensive grounding or clarification) in policy debates.¹³ Even national governments are not immune to the magnetism of the rhetoric.¹⁴ Tax sovereignty, though, is not a “good” in and of itself. Rather, it is a *tool* to achieve important missions of the democratic sovereign state: (1) the continued operation and existence of a functioning government (predicated on revenue and sustainable fiscal policy) and, (2) the accountability and legitimacy underpinning that democratic state. But even though tax sovereignty can be a tool for good, sovereignty ideals do not answer the question, “what should be the response to and the outcome of tax competition?” As explored later in the paper, if an appropriate state goal is not tax sovereignty per se, but rather the functional and normative goals stated above, we may revise our expectations about the need for and required scope of tax sovereignty. Moreover, to the extent that the examination of tax competition moves beyond the theoretical and into the practical, strategic realm, a realistic appreciation of the lure of “tax sovereignty” claims becomes an invaluable asset.

One important way to consider the question of how to achieve cooperation in tax competition is to consider how knowledge about tax sovereignty might guide us. If we are sensitive to tax sovereignty, what should we highlight or emphasize to encourage cooperative action? What should we avoid? What techniques or cooperative methods of responding to tax competition are most likely to be successful and why?

13. For example, the consideration of a variety of “tax harmonization” possibilities in the European Union, including the prospect of a common consolidated corporate tax base has generated innumerable comments from business, government officials and others on the perceived sovereignty implications of such a move. See, e.g., Bruno Gibert, Chairman of the European Joint Transfer Pricing Forum, Remarks at European Competitiveness Roundtable, European Competitiveness Roundtable: Competition View with Common Case, (Dec. 1, 2006), in *Int’l Tax Rev.*, available at 2006 WLNR 23404159. See generally, Ring, *supra* note 2 at 209-213.

14. See, e.g., Steinbruck Accuses Ireland of Unfair Tax Practices, 46 *Tax Notes Int’l* 1197 (Jun. 18, 2007) (at meeting of the EU Council of Economic and Finance Ministers, Ireland repeated its objection to the common consolidated corporate tax base because it would undermine states’ fiscal sovereignty).

Finally, although this article firmly accepts the reality of an international system premised on sovereign states and operates with a core definition of sovereignty reflecting the modern conception of rights and duties of the state, this vision need not be fixed for time. Our conception of the sovereign state developed over the 20th century to incorporate ideas regarding human rights and anti-imperialism.¹⁵ It is possible that the fiscal challenges of the 21st century will further refine our vision of appropriate and necessary tax sovereignty for the sovereign state. Even if this refinement in the sovereignty concept ultimately takes root, the proscriptions for tax competition cannot significantly *anticipate* such a shift. The experience of tax competition may be crucial in defining a new “tax sovereignty,” but that experience cannot realistically dictate a view of sovereignty and cooperation dramatically different from the one that currently holds sway in most states. Instead, tax competition policy, and any calls for cooperation, must remain part of an interactive relationship among fiscal reality, operational solutions, and prevailing ideas of the sovereignty. Tax competition might lead the global community to a new vision of tax sovereignty, but it cannot drag it there.

II. TAX COMPETITION AND THE LOCUS OF SOVEREIGNTY ARGUMENTS

A. Introduction to the Tax Competition Concept

Just as an understanding of sovereignty is necessary to assess its impact on the tax competition debate, so too is a precise consideration of what is intended by the term “tax competition.” Tax policy discussions are notorious for widely (and wildly) differing uses of terminology,¹⁶ and the active debate over tax competition proves no exception. In its broadest conception the phrase captures a country’s use of any feature of its tax system to “enhance” its competitive advantage in the marketplace for capital,

15. See Sikkink, *supra* note 6 at 413; Robert H. Jackson, *Quasi-States, Dual Regimes, and Neoclassical Theory: International Jurisprudence and the Third World*, 41 *Int’l Org.* 519, 526 (1987) (following World War II, colonialism “became controversial and finally unacceptable in principle.”); Fowler & Bunck, *supra* note 4 at 73 (“A century ago sovereignty implied that a state could go to war whenever it pleased. Once again, states have renounced such a sovereign prerogative.”).

16. A glaring example from U.S. political discourse on tax reform is the use of the term “flat tax” to mean and convey a wide range of ideas, some of which are not even inherent to the idea of a flat (i.e. single rate) tax system. See e.g., Michael Graetz, *Statement on Flat Tax Proposals Presented at Hearings Before the Senate Finance Committee on May 18, 1995*, 67 *Tax Notes* 1256 (May 29, 1995) (noting that contrary to common misconceptions, flat tax systems do not offer significant simplification of the tax system, do not have a single rate, do not guarantee a low tax burden, and are often actually consumption as opposed to income taxes).

investment, and/or nominal business presence. The tax features readily susceptible to enlistment in this mission include tax rates, tax base, administrative system,¹⁷ transparency, disclosure, information sharing, and special credits, exemptions and deduction.

Much of the current debate over tax competition emerged in the aftermath of the OECD's 1998 project on "Harmful Tax Competition." The competition identified and targeted in that project (and through the OECD's subsequent efforts and reports) is much narrower than the broad definition of tax competition above. First, the OECD sought to identify and address *harmful* tax competition, not all tax competition. The OECD expressed a commitment to the view that "there are no particular reasons why any two countries should have the same level and structure of taxation" and that "[c]ountries should remain free to design their own tax systems as long as they abide by internationally accepted standards in doing so."¹⁸ Second, at the time of the 1998 project, the OECD was not prepared to consider all realms of tax competition in its effort to ferret out the harmful versions. The Report and its recommendations focused on "geographically mobile activities, such as financial and other service activities, including the provision of intangibles."¹⁹ Questions of competition for less geographically mobile activities (such as manufacturing, plants, and equipment) and for cross-border interest-bearing instruments were reserved for later work.²⁰

An important thread that runs through the public discourse on tax competition, both in the context of the OECD and elsewhere (such as the European Union) is the belief that there is a gap between stated goals and

17. This could include the opportunity for taxpayers to "negotiate" with the state over ultimate tax obligations.

18. OECD 1998 Report, Harmful Tax Competition: An Emerging Global Issue at 15. For some readers, the OECD statements in both the 1998 Report and the 2000 Progress Report provided no adequate acknowledgement of the benefits from tax competition, although the 2001 Progress Report did include an explicit recognition that competition contributed to the desirable base broadening and tax rate reductions of the 1990s. See, e.g., Alex Easson, Harmful Tax Competition: An Evaluation of the OECD Initiative, 34 Tax Notes Int'l 1037, 1054 (June 7, 2004). The OECD in recent years has expressly stated that it does not aim to create a system of uniform rates. See, e.g., TNI Interview: Jeffrey Owens, Tax Notes Int'l 913, 917 (May 28, 2007) ("the OECD favors competition and that includes tax competition," and "I believe that in the longer term, having countries compete on the basis of tax rates and the business friendliness of their tax environment (e.g., the consistency and certainty surrounding the application of tax rules) is probably healthier than competing by means of "niche" regimes").

19. OECD 1998 Report, *supra* note 18 at 8.

20. *Id.* at 8-9. Taxation of interest, including interest on bank deposits was reserved at least in part because it was currently under examination as part of a plan to explore the use of withholding taxes and exchange of information techniques. *Id.* at 9-10.

ultimate desires. Critics of the OECD tax competition project and also of certain efforts at tax harmonization in the EU object not only to the explicit plans and proposals on the table (e.g. the OECD's 1998 harmful tax competition recommendations) but to what they believe are the unstated and more extreme end goals (e.g., uniform rates).²¹ Both organizations, the OECD and the EU, are limited in their ability to persuade critics that their goals are more modest. Just like legislatures, these are entities with many members holding differing views on the underlying questions. The majority may support a particular step (e.g., the 1998 OECD Report or the EU common consolidated corporate tax base) but may have very different rationales and very different views on the appropriate extensions of that step.

B. The States in the Tax Competition Debate

As we consider sovereign state claims for fiscal control, moral claims for global justice, and the possible outcome for tax competition, we must differentiate the various competition scenarios likely to be at issue. In describing the tax competition cases, this section targets three major features – the identity of the state in the debate (OECD member or not – as an initial indicator of likely power, wealth and resources), the type of activity or investment the competing state's behavior seeks to attract, and the success of that competitive effort. The attention to these factors is *not* intended to suggest that they are the exclusive points of distinction among competition cases. For example, not all havens are in developing, less regulated environments (see, e.g., the role of Switzerland and Luxembourg). Also, not all havens are only havens – Belgium and the Netherlands function as headquarters “havens” despite having many other developed business and investment activities. And finally, competition can be fictitious (i.e. competition over fictitious activities),²² can involve real but specialized or limited regimes, or can be comprehensive and broad based. This section

21. See, e.g., Eileen O'Grady, *United Kingdom Holds Its Ground in Opposing EU Tax Harmony*, 31 *Tax Notes Int'l* 1121, 1122 (2003) (quoting a British government spokesman in Brussels, “The Commission talks about moving to majority voting only on issues of tax administration in Europe – but that is a slippery slope.”); David Cay Johnson, *Former I.R.S. Chiefs Back Tax Haven Crackdown*, *N.Y. Times*, Jun. 9, 2001, at C1 (following then-Treasury Secretary Paul O'Neill's rejection of the OECD project on the grounds that the U.S. does not support harmonization of tax systems, a “bipartisan group of tax commissioners suggested that Mr. O'Neill was misinformed about the purpose of the [tax competition] campaign,” and that the “project explicitly rejects harmonizing tax codes,” and that any effort to “unify tax rates would not work,” given the variety of tax systems.).

22. See *Oxfam Tax Havens: Releasing the Hidden Billions for Poverty Eradication* at 6-8 (Jun. 2000) (at http://www.oxfam.org.uk/resources/policy/debt_aid/).

organizes the tax competition discussion by identifying categories of state actors based on their status, behavior, and success because these elements capture the state's interests, goals and motivations, and provide a strong baseline for evaluating prospects for cooperation.

1. *OECD member states eager to limit tax competition*: This group of countries forms the backbone of the OECD initiative. They are higher income countries with significant infrastructure and social welfare benefits whose multinational corporations and wealthy individual investors avail themselves of a range of attractive tax opportunities abroad, including but not limited to low tax rates, nondisclosure of information (tax and financial), "taxpayer-friendly" administrations, and special regimes (investment, headquarters, "fictitious" location/activities). Some of these competitive tax features may be within the ambit of the OECD harmful tax competition category.

2. *OECD member states engaging in competitive behavior*: As part of the OECD's project on harmful tax competition launched in 1998 (from which Switzerland and Luxembourg were the only member countries to abstain),²³ the member states themselves were asked to examine their own domestic tax practices for any regimes that would be deemed harmful under the organization's guidelines. Among member states, 47 preferential tax regimes were labeled as potentially harmful. Sensitive to accusations that the OECD did not move as aggressively or quickly against member states, the OECD's 2004 Progress Report noted that 18 of these member regimes had been or were being abolished, 14 had been revised to eliminate the potentially harmful features, and 13 of the regimes were deemed not harmful.²⁴ The two remaining regimes (Switzerland and Luxembourg) were then under discussion and ultimately resolved.²⁵ The fact that the harmful preferential regimes in OECD member countries – and in many of the havens that the OECD identified were addressed does not invite the conclusion that competition was eliminated. After the United States announced a significant

23. Both countries abstained from the report and provided written statements outlining their concerns, including those based on the information exchange proposals in the OECD plan. OECD 1998 Report, *supra* note 18 at 73-78.

24. OECD, *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report 7-13* (2004); Easson, *supra* note 18 at 1046.

25. By the time of the 2006 Progress Report, the Switzerland issue had been resolved. OECD, *The OECD's Project on Harmful Tax Practices: 2006 Update on Progress in Member Countries 4* (2006). Soon after the release of the 2006 Report, the Luxembourg regime at issue (1929 Holding Companies) was repealed by domestic law. See Jean-Baptiste Brekelmans, *Luxembourg – Year in Review*, 44 *Tax Notes Int'l* 1072 (Dec. 25, 2006).

shift in the scope of its support for the OECD project in May 2001,²⁶ the standard for what constituted cooperation with the project changed to consist of a commitment to improve transparency of the tax system and to exchange information (evidenced by the havens' willingness to enter into exchange of information agreements).²⁷ Although these measures do (if fully executed) curb certain competitive (perhaps more aptly labeled evasion) behaviors, much remains open to competition. As the OECD head of the Centre for Tax Policy and Administration acknowledged in 2007:

OECD work in eliminating harmful preferential regimes characterized by a lack of transparency, ring-fencing, and with no effective exchange of information – has been very successful. . . . Yet, what we see today is a slow proliferation of what I call 'niche' regimes that are designed to meet OECD and EU standards, but which nevertheless, give a country a competitive edge. . . . You can see this as a healthy sign that tax competition is thriving, but there is a danger that we will end up with tax systems looking very much like the proverbial Swiss cheese: more holes than substance.²⁸

Certainly one can anticipate that the same potential for newer, carefully tailored niche regimes exists outside the OECD as well.

3. *Non-OECD states that feel "forced" to engage in tax competition to secure significant, nonmobile business investment (e.g. manufacturing, production, etc):* Some developing countries consider tax competition their only option to retain or attract "real" business investment.²⁹ Such countries would prefer a system in which they could both collect reasonable tax revenues and maintain investment in their economy. Within this group of countries, there are likely instances in which their perception that they must compete (at least in the short term) to attract and keep otherwise fairly mobile business investment is accurate. Implicit in agreeing with their need to "compete" is a determination that the benefits of investment encouraged

26. See, *infra* text accompanying note 36.

27. See, e.g., Easson, *supra* note 18 at 1077; see generally, OECD, *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report* (2001).

28. TNI Interview: Jeffrey Owens, *Tax Notes Int'l* 913, 917 (May 28, 2007).

29. See, e.g., Yoram Margoloth, *Tax Competition, Foreign Direct Investments & Growth: Using the Tax System to Promote Developing Country Growth*, 23 *Virginia Tax Rev.* 161 (2003) (exploring the ways in which developing countries might benefit from engaged in tax competition for real, direct investment).

by competition through taxes more than offset the loss in revenue.³⁰ However, also within this group are likely cases in which the state is in error in assuming that the benefits from competition outweigh forgone revenue, either because the benefits of that investment to the state were low or because business was likely to choose to invest in that state for other reasons. In such cases, the state would be better off not engaging in competition. In making this determination, it is assumed that other countries will continue to engage in tax competition. The only question, given that condition, is whether the state in question truly gains from competition. There is a separate question as to whether all countries would gain from an agreement not to engage in this competition – i.e. whether there is a race to the bottom where all states are losers. The implications of this question for cooperation by sovereign states are taken up in Part III.

4. *Non-OECD members engaged in tax competition over mobile financial and other activities*: These states include both those more likely to be characterized as tax havens (whether under the OECD's 1998 formal definition, including the absence of substantial activities³¹ or more colloquially), and those states which would not typically be thought of as havens but which may have a regime competing for such activities. The former might be the most resistant to change, assuming that their dominant commercial existence is perceived to be as a "haven" for business and wealthy individuals from the tax regimes of their residence countries. However, in both cases there is the question of whether the state is accurate in its determination that the competitive behavior is a net positive for the country (lost revenue v. benefits). Not only could the calculus be inaccurate,

30. An extensive literature has developed to measure and assess the impact of tax competition on business decisions. Not surprisingly the results are complicated and depend on a variety of factors including the nature of the investment, whether it constitutes new investment, and the non-tax factors against which it competes in driving the final business decisions. See, e.g., Rosanne Altshuler & Harry Grubert, *The Three Parties in the Race to the Bottom: Host Governments, Home Governments and Multinational Companies*, CESifo Working Paper Series No. 1613 (Dec. 2005); Mihir A. Desai, C. Fritz Foley, & James R. Hines, Jr., *Do Tax Havens Divert Economic Activity?* Ross School of Business Paper No. 1024 (Apr. 2005); Rosanne Altshuler, Harry Grubert & T. Scott Newton, *Has U.S. Investment Abroad Become More Sensitive to Tax Rates?* NBER Working Paper No. W6383 (Jan. 1998); Dhammika Dharmapala & James R. Hines, Jr., *Which Countries Become Tax Havens?* NBER Working Paper No. 12802 (Dec. 2006); Harry Gruber & John Mutti, *Do Taxes Influence Where U.S. Corporations Invest?* 53 *Nat'l Tax J.* (2000).

31. OECD 1998 Report, *supra* note 18 at 23 (listing four key factors in identifying tax havens: no or nominal taxes; lack of effective exchange of information; lack of transparency; and no substantial activities required).

it could be measuring costs and benefits for only a segment of society – the competition may benefit some subset of the state, but overall be undesirable. (Once again, as with category three above, we assume a world in which continued tax competition by other states is a given).

The grouping of states into different categories above is intended to facilitate the consideration of motives and rationales that might ultimately generate some measure of cooperation. To further that effort, a brief review of the evolution of the tax competition debate in the OECD and the EU is outlined in the next section.

C. Evolving Positions on Tax Competition

In the years following the OECD's 1998 report, an anti-OECD momentum developed, fueled in part by the labors of the U.S.-based Center for Freedom and Prosperity (CFP), which was formed in 2000 with a mission to challenge the OECD's Tax Competition project and the United States' participation in that work.³² The CFP lobbied both Congress and the administration, and many of the tax havens. With the Congressional Black Caucus, the CFP characterized the tax competition project as harmful to poor, developing, neighboring countries.³³ In other government circles, the CFP contended that the project would ultimately harm the United States both because the United States itself is a successful tax haven and because U.S. taxpayers benefit from the existence and use of (other) tax havens.³⁴ And with the havens, the CFP encouraged their resistance to OECD efforts to secure haven compliance with the recommendations of the tax competition

32. See Ring, *supra* note 2 at 187.

33. Ring, *supra* note 2 at 188 n.136. See also, Thomas Field, *Tax Competition in Europe and America*, 29 *Tax Notes Int'l* 1235, 1242-43 (2003); Cordia Scott, *Congressional Black Caucus Says OECD Tax Moves Unfairly Blasts Developing Nations*, 22 *Tax Notes Int'l* 1600, 1600-01 (2001). Letter from the Cong. Black Caucus to Paul O'Neill, U.S. Sec'y of the Treasury, (Mar. 14, 2001) available at <http://www.freedomandprosperity.org/cbc/pdf>.

34. Ring, *supra* note 2 at 191-93 (describing the CFP campaign). See Daniel Mitchell, *An OECD Proposal to Eliminate Tax Competition Would Mean Higher Taxes and Less Privacy*, 21 *Tax Notes Int'l* 1799, 1821 (2000) ("the OECD initiative. . . is a threat to America's national interests. . . [and] will be bad for U.S. taxpayers"); Letter from Don Nickles, U.S. Senator, to Paul O'Neill, U.S. Sec'y of the Treasury (Feb. 6, 2001) ("Our relatively low-tax status has fueled economic growth and enabled our economy to draw investors and savings from many of our high-tax European competitors. Those competitors will eventually use the OECD initiative as a weapon to undermine our own sovereignty right to enact pro-growth tax policies.").

report.³⁵ The United States, then under a new Bush administration (2001), withdrew its prior strong support for the OECD project. The Secretary of the Treasury announced in May 2001 that the “United States does not support efforts to dictate to any country what its own tax rates or tax systems should be, and will not participate in any initiative to harmonize world tax systems. The United States simply has no interest in stifling the competition that forces governments – like businesses – to create efficiencies.”³⁶ Although the United States ultimately continued participating in the OECD tax competition project, the involvement and the scope of the project were both scaled back.³⁷

As the OECD has grappled with how to frame its challenge to tax competition and how to respond to the debates that challenge has generated, the European Union has similarly devoted substantial energy to questions of tax competition and tax harmonization within its borders.³⁸ The ultimate question of EU tax harmonization begins with the rules for voting on tax matters. Although the EU uses qualified majority voting (QMV) for a growing number of issues, taxation remains subject to unanimous voting rules.³⁹ The unsuccessful EU Constitutional Treaty would have expanded the number of issues subject to QMV, but nonetheless anticipated retaining unanimous voting for taxation.⁴⁰ The special place reserved for tax matters in the pantheon of EU voting sends a resounding message of tax sovereignty. Even if these voting rules do not reflect the aspirational goals of many in the EU, the rules certainly reflect the clear reality of what is currently plausible – and what is not – in the EU today. Against such a backdrop, it is not surprising that the efforts to harmonize the corporate tax base of EU members faced resistance.⁴¹

35. Ring, *supra* note 2 at 195. Two of the founders of the CFP convinced Antigua to allow them to represent the state as “its official delegates to a January OECD summit with other Caribbean tax-have countries.” David S. Cloud, *Virginian Fights for International Tax Havens: Lobbying Finds Bush Receptive to Ideas Clinton Rejected*, *Wall St. J.*, Jul. 30, 2001, at A20.

36. Cordia Scott, *U.S. Secretary Says OECD Tax Haven Crackdown is Out of Line; Treasury and OECD Hold Talks in Paris, 2001 WTD 92-1* (May 11, 2001).

37. See, e.g., Ring, *supra* note 2 at 189; Easson, *supra* note 18 at 1059-1063.

38. See, e.g., Carlo Pinto, *Tax Competition and EU Law* (2003); Easson, *supra* note 18 at 1047.

39. EU website, http://europa.eu/institutions/inst/council/index_en.htm. See also, Sir William Nicoll & Trevor C. Salmon, *Understanding the European Union* 25, 555-56 (2001).

40. See EU website, http://europa.eu/scadplus/constitution/majority_en.htm.

41. Interpretations of the EU tax competition experience to date have an aspect of the glass half full, glass half empty quality about them. Although the history behind the EU’s savings directive could be viewed as suggesting increasing tax unity in the EU, the continued resistance to QMV for direct taxation provides a

Several fears dominate the harmonization debates, and they reflect the different socio-economic positions of various member states. For example, those EU members who consider their tax systems to be significant, attractive features of their total business climate (e.g., Ireland, United Kingdom) resisted steps that shift control over tax system design away from the national government and toward the EU because they anticipated that higher tax rates will result.⁴² Even where the issues on the table have concerned only corporate tax base harmonization or voting majorities on administrative tax matters (and not the admittedly sensitive subject of rates), suspicion lingered that a concession of “sovereignty” here would effectively open the floodgates to loss of state control over crucial tax policy.⁴³ According to this story, low tax rates in countries such as the United Kingdom and Ireland would be the first casualty in this loss of state power. But, perhaps somewhat counterintuitively, the other major set of EU members resisting harmonization efforts in taxation were Denmark, Sweden, and Finland. Characterized as “high-tax, high-welfare states,”⁴⁴ these Nordic states placed a high priority on maintaining their social welfare systems and considered efforts at tax harmonization as a threat that would in the future force them to *lower* their tax rates.⁴⁵

powerful statement regarding the EU members’ desire to retain the ability to say no to cooperation, even members’ when they may sometimes ultimately say yes. See generally Cynthia Blum, *Sharing Bank Deposit Information with Other Countries: Should Tax Compliance or Privacy Claims Prevail?*, 6 Fla. Tax Rev. 579 (2004), (describing the content of the EU savings directive); George Guttman, *EU Taxation of Foreign Interest Is a Multiple-Choice Game: Withhold, Report, Ignore*, 28 Tax Notes Int’l 459 (Nov. 2. 2002) (same).

42. See, e.g., Chuck Gnaedinger, *EU Parliament President Discusses Tax Veto Under Draft Constitution*, 30 Tax Notes Int’l 1312, 1312 (2003) (commenting on the impact of lower tax rates in Ireland and England). Whether these fears are realistic is a separate matter.

43. See, e.g., Turlough O’Sullivan, *EU Tax Policy is Bad News for Business*, Irish Times, Jun. 8, 2007, Finance Sec. at 14 (expressing the view that the common corporate tax base project in the EU would result in higher taxes for Irish business outside the EU and/or higher tax rates in Ireland and contending that “[m]ember states must maintain their sovereignty over tax issues and retain their ability to adopt taxation policies suitable to their needs.”); Eileen O’Grady, *United Kingdom Holds Its Ground in Opposing EU Tax Harmony*, 31 Tax Notes Int’l 1121, 1122 (2003) (quoting a British government spokesperson in Brussels, “Tax is the province of the national state. . . . Anything to do with tax is about sovereignty, and the Treasury must have control over how and what is collected.”); see *supra* text accompanying note 21.

44. Chuck Gnaedinger, *EU Parliament President Discusses Tax Veto Under Draft Constitution*, 30 Tax Notes Int’l 1312, 1312 (2003) (quoting European Parliament President Cox).

45. *Id.*

These insights from the EU experience with tax competition highlight several points. First, even among developed countries, there can be a strong resistance to steps perceived to constitute a surrender of tax sovereignty and control over tax decision-making.⁴⁶ Second, resistance to tax harmonization ideas in the EU is not restricted to the more “tax competitive” of its members. The position of the Nordic members reminds us that support for tax sovereignty need not be a “cover” for tax competition strategies; it can embrace a broader set of concerns about regulating the system of taxation and expenditure in a state. Third, the EU story reinforces the reality that no debate takes place in isolation. Part of the objection to both qualified majority voting for tax administrative matters and to corporate tax base harmonization derived not from the actual effects of change on those issues, but to the possibility that they would lead directly or indirectly to tax rate changes that were deemed very undesirable. Questions of good faith and “inevitable” tax policy creep infiltrate the debate and can be difficult to dismiss, even among states already formally committed to each other to a degree not seen elsewhere in the world.

III. THEORETICAL CHALLENGES TO TAX COMPETITION AND THE UNDERLYING VISION OF SOVEREIGNTY

A. Normative Claims Against Tax Competition: An Introduction

How is tax competition justified? The dominant arguments articulated on behalf of tax competition sound in efficiency.⁴⁷ The strong version of the argument maintains that all tax competition is good because it will lead to an efficient market in government services. But is a market analogy appropriate for taxation? The answer turns on the purposes and the effects of taxation.⁴⁸ Taxation can be characterized as a market in which

46. See, e.g., Julie Roin, *Taxation Without Coordination*, 31 *J. Legal Stud.* 61 (2002) (considering the reluctance of states to harmonize on tax issues, and discussing the EU work on savings taxation).

47. See, e.g., Letter from Milton Friedman and over 200 other economists urging President Bush to reject the OECD’s tax competition project (May 31, 2001) 2001 WTD 107-31 (“Tax competition is a liberalizing force in the world economy, something that should be celebrated rather than persecuted. It forces governments to be more fiscally responsible lest they drive economic activity to lower- tax environments.”); Julie Roin, *Competition and Evasion: Another Perspective on International Tax Competition*, 89 *Geo. L.J.* 543 (2001), M.B. Weiss, *International Tax Competition: An Efficient or Inefficient Phenomenon?*, 16 *Akron Tax J.* 99 (2001); J.D. Wilson, *Theories of Tax Competition*, 52 *Nat’l Tax J.* 269 (1999).

48. Certainly much of tax policy, especially income taxation, directly affects and influences economic activity. In designing tax rules we must be ever cognizant of their effects. At a minimum, virtually all taxation we see today affects

different governments offer different packages of goods and services (e.g., security, roads, educated workforce) in return for a certain price, “taxes.” The market image maintains that the states compete with each other to provide their services and goods at the best price. By eliminating waste and inefficiency in its provision of goods and services, a state can reduce its price and be more “competitive.” To the extent a “market” vision of taxation and government services (with an explicit role for tax competition) can improve efficiency in the provision of government services, certain competitive pressures in taxation can be quite positive.⁴⁹ However, we must also confront the central ways in which tax regulation is different from other fields of regulation. Most government regulation is premised on the view that the government steps in to resolve market failures including externalities and information costs.⁵⁰ Presumably if the market were fully functioning there would be no government involvement. Such is not the story of taxation.

First, states quite obviously impose taxes to collect revenues that fund government operations including more tangible infrastructure (e.g., roads, utilities) and less direct services (e.g., legislative functions, international negotiations, military, and defense). One could imagine trying to force taxation to remain squarely in the “market” model by arguing for taxation on a benefits only principle: government is treated as just another service provider in the economy, which should charge for its services. In some cases this may be feasible – and we do see certain government charges levied on a “use” basis (e.g., toll roads).⁵¹ But more broadly, this exercise is unrealistic. Many of the goods are collective goods and/or the amount of

behavior. Moreover, we regularly use tax policy to affirmatively shape taxpayer behavior, whether social or economic.

49. See, e.g., *supra* note 47.

50. Public choice theory of administrative law starts with the view that regulations are generally justified as a necessary response to market failure. See, e.g., Richard A. Posner, *Theories of Economic Regulation*, 5 *Bell J. Econ. & Mgmt Sci.* 335 (1974) (discussing other regulatory theories as also viewing regulation as the government response to the existence of market failures); see also Sam Peltzman, *Toward a More General Theory of Regulation*, 19 *J. L. & Econ.* 211, 212 (1976). Of course, even if much regulation would be justified by market failure, the reality of the legislative and administrative process may produce an entirely different result. Competing theories of regulation and administrative law (including public choice, neopluralism, and public interest) question the degree to which the ideal of regulation as a solution for market failure comports with the actual regulations implemented. See Diane M. Ring, *On the Frontier of Procedural Innovation: Advance Pricing Agreements and the Struggle to Allocate Income for Cross Border Taxation*, 21 *Mich. J. Int'l L.* 143, 221-24 (2000).

51. Although even here, any potential market comparison would be distorted by the fact that most consumer alternatives to the toll road are “free” roads supported by tax dollars.

each taxpayer's use or benefit is indeterminate. Thus, taxes are not imposed as pure benefit taxes. Second, taxation as a theoretical matter has affirmatively adopted a distributive role in society.⁵² It is not merely practical considerations that prevent the design and pursuit of pure benefits taxation, but also philosophical and moral views on the meaning and legitimacy of government, its roles, and the duties and obligations of citizens.⁵³

[R]egulation in areas such as environment, food safety, and occupational safety differ from regulation in taxation and social security. The former represent acts of government intervention into conduct otherwise undertaken by the market. The government justifies its intervention on the grounds of market failure. In contrast, redistribution regimes such as taxation and social security, do not redress market failure but instead serve a function entirely separate from the market.⁵⁴

If someone seeks to limit taxation solely to an economic service provider model, then a direct confrontation is required with the practical limitations of pricing government goods and services and with the redistributive political theories underlying the implementation of taxation and social security regimes in a democratic state.⁵⁵

That said, those who view the tax competition question through a pure market competition lens can legitimately demand an explanation of how the above arguments regarding the special role for tax legislation in our society translate beyond national borders in a sovereign state world. Such an advocate of tax competition could contend: (1) yes, the market price for government services may be imprecise, but as countries set their tax systems (and "tax prices") for the business environment they offer, investor enthusiasm will tell them whether they have set their price too high or too low for the package they offer (leaving the countries the option of changing either); and (2) taxation might have a significant redistributive function (implicit in fairness features) domestically because that comports with our domestic socio-political commitment, but we have no such structure of

52. See, e.g., Ring, *supra* note 50 at 222; Steven P. Croley, *Theories of Regulation: Incorporating the Administrative Process*, 99 *Colum. L. Rev.* 1, 4 n.7 (1998).

53. Asserting this goal as a principle of our political system does not suggest it is self-executing. As noted elsewhere, the degree, contours, measurement, and context of "redistribution" in the domestic tax system remains contentious.

54. Ring, *supra* note 50 at 223; see also Posner, *supra* note 50; Croley, *supra* note 52 at 4 n.7.

55. See James Repetti, *Democracy and Opportunity: A New Paradigm in Tax Equity*, 61 *Vand. L. Rev.* 1129 (2008).

commitment beyond our borders – that is the nature of a sovereign state system. Thus, critics of tax competition must answer the challenge of the “pro-competition” position.

B. An Efficiency Critique of the Pro-Competition Position?

One obvious option is to accept (at least for purposes of argument) the market model of taxation and demonstrate that this market experiences “failures” which, even under a market model, would support intervention. Thus, even if taxation constitutes a market in government services, regulation is justified where the market generates externalities. The OECD 1998 report can be read as urging that view, at least in part:

The [OECD] seeks to safeguard and promote an open, multilateral trading system and to encourage adjustments to that system to take into account the changing nature of international trade, including the interface between trade, investment and taxation. . . . [The report’s proposals] will further promote these objectives by reducing the distortionary influence of taxation on the location of mobile financial and service activities, thereby promoting fair competition for real economic activities.⁵⁶

Essentially, proponents of the OECD plan can justify the project on market failure grounds.⁵⁷ The problem, however, in trying to cast harmful tax competition as market failure requiring *government* intervention (i.e. regulation) is that the necessary “regulation” would be supranational. If the market experiencing failure is the states’ selling of services and infrastructure for the “price” of taxes, then presumably the design, implementation and enforcement of that regulatory intervention must come from a body above the market players – i.e. a suprastate body.⁵⁸ But do supranational bodies possess the requisite authority? Within the domestic arena the justification (as opposed to “need”) for government intervention itself and for the use of *force* by a state on its people derives from the nature

56. OECD 1998 Report, supra note 18 at 9.

57. The precise nature of that market failure may depend on context. For example, where havens’ rules enable easily hidden financial assets to stay hidden, we might say the market lacks complete information. If a residence country has incomplete information on a taxpayer’s true income and financial situation, it is unable to charge the “accurate” price for the benefits being provided.

58. For comparison, if the market for beef in the United States is experiencing some market failure (perhaps due to information and transaction costs) then remedial intervention would be needed at an enforceable level above the market participants (beef producers).

and sources of legitimacy in a democratic sovereign state.⁵⁹ The same rationale fails at the international level. International bodies can be powerful and influential but their ability to use *force* is constrained by the nature of their legitimacy which differs from that of sovereign states. Globally, we may see market failure but we do not see the same political theory supporting supranational imposition of force. Yet that is what “regulation” of tax competition on market failure grounds would require. Without justification, what is the legitimate role here for the OECD, the EU or other global actor?

Proponents of the OECD project (or of similar efforts to limit certain tax competition) could challenge this interpretation of the market failure story by contending that their goal is only to *curb* such “harmful” tax competition and that they do not need or seek a supranational body to enforce it (and thus there will be no use of “force” to justify). The OECD’s harmful tax competition recommendations would be consistent with a world in which no supranational body exists to govern these matters. Why? There is no use of force on other actors (including other states), instead merely a redesign of OECD members’ domestic tax and regulatory rules, actions well within the traditional scope of sovereign powers.

Does acceptance of this OECD story line “answer” the proponents of tax competition? That is if we agree (1) that taxation constitutes a market in government services, (2) that this market experiences failures (externalities from some competition), (3) that the failures justify intervention, (4) that the intervention must be supranational, and (5) that this intervention does not pose legitimacy and use of force concerns precisely because the intervention is not accomplished *through* force, have we resolved the debate over tax competition? Clearly we have not – and the reason why reveals that arguments regarding tax competition are not confined to an efficiency framework but extend beyond to encompass ideas of international political structure and global society. Some states resist efforts to change harmful tax practices on the grounds that these practices are valuable from their *sovereign* perspective (even if potentially inefficient globally). Of course the states challenging tax competition consider certain competitive practices to be harmful from their sovereign perspective. Thus, there is a clash of sovereign positions, and an appeal to global efficiency provides no clear trump card.

Why do efficiency arguments fail to resolve the clash here, but not in a domestic market failure? In a domestic market, the players (just like the states in tax competition) may not be concerned with system-wide efficiency and externalities. However, these domestic players are part of a system which has invested the supra-market actor (i.e. the nation-state) with the authority to regulate and use force. Where the participants in the market are

59. See, e.g., Thomas Nagel, *The Problem of Global Justice*, 33 *Phil. & Pub. Aff.* 113 (2005).

sovereign states, there is no supranational government with legitimate authority to enforce regulation of the market for government services and taxes. Thus, efficiency may be a problem but it is not a problem “belonging” to a body with the ability to resolve it. The highest level actors with formal authority (the states) define their interests through their sovereign status. Any appeal to change current behavior implicates not only on efficiency but also sovereignty – i.e. the “agreed” terms of global political organization. The positions of both the OECD anti-competition states and the pro-competition states reflect this posturing. The former emphasize the inefficiencies and externalities of the failed market but also identify the infringement upon the tax system of their own sovereign states by the competitive behaviors. Conversely advocates for competition identify not only the potential benefits of broad competition by tax systems but also their “inherent” rights as sovereign states to design and utilize their tax systems to best support their state. Resolution of this debate can only occur through the processes of international relations whereby sovereigns attempt to persuade others to accede to their views whether through enticements or threats of retaliation, or both.⁶⁰ If limits on harmful tax competition would generate global efficiency gains, and if the winning states would share those gains with the losing states, a sufficient carrot could exist without a supra-state entity, however, winning states are not obliged to redistribute the gains.⁶¹

What do these observations on efficiency analysis of tax competition reveal? Recall that the goal of the paper is not to establish whether tax competition is good or bad, or whether it generates certain market failures or not. Rather the point is to delineate how the structure of the tax competition problem derives from a sovereign state world and how traditional market regulation analysis of the problem fails for the same reason. Tax competition is a problem of sovereign states that cannot be regulated precisely because they are sovereign states. Any solution must be a cooperative one grounded in the structure and reality of international relations among sovereign states. To the extent that the much of the analytical discourse on tax competition has focused on assessing the efficiency consequences and merits of the competition and whether it should be regulated, the reality of the question as one more intimately connected to matters of international relations is often obscured.

60. See *supra* text accompanying notes 7 and 12 (discussing the basic framework of the sovereign state world system and what rights, duties, and behaviors are consistent with that system).

61. If there is the possibility that eliminating “harmful” tax competition might be more efficient globally, but the benefit of that increased efficiency would not be distributed equally across the states, the anticipated implications of traditional efficiency analysis collide with reality.

C. Equity Grounds for Curbing Harmful Tax Practices

1. Introduction

Other grounds on which tax competition has been challenged further reflect sovereignty's role in both defining the problem and shaping potential resolutions. What are these other normative grounds? Two equity arguments, each mirrored in a classic story of tax competition, provide a central starting point. In the first story, a society has implemented its income tax system (including a tax on income from capital) as part of a societal plan to provide a comprehensive range of benefits to its members ("social welfare"). If that state then faces tax competition (sometimes the "competition" might be more aptly characterized as evasion), the state will be "forced" to either reduce those services and benefits, or alternatively, increase taxes on a less mobile base – typically employment and consumption.⁶² Either option potentially levies an increased burden on a subset of society, sparking equity concerns within that state.⁶³ These equity concerns may dominate the story if the purported benefits of competition fail to materialize (i.e. the competition is "harmful" and does not improve government efficiency).

In the second story, a developing country is trying to attract business, perhaps manufacturing, to further its economic growth. The necessary and desired economic growth, however, requires both business activities (including investment and manufacturing) and tax revenues (used for infrastructure). Where either prong is inadequate, the country's growth, measured by the quality of government services⁶⁴ and by the residents' standard of living, is in peril. If the developing country believes itself obliged to engage in tax competition (e.g., lower income tax rates on manufacturing profits earned in the jurisdiction), the revenue prong is compromised. It may be possible for the country to exact some additional (i.e. compensating)

62. See, e.g., Pedro Gomes & Francois Pouget, Corporate Tax Competition and the Decline of Public Investment, CESifo Working Paper No. 2384 (Sept. 2008) (their model and simulations indicate that the corporate tax rate and public investment are endogenous and that "if the tax rate goes down by 15%, public investment in steady state goes down between 0.2% and 0.4% of GDP;" their empirical analysis indicates "higher values: between 0.6% and 1.1% of GDP.")

63. These concerns have been extensively explored in the literature. See, e.g., Reuven Avi-Yonah, Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State, 133 Harv. L. Rev. 1573 *passim* (2000); OECD, 1998 Report, *supra* note 18.

64. Such government services include infrastructure facilitating business operations and social welfare services (e.g., providing access to education and healthcare).

revenue from sources not as sensitive to tax competition such as labor or less readily mobile commercial ventures. But for a population of little wealth (an assumed fact given the country's designation as a developing nation) these prospects are limited. The resulting revenue fails to support much of the necessary internal development. Moreover, it is not clear whether the competition for business investment garners the country any net increase in investment. As suggested in Part II's outline of tax competition actors, a developing country may earnestly believe competition is necessary but may be wrong in its calculus. From this perspective, who is the "winner" among the developing countries competing for global business investment?

One assessment is that the multinational enterprises, and potentially their residence countries, benefit. The multinationals gain because the income from business activities located in the competing developing countries bears little or no current tax (and presumably is structured so as to trigger little or no current residence country tax). Assuming that most multinationals are not owned by the residents of developing countries, the gain to the corporations translates into gain for its owners who are members of developed countries. In addition to the corporations themselves (and their shareholders), the residence countries might see some gain – at least where the residence country uses a foreign tax credit, not an exemption system, to prevent double taxation of foreign source income.⁶⁵ If little source country tax is collected, then little credit must offset the residence country's collection of income tax. This latter point (the revenue advantage to the developed/residence country) should not be overstated. Profitable business operations located in developing countries are unlikely to be structured as permanent establishments instead of subsidiaries, and any dividend and interest payments by the foreign subsidiaries to their parent corporations in developed countries are discretionary.

65. The residence country would tax either the current profits of a domestic corporation with a permanent establishment in a low tax developing country or the dividends and interest received by a domestic parent of a foreign subsidiary operating in a low tax country. Additionally, strong controlled foreign corporation rules (or similar regimes) might collect current residence country income tax for the parent of a foreign subsidiary.

2. The Equity Link to Sovereignty

a. Domestic Pursuit of Inter-Individual Equity

In both of these stories (a developed country supporting a social welfare system and a developing country seeking economic growth), the equity arguments against tax competition can be understood as making claims based on both inter-individual equity and inter-nation equity, although the full theoretical underpinnings may not be adequately established. For the developed sovereign state seeking to implement its desired vision of a modern social welfare state, tax competition curtails its ability to “appropriately” distribute the revenue burden among its population. To the extent that the major multinationals and wealthy individual investors can rely on “havens”⁶⁶ with attractive tax and regulatory structures to limit current taxation (through a combination of little or no local tax and a lack of transparency) their tax bills both abroad and at home will be reduced.⁶⁷ Where the competition takes the form of lower rates on actual business activity (for example manufacturing) the loss arises *because* the business has located elsewhere, moving both jobs and current income from the reach of the parent’s residence jurisdiction.⁶⁸ When and under what circumstances

66. As reviewed in Part II, the term “tax competition” is often used broadly to cover different situations such as havens relying on a combination of low/no taxes, secrecy, and paper functions, and “real” competition for true economic activity, typified by the competition over manufacturing investment. These cases can be distinguished and can raise unique questions, particularly for the assessment of good and bad competition.

67. The residence jurisdiction will either have no picture or an inaccurate picture of that global taxpayer.

68. Although the question of whether foreign investment is always a substitute for domestic investment is contested, the experience of the past two decades has demonstrated a significant exodus of manufacturing, technology and information services operations from some developed countries to developing countries. See, e.g., Ashok D. Bardhan & Cynthia Kroll, *The New Wave of Outsourcing*, Fisher Center for Real Estate and Urban Economics, U.C. Berkeley, Paper No. 1103 (2003) (discussing the loss of manufacturing jobs in the United States and comparing it to the prospects for service job loss). Certainly these moves are not driven exclusively by taxes; wage costs have been a crucial factor in these decisions. See, e.g., James R. Areddy, *China’s Export Machine Threatened by Rising Costs – Orders Drops, Shops Idle in Sweater City; Losing Wal-Mart*, Wall St. J. A1 (Jun. 30, 2008) (describing the manufacturing threat that China faces from low cost countries such as Vietnam). The rise of corporation inversion transactions, where for example a U.S. multinational reorganizes its corporate structure so that the U.S. entities are only subsidiaries and the new parent corporation is a foreign corporation in a desirable jurisdiction, complements the picture of large multinationals placing business activities outside of developed jurisdictions like the

these competitive scenarios are definitively “bad” is one question,⁶⁹ but another is how the complaining state suffers its harm. From the residence country perspective, the argument is that the competition impedes its ability to fully achieve inter-individual equity, a generally accepted principle of domestic tax policy.⁷⁰ The equity at stake is a domestic one. The violation “committed” by the competing state is not a failure to achieve equity, but rather an interference with the residence state’s efforts to achieve equity in taxation. The competing state has undermined the residence state’s “tax sovereignty,” broadly understood as the ability to effectively implement desired tax policy for its own taxpayers.⁷¹

Although most nations readily assert and support the concept of tax sovereignty as a crucial power of the sovereign state, there is no clearly established scope or content for this sovereignty.⁷² Definitional ambiguity, however, is not the only problem for tax sovereignty. Just as the residence states frame their inter-individual equity objections to tax competition in the language sovereignty, so too have the states engaging in competition. In fact, they have generally been more successful in using sovereignty arguments to further their pro tax competition stance. After the OECD issued its 1998 report, and began pursuing the report’s recommendations, many targeted tax havens resisted. Havens and other advocates of competition (or, more

United States. Moving operations “offshore” provides little advantage if the parent jurisdiction can still reach that activity for income tax purposes. For jurisdictions such as the United States with some real capacity to reach a portion of that income, the “logical” next step for corporate tax planning would be to take the United States out of the loop by transforming the U.S. multinational into a foreign multinational.

69. See *infra* Part III.

70. Even where the contours of this inter-individual equity may be debated (see, for example, the continuing dialogue over horizontal and vertical equity), the expectation that a tax system will implement a system of inter-individual equity is presumed. See, e.g., Paul McDaniel & James R. Repetti, *Horizontal and Vertical Equity: The Musgrave/Kaplow Exchange*, 1 Fla. Tax Rev. 607 (1993); Louis Kaplow, *Horizontal Equity: Measures in Search of a Principle*, 42 Nat’l Tax J. 139 (1989); Richard A. Musgrave, *Horizontal Equity, Once More*, 43 Nat’l Tax J. 113 (1990).

71. One question that arises is how much these problems are those of the residence state’s own making. If the residence country instituted an entirely different tax regime, for example elimination of deferral, would that be a sufficient solution. The answer depends in part of the nature of the competitive practice (e.g., secrecy cannot be countered by an expansion of the residence country’s current tax base); other competitive pressures (does it matter what other residence countries do); and resolution of the complex challenges of using corporations as proxies for their shareholders. Interestingly, the much maligned OECD 1998 recommendations called upon the residence jurisdictions to increase their use of anti-deferral regimes.

72. See, e.g., Ring, *supra* note 2 at 197-201 (examining the content of “tax sovereignty” in modern debates).

accurately, advocates of minimal taxation) painted the OECD and its member states as aggressively infringing upon the tax sovereignty of these “poor” (literally and figuratively) haven nations.⁷³ The fact that some of this reaction was shaped and prodded by forces in the United States proves interesting on other grounds,⁷⁴ but does not diminish the reality that the tax havens were able to generate what was perceived by many as a plausible, credible claim that tax sovereignty protected their “competitive” tax behavior.⁷⁵

Ultimately, the tax competition debate could be understood as a battle of competing claims to tax sovereignty. Essentially, the havens argue that they have the right to design their own tax and regulatory system in any way they deem beneficial to their state, even if a “side-effect” is reduced taxes collected by residence (generally developed) countries. Any steps by the residence countries to try to limit the havens’ effectiveness is an infringement upon the havens’ tax sovereignty. Correspondingly, the residence countries (typified by the states supporting the OECD tax competition project) contend that they have the right (as a matter of tax sovereignty) to use their tax and regulatory system (and other rules) to implement a tax system (including one that seeks to limit tax competition) they deem beneficial to their state, even if it limits the attractiveness of havens and competing jurisdictions. Although the tax competition problem was not immediately characterized as one of competing claims of tax

73. See, e.g., Ring, *supra* note 2 at 195-197. See also, *supra* note 35 reviewing the CFP’s role as official delegates on behalf of Antigua.

74. See *infra* Part IV.C (discussing the lack of a monolithic position on tax competition within the various countries).

75. For example, twenty six of the thirty eight members of the Congressional Black caucus signed a letter sent to then Secretary of Treasury Paul O’Neill arguing that the OECD project on tax competition: (1) “will undermine the ability of developing nations . . . to strengthen and diversify their economies as well as reduce poverty,” (2) “threatens to undermine the fragile economies of some of our closest neighbors and allies, and (3) “will impose serious economic harm on developing nations.” Letter from the Cong. Black Caucus to Paul O’Neill, U.S. Sec’y of the Treasury, (Mar. 14, 2001) available at <http://www.freedomandprosperity.org/publications/publications.shtml>. See also, Kimberly Carlson, *When Cows have Wings: An Analysis of the OECD’s Tax Haven Work As It Relates to Globalization, Sovereignty and Privacy*, 35 *J. Marshall L. Rev.* 163, 172 (2002) (“The OECD scheme would encourage the world’s major economies to penalize 41 low-tax countries and territories for maintaining attractively low rates unless they essentially relinquish their fiscal sovereignty.” Quoting Deroy Murdock, *Attack of the Global Tax Police*, National Review Online, Apr. 23, 2001, <http://www.nationalreview.com/murdock/murdock042301.shtml>).

sovereignty, the duality of tax sovereignty in the tax competition realm eventually emerged.⁷⁶

How can these competing sovereignty claims be resolved? What is the source of the alleged rights to such “tax sovereignty?” At this point the states have moved beyond formal law in their appeal and have drawn upon the general expectations and understandings of the sovereign state world system. Ultimately, the sovereignty of any one state is dependent upon the acceptance and recognition of that state by other states in the world. In the modern sense, the system of sovereign states functions precisely because all of the players have a shared commitment to a basic structure and vision of international order and international relations.⁷⁷ Despite the existence of some basic structure, there is not agreement on the exact nature of certain dimensions of sovereignty – such as the tax sovereignty claimed in the tax competition context. Neither the literature nor the theory of the sovereign state political system provides an answer.

On the most fundamental level, regardless of how egregious some states find the behavior of other states in the realm of tax competition, the conduct does not arise to the level of clear violation of state sovereignty in the way that physical invasion of a state’s territorial borders would. Although the analysis and literature currently contemplating these competing claims fails to offer a clear resolution,⁷⁸ some of the arguments on behalf of the havens foreshadow arguments they may hope will break the deadlock: the actions of the OECD and its member states are “bad” because they constitute the efforts of a powerful state (or group of states) to restrict the options and opportunities of a poor and developing nation.

The norm implicated here by the havens is not just respect for sovereignty, because that has proven insufficient, but respect by the powerful

76. See Michael Littlewood, *Tax Competition: Harmful to Whom?*, 26 *Mich. J. Int’l L.* 411, 480 (2004) (“if the tax havens are free to structure their tax systems so as to facilitate the avoidance of other countries’ taxes, it seems to follow that the other countries should be free to structure their tax systems so as to discourage the use of havens.” (e.g. by disallowing deductions to haven entities, levying withholding taxes on payments to haven residents)).

77. The existence of the basic shared understanding that underlies the system does not eliminate disagreements. For example, the status of Taiwan remains uncertain. In contrast, where all the relevant parties “agree” then *de jure* independence can be established – essentially in a moment. For example, the former British colony the Ellice Islands became independent and sovereign (with British assent) at midnight on September 30, 1978 under the new name Tuvalu. Alan James, *Sovereign Statehood* 23 (1986). Thus, Tuvalu made the shift to sovereign status at a specified moment in time by virtue of the collective acceptance by the global community of this change.

78. Ring, *supra* note 2 at 179-80, 200-201 (discussing that lack of a clear theoretical solution to the problem of competing claims of tax sovereignty).

states for the needs of the weaker states. Although there may be many reasons that global society would decide that some preference or advantage should be accorded poorer nations, sovereignty per se has not been traditionally understood to require this. As noted in Part I,⁷⁹ an international system based on sovereign states does not anticipate or require equality of power, wealth, or outcome for individual sovereign states. It is not inconsistent with the theory of the sovereign state system for one state to leverage its power and resources to influence the actions of another sovereign and thereby secure an advantage to itself.

One critic of the OECD and its tax competition project attempts to distinguish general power plays by nations (permissible) from the specific anti-tax competition activities of the OECD and its members over tax competition (characterized as impermissible): “Any sovereignty that is lost by signing worldwide trade agreements . . . is tolerable because it is only forfeited after an opportunity to negotiate. By excluding non-OECD members in the analysis and by recommending coordinated defense measures, the OECD violates the sovereignty of those nations that it unilaterally deems tax havens.”⁸⁰ According to this vision of sovereignty, the problem is not that the haven nations got a bad deal from the OECD members, but rather that they got this bad deal without having a chance to negotiate for a better one. Although this argument implicitly accepts that sovereignty can “legitimately” sustain unequal effects, it still ascribes to sovereigns more “rights” than are traditionally acknowledged. Certainly the negotiation of a bad (or perhaps more accurately, uneven) deal is a legitimate act of sovereign states. However, the *opportunity* to negotiate *before* another state takes domestic regulatory steps (e.g. tax, banking, foreign aid) is not traditionally understood as an inherent right of a sovereign. Moreover, this argument cannot really resolve the impasse created by the competing claims of tax sovereignty because the OECD member states could likely counter that they were not granted a chance to negotiate with the havens before the havens implemented their regimes.

This point returns us to one thread of the anti-OECD critique that could tip the balance: the idea that the strength of competing sovereignty claims can differ depending on the wealth and power of the countries involved.⁸¹ The idea that the havens’ claim to tax sovereignty in designing their system should be superior to a counterclaim by the OECD members precisely because they are poorer, less powerful nations is essentially an argument for inter-nation equity – the idea that there is some type of fairness calculus on the global state-to-state scale taking account of the difference in situation among states. Often inter-nation equity is envisioned loosely as an

79. See *supra* text accompanying note 7.

80. Carlson, *supra* note 75 at 177-178.

81. See Ring, *supra* note 2 at 179-80, 200-201.

analog to inter-individual equity. However, as the literature on that question has recognized, the parallels are not complete.⁸² The principles and premises of inter-individual equity (generated as a guiding principal of the relationship among members of a political community) cannot be immediately transported to the inter-nation context.⁸³ At present, firm foundations for a generally accepted vision of inter-nation equity have yet to be established although a number of scholars are working actively in this area. Until we can generate such a vision, the competing claims of tax sovereignty must be resolved on other grounds.

Thus, what started out as an objection to haven tax competition because it impeded the residence state's ability to implement a tax system consistent with domestic inter-individual equity became a conflict over competing claims for tax sovereignty which looks to an as yet unspecified idea of inter-nation equity as a possible resolution.⁸⁴ Yet, inter-nation equity was the basis of the other set of normative equity-based arguments against tax competition: the case of the developing country seeking active business investment.

3. Developing Countries' Race to the Bottom – A Call for Inter Nation Equity

Another dimension to the tax competition problem highlighted above in Part II.A. reflected on the plight of developing countries seeking revenue and investment in their effort to enhance the condition of their economy and social welfare. One way of characterizing the argument on behalf of these havens *against* competition, is that continued unrestrained competition is a negative race to the bottom where they lose vital revenue, de facto secure no

82. See, e.g., Nancy H. Kaufman, *Fairness and the Taxation of International Income*, 29 *Law & Pol'y Int'l Bus.* 145, 153-54, 188-89 (1998); Kim Brooks, *Inter-nation Equity: The Development of an Important But Underappreciated International Tax Value* (Oct. 30, 2008) in *Tax Reform in the 21st Century* (Richard Krever, John G. Head, eds., Kluwer Law International) forthcoming (available at SSRN: <http://ssrn.com/abstract=1292370>); Richard A. Musgrave & Peggy B. Musgrave, *Inter-nation Equity*, in *Modern Fiscal Issues: Essays in Honor of Carl S. Shoup*, (Richard M. Bird & John G. Head, eds., 1972).

83. See *infra* text accompanying notes 92-93. See also Brooks, *supra* note 82; Ilan Benshalom, *The New Poor at Our Gates: Global Justice Implications for International Trade and Tax Law* (Dec. 19, 2008) Northwestern Public Law Research Paper No. 08-43. Available at SSRN: <http://ssrn.com/abstract=1319465>.

84. Although even if we established a clear interest in inter-nation equity, it would still need to be considered against the modern welfare state's desire to achieve inter-individual equity for a wide group of people.

real additional business investment,⁸⁵ and the “advantage” of the competition goes to the multinationals and their home counties.⁸⁶ These developing countries gain little ground in the fight against poverty and its related ills, and the gap between wealthy and poor states in the global economy widens. According to this critique, such tax competition must be reconsidered in order to promote and support “inter-nation equity.” In this context, the idea of inter-nation equity connotes “more equitable distribution” of the tax pie, but again relies on a concept that has visceral appeal (inter-nation equity) yet unclear foundations.⁸⁷ Tax competition is not the only context in which this type of inter-nation equity argument has been proffered. Bilateral double tax treaties face scrutiny as inappropriately favoring capital exporting nations through their allocation of primary and residual taxing rights. Developing countries reportedly have made “concessions” in tax treaties without a full awareness of their implications because they believed the provisions were standard and because the provisions were formally reciprocal (enhancing their appearance of mutuality and comparable impact).⁸⁸

85. As to whether the countries engaging in the “forced” competition do benefit and obtain valuable investment – the question has both a short-term and long-term dimension. Short-term – is the state accurate in calculating the loss of revenue and the benefit of business and investment secured by competition? If the state inaccurately concluded competition was needed, the state could improve its fiscal position immediately by ending its competitive features. If the state is “correct” that current competition is crucial to maintaining its place in the business and investment world (but is leading to zero revenue with no significant efficiency gains – i.e. the race to the bottom), then the solution is longer-term and multiparty.

86. For example, the World Bank’s statistics paint a picture in which the income gaps have been growing: “Trends in global inequality depend on changes in inequality *between* and *within* countries. Inequality between countries has been characterized by two divergent trends in recent decades. The gap between the richest and the poorest countries has progressively widened (for example, doubling between the top 20 and bottom 20 countries over the past 40 years – figure 2) as a significant number of countries are falling further behind compared not only to industrial countries but to other developing countries. The income distribution between countries has consequently worsened (figure 3). At the same time, there has been an acceleration in growth in many developing countries, including the most populous ones, so that the gap between their average incomes and that of industrial countries has begun to narrow. Overall, inter-country inequality weighted by population has decreased as a result (figure 3). China and India account for the bulk of this improvement. While inter-country inequality has improved, inequality within many of the most populous countries, with a large number of poor, has increased modestly.” World Bank, *Poverty in an Age of Globalization* 4 (2000). See also, Avi-Yonah, *supra* note 63.

87. See, e.g., Brooks, *supra* note 82; Benshalom, *supra* note 83.

88. The reciprocity was more apparent than real because the difference in economic situation of the two states meant that in practice, applications of the

a. Normative basis for inter-nation equity

In both the treaty and tax competition context, the inter-nation equity argument captures the belief that the developing nations currently secure an inadequate and unfair share of the global tax revenue pie. This idea, that international practices disfavoring poorer states might be labeled unfair and warrant re-evaluation to address inter-nation equity, seems plausible. But once again, we are faced with the question – what forms the normative basis for this inter-nation equity? One version of this inter-nation equity claim emerges from the broader inquiry of philosophy and political science into concerns for global justice. Globalization has prompted a reconsideration of ideas of distributive justice and its traditional focus (almost exclusively) on the “domestic sphere.”⁸⁹ Among the questions raised are a number that might sound familiar to the tax world, including: “Should we recognize a basic right to subsistence or to a basic income?” “How should we distribute or redistribute natural resources or social primary goods?” and “What are the limits of state sovereignty?”⁹⁰

The answers are unclear because there is no “universal” agreement on obligations (at least above some “basic” human rights minimum) owed to others globally.⁹¹ However, the challenge to tax competition sounding in inter-nation equity and global resource allocation relies on some version of moral and political theory in which our obligations extend beyond national borders. A likely candidate for this theoretical support lies in the broad umbrella of cosmopolitan theories of the justice. Quite generally, cosmopolitanism is a “moral perspective that emphasizes the unity of humanity as a single moral community of equally valuable individuals [where] justice requires each person, regardless of citizenship or nationality, to be treated as an equal for the purposes of determining the claims and

reciprocal provisions would not offset. See generally, Tsilly Dagan, *The Tax Treaties Myth*, 32 N.Y.U. J. of Int'l L. & Politics 939 (2000); Allison Christians, *Tax Treaties for Investment and Aid to Sub-Saharan Africa: A Case Study*, 71 Brook. L. Rev. 639-713 (2005).

89. Ronald Tinnevelt & Gert Verschraegen, *Global Justice Between Cosmopolitan Ideals and State Sovereignty: An Introduction*, in *Between Cosmopolitan Ideals and State Sovereignty*, 1, 2 (Ronald Tinnevelt & Gert Verschraegen eds., 2006).

90. Tinnevelt & Verschraegen, *supra* note 89 at 2; see also Charles Jones, *Global Distributive Justice*, in *Between Cosmopolitan Ideals and State Sovereignty*, 13, 13-14 (Ronald Tinnevelt & Gert Verschraegen eds., 2006).

91. See, e.g., Jones, *supra* note 90 at 13-24 (discussing the differing approaches taken by Peter Singer, Robert Nozick, John Rawls, Thomas Pogge, and Thomas Nagel)

duties of distributive justice.”⁹² As an umbrella concept, cosmopolitanism has a range of variants. The strong version contends that a special concern for an individual is justified *only* if it is good for humanity as a whole.⁹³ The moderate version acknowledges that although we have duties to all other persons, we might have special duties to a subset (such as fellow members of our nation-state) which are not justified on the grounds of benefiting humanity as a whole.⁹⁴ Cosmopolitanism’s focus on the *individual*, when directed at international taxation, prompts the question - why should a group of individuals have a smaller piece of the revenue pie by virtue of their residence in a historically weak and impoverished state? Inter-nation equity demands attention not because nations, per se, have these rights, but because the nation stands as the representative of a large group of individuals. When the nation’s share is not equitable, what we are really saying is that the population’s share is not equitable and is “artificially” based on the division of the world into nation-states.

Of course this picture of cosmopolitan justice drastically understates the complexities, nuances and disagreements of the multiple theoretical paths. Much attention can be and is devoted to examining the implications, variations, limitations, and potential extensions of the rich universe of cosmopolitan thought. However, two important points can be made.

i. Link between inter-nation equity and inter-individual equity

First, as noted above, the cosmopolitan ideal and its pursuit of global justice, including distributive justice, has not yet generated a widely accepted vision of the contours of our global commitment to individuals and of the appropriate standard for allocating resources and evaluating distributive justice. When and why does an allocation of resources that would be unacceptable domestically become acceptable globally? In some sense, the inquiry of cosmopolitanism and global justice links inter-individual equity and inter-nation equity by essentially forcing us to answer the questions, “Why do inter-individual equity obligations and goals end at the national border?” and “Why isn’t inter-nation equity really the same as inter-individual equity?” Extensively developed answers to these questions are

92. Jones, *supra* note 90 at 14. See generally, Thomas Pogge, *World Poverty and Human Rights* (2002).

93. Jones, *supra* note 90 at 15. See also Samuel Scheffler, *Boundaries and Allegiances: Problems of Justice and Responsibility in Liberal Thought* 111-130 (2001).

94. Jones, *supra* note 90 at 15. See also Samuel Scheffler, *Boundaries and Allegiances: Problems of Justice and Responsibility in Liberal Thought* 111-130 (2001).

grounded in the relationship of government, society, law and the individual.⁹⁵ Our relationship to other members of our own nation-state is different according to these measures, from our relationship to members of other countries.

Recognizing the interaction between arguments for inter-nation equity and those for inter-individual equity helps identify the sovereignty-based constraints under which they operate and the current limitations on their ability to provide a clear and widely accepted foundation for certain kinds of global justice. Inter-individual equity⁹⁶ issues arise within the nation-state and are consistent with the concepts and expectations in a democratic sovereign state regarding the relationship between the government and the people.⁹⁷ Inter-nation equity, with its demand that equity and distributive justice not be limited by national borders, struggles under cosmopolitanism theory to find its grounding. One “obvious” solution is to characterize inter-nation equity as inter-individual equity (because it is the individuals for whom we are ultimately concerned). However, to fit inter-nation equity into the current framework of inter-individual equity (premised on a legitimate nation-state and community) we can only endorse the “inter-nation version” of inter-individual equity *if* in fact all of these individuals are members of a single community under one government – a global state.⁹⁸ That is, if we had a single global state then in theory the arguments that bind us on inter-individual equity grounds to our fellow citizens would now bind us to all humanity. Without an accepted and fully developed theory of duty and obligation for “others,” inter-nation equity collapses itself, both theoretically and literally, into inter-individual equity. Of course, if that were to happen (the creation of a world state) we would no longer be discussing inter-nation equity.

95. See generally, Jones, *supra* note 90 at 13-22; Benshalom, *supra* note 83; see *infra* note 96.

96. It is useful to reiterate that although the concept and goals of inter-individual equity are more clearly consistent with the system of sovereign states, that does not mean that the application of inter-individual equity principles are without debate. At quick review of the tax literature, see *supra* note 70 as well as currently political discourse clearly indicates otherwise.

97. See generally Repetti, *supra* note 55.

98. Some theorists affirmatively maintain that global justice obligations as envisioned by the cosmopolitan theorists are not possible absent a world government because “justice is necessarily connected to sovereignty, it only applies ‘to a form of organization that claims political legitimacy and the right to impose decisions by force and not to a voluntary association or contract among independent parties concerned to advance their common interests.’” Tinnevelt & Verschraegen, *supra* note 89 at 3 (quoting Thomas Nagel, *The Problem of Global Justice*, 33 *Phil. & Pub. Aff.* 113, 140 (2005)).

But could it happen? Certainly, as a practical matter, a single global state is unlikely to appear any time soon. Moreover, as the author has explored elsewhere, the move to a global state is not just practically implausible, but also theoretically distinct from a world with a multiplicity of sovereigns. A stable, legitimate government with the capacity to enforce sanctions requires a certain connection among the people. According to this view, “democratic legitimacy is possible only within the framework of a *demos* – that is, a political community expressed in the concept of a nation. Beyond the nation-state, there is no strong sense of public interest, and the potential for political regulation is limited.”⁹⁹ Nothing formally limits the *demos* to the level of the nation-state, but as yet no real *demos* has emerged beyond that level. Even in the European Union, with its unique set of commitments among sovereign states, political discourse and commitment remains predominantly national.¹⁰⁰ Thus, the prospect for grounding inter-nation equity in inter-individual equity is unrealistic and essentially eliminates the distinction between the two.

What about inter-nation equity standing alone? Why do we have such difficulty establishing the normative framework for this position? As noted, above, there has been extensive work done demonstrating why the justifications and rationales supporting inter-individual equity cannot be directly translated to inter-nation equity. This work focuses in part on the grounding of inter-individual equity in the political theory of the nation-state.¹⁰¹ The political theory supporting the nation state structure (including concepts of justice, power, legitimacy, and the need for a people with a *shared* political commitment – a *demos*) would clash with cosmopolitanism’s premise that there should be no distinction among individuals despite their membership in another sovereign state.¹⁰²

But what if we could imagine a theoretical foundation for inter-nation equity, would that be enough? Probably not. The practical barrier that the current sovereign state system poses to the international redistribution required under a cosmopolitan ideal is starkly illustrated by hypotheticals

99. Michael Zurn, *Democratic Governance Beyond the Nation-State*, in *Democracy Beyond the State* 91, 95 (Michael Th. Greven & Louis W. Pauly eds., 2000).

100. Ring, *supra* note 2 at 176-177; Marc Plattner, *Democracy Without Borders? Global Challenges to Liberal Democracy* 97 (2008). This assessment may change over time as, and if, the interactions and bonds within the EU continue to develop. But at present, the view that political discourse in the EU is better characterized as national seems accurate.

101. See *supra* text accompanying note 97-98.

102. Could this clash be resolved by positing a single nation-state where all individuals by definition shared that political commitment? In theory this might be possible, but as noted above, *supra* text accompanying notes 99-100, is highly implausible and likely not even desirable.

offered by Ilan Benschalom.¹⁰³ Cosmopolitan ideals of justice would dictate transfers from wealthy states and their peoples to poor states, without regard to the political identity of the recipient. Thus, Japan could be asked to redistribute to North Korea, and Israel to Syria, irrespective of the political and military tensions between the states.¹⁰⁴ Sadly, in a world of substantial political and military conflict, many other compelling examples can be drawn from 20th century history to the present. Even if the underlying cosmopolitan theory were morally sound and internally developed, the practical outcome would be a political non-starter at present.

Ultimately, the sovereign state system requires that claims for inter-nation equity either find a compatible interpretation *within* the sovereign system or argue persuasively and plausibly for its *replacement*.¹⁰⁵ Thus, arguments against tax competition based on inter-nation equity face a significant hurdle from the sovereign state system.

ii. Revisiting the Classic Sovereign State

The second observation we can make with respect to inter-nation equity, sovereignty, and challenges to tax competition is that history shows us the flexibility of the sovereign nation concept. The stereotyped concept of a sovereign state as independent from all external forces and in complete control domestically, has been a fiction,¹⁰⁶ and certainly is not theoretically required today. The “compromises” of the 20th century to the ideal image of the sovereign state include acknowledgment of human rights claims and the recognition of the illegitimacy of imperial rule. Perhaps we can find room for a moderate variant of cosmopolitan theory which grants a special, and possibly dominant, obligation to fellow citizens but maintains a heightened set of duties to all persons. One question arises: if there are global duties does that imply the need for global institutions (even if not necessarily a world state)? Once again, if the currently incomplete cosmopolitan theories could develop a framework for the stable world order that would implement their vision of global justice,¹⁰⁷ the sovereign state system might be flexible enough to accommodate it.¹⁰⁸

103. Benschalom, *supra* note 83 at 5.

104. *Id.*

105. See generally Benschalom, *supra* note 83 at 2-19.

106. See, e.g., Ring, *supra* note 2 at 161-62.

107. See Leif Wenar, States, Individuals, and Equality, in *Between Cosmopolitan Ideals and State Sovereignty*, 25, 33-34 (Ronald Tinnevelt & Gert Verschraegen eds., 2006) (encouraging cosmopolitan theorists to provide a more comprehensive theory).

108. Simply taking a basic cosmopolitan duty to redistribute to others and funneling that duty through a world organization (instead of a state-to-state transfer, as in the North Korea/Japan and Syria/Israel examples) would fail to remedy the

b. Realistic Application of Inter-nation Equity Claims

But until cosmopolitan theories answer these calls for a more specified vision of the required economic justice and of its stable implementation in the world, where are we? Are inter-nation equity challenges to tax competition without support? Although the strong moral claim potentially promised by cosmopolitan theory may emerge in the future, there are three ways in which states can press an inter-nation equity claim in the modern sovereign state world. First, policy makers can make appeals on humanitarian grounds that essentially correspond to what the literature refers to as “charity,” in contrast to moral obligations.¹⁰⁹ Such calls are weaker than a statement of moral obligation, and according to Nagel do not constitute true global justice,¹¹⁰ yet they may yield some results, particularly in combination with the two additional points below. To the extent that we believe it is possible to shift and shape norms and behavior without a full scale rethinking of foundational philosophical theory, developing countries might benefit from efforts to promote a charitable norm of this type.

Second, and likely related to the first, it may be possible to expand upon some of the accepted thinking on human rights to encompass more clearly defined economic rights. Some scholars are currently pursuing this line of reasoning,¹¹¹ considering whether support for human rights can make sense without a corresponding commitment to certain economic baselines for the society. If the latter can be established, or at least argued, then ensuring adequate tax revenue to those developing nations which are the locus of significant human rights concerns (in terms of standard of living and related measures) could constitute a necessary component of a national commitment to human rights globally.

Third, it may be possible to make arguments against tax competition (influenced by inter-nation equity) that appeal to the core of state sovereignty – the call to national self interest. Assuming a competing state inaccurately views its competitive behavior as beneficial, then if that state were convinced its calculation was in error it might change its tax rules and eliminate the competitive component in an act of self interest. However, given the

problem. If one country *strongly* resists direct redistribution to another country given their military/political situation, it is unlikely to view that transfer differently when run through an international body. The transferor state is not in need of an intermediary to save face and avoid a direct transfer it objects (according to the facts of the hypothetical) to such a transfer in any form.

109. See, e.g., Thomas Nagel, *The Problem of Global Justice*, 33 *Phil. & Pub. Aff.* 113, 140 (2005)

110. *Id.*

111. See, e.g., Allison Christians, *Fair Taxation as a Human Right*, Univ. of Wisconsin Legal Studies Research Paper No. 1066 available at <http://ssrn.com/abstract=1272446>.

difficulty in making these determinations in many cases, and given the pressures on governments to appear active in trying to attract business, this effort at persuasion on the facts is unlikely to be successful. But another push at self interest remains, this time on the developed country side. To the extent one can make plausible arguments that the current distribution of global tax revenues among states is not merely inadequate for developing countries, but also inevitably undesirable for developed countries (perhaps due to decreased political stability in developing countries, or due to a stagnant consumer market in those countries), then challenges to tax competition and the race to the bottom could be re-cast in a manner entirely consistent with the operation of a sovereign state world system.

Thus, given that cosmopolitan theories of justice have not yet unseated the sovereign state system, either as a theoretical or practical matter, their moral claims for inter-nation equity as it relates to tax competition will have limited force. Advocates for developing countries must therefore look to charity arguments, to national self-interest, and to an expanded and clarified conception of human rights (with a detailed economic component) to achieve their desired fiscal changes.

IV. STRATEGIC USE OF SOVEREIGNTY IN THE MISSION TO SECURE COOPERATION OVER TAX COMPETITION

If a sovereign state system remains the framework against which the battle over tax competition rages, can features of the sovereign state system be co-opted by those aiming to curb harmful tax competition? Rather than serving as a reminder of our current absence of a complete, viable theoretical framework of global justice that would demand increased attention to equity, can the sovereign state become part of the solution? This section explores a range of connected strategies that might be available in different circumstances and in different combinations.

A. Resurgent Sovereignty Claim

The first possibility is a return to tax sovereignty – the very place we left with an impasse. Is it possible to characterize a subset of tax competition practices – those that really constitute tax evasion –¹¹² as cases in which it is not “merely” the general tax sovereignty of the state that is at risk but instead the more fundamental obligations of accountability to its people? Consider Country X, with a number of resident multinational corporations and wealthy individuals who have invested in havens in an effort to hide and avoid

112. Even this term is likely to elicit some disagreement over what constitutes permissible facilitation of non-payment of tax in a home jurisdiction and what does not.

otherwise due Country X tax. If Country X cannot guarantee to its population that it is acting with reasonably full and complete knowledge in imposing tax burdens and enforcing tax rules,¹¹³ (i.e. that its tax bills and enforcement actions adequately reflect the reality of its own taxpayers' haven investments) and if the people cannot verify those decisions, is a vital component of a legitimate democracy – accountability – missing? To the extent that this line of reasoning can successfully refocus the competing sovereignty claims, it could provide support in a subset of cases.

In addition to framing the revitalized sovereignty argument as a question of accountability, it might be useful to return to the core definition of a sovereign state. Recall that despite some variation in the definition, the core accepted components of a sovereign state included control over territory and people. The state challenging tax competition should anchor its objections in the very definition of sovereignty purportedly cherished by the competing state. If sovereignty presumes that states exert control over their own people, then tax practices that facilitate the avoidance of domestic country taxes would be an attack on the core sovereignty of that residence country, arguably no different than physically invading its territory (the other feature over which the sovereign state is expected to exhibit control).

Finally, where examples of tax competition depend significantly on the host jurisdiction's commitment to secrecy, nondisclosure and little or no information sharing with the residence country, then the tax sovereignty claims of the developed (residence) country might be better paired with a broader challenge to these competition behaviors based on their ability to facilitate terrorism, money laundering, and other "non-tax" problems. In recent years, the tenor of the debate over issues of secrecy, disclosure and information sharing outside the tax realm has shifted significantly. The tax competition debate though has exhibited less influence from these major events. However, reframing the tax issues as part of, not simply analogous to, the broader financial concerns may prove powerful.

B. Sovereigns and the "Right" to Use Power, Leverage and Deal Making

Sovereignty ideals validate one state's use of its influence and power to exact agreements and concessions from another state. To the extent, for example, that the OECD members sought to use their "power" (including economic advantages) to obtain the consent of havens to the OECD plan to eliminate harmful tax competition, sovereignty is not inherently violated. It

113. Recall that in democracies engaged in some measure of redistribution through the tax system, the tax burden varies depending on income levels. If one group of taxpayers can hide their income, then they are not paying their nationally agreed share (and the other will have to pick up the fiscal slack or spending will be reduced).

seems that the OECD did initially take a route more aptly characterized as a power move than an invitation to negotiate when it issued the 1998 Report. OECD success though would depend on the true power behind the asserted positions. It is unclear what trajectory the 1998 report and its recommendations would have taken in subsequent years had the United States remained fully invested in the project.¹¹⁴ However, without the United States on board, and given the other fractures, sufficient power did not exist as of 2001.

At that stage, the strategy of sovereign deal making and negotiation moved to the fore. Consideration of this shift draws our attention to the running debate in international relations theory as to whether the neorealists or the neoliberals more accurately describe the nature of inter-state cooperation and regime formation. Does power shape the international world, or do the agreements that we see and the regimes that are formed reflect the market nature of interactions and the ever-present desire to produce a more efficient outcome?¹¹⁵ The tax competition controversy does not answer that century old debate, but it provides additional fodder for the theorists. More importantly, however, if a deal on tax competition can make all of the states better off, then cooperation is certainly possible. But as noted earlier, even if certain competitive practices are globally inefficient, simply eliminating those practices may not improve all states' positions. States achieving an advantage from competition become losers by cooperating unless redistribution (the sharing of the global gain) takes place. Although we lack a fully viable theory of global justice that would require redistribution globally, we do not need such an equity theory to justify redistribution undertaken as part of a trade. Exactly how this deal would take shape would depend on the machinations of the extensive game theory and modeling that occupies much of the international relations and international regime formation literature.¹¹⁶ Three immediate versions can be identified:

- (1) Share the gain – If eliminating certain harmful tax practices generates a net gain for the OECD countries then they can offer to share that gain. This sharing could be done directly, as suggested by Steven Dean, by paying havens when they

114. See, e.g., Hugh Ault, *Reflections on the Role of the OECD in the Development of International Norms* (U.S. response to the OECD project may have unexpectedly pushed the process not just in the direction of information exchange, but information exchange beyond the harmful tax competition context) (Draft on file with the author).

115. Diane M. Ring, *International Tax Relations: Theory and Implications*, 60 *Tax L. Rev.* 83 (2007).

116. See, e.g., Ring, *supra* note 115 at 104-110 (considering the range of models and factors implicated in the game theory modeling of regime formation theory).

facilitate the identification of income and taxpayers who are avoiding home country taxation.¹¹⁷ Such a plan is not without obstacles including the need to limit negative incentives of states to implement regimes so as to collect the finder's fee. This sharing could also be done indirectly by modifying certain features of the residence country's tax system or treaty provisions to expand the source country's opportunity to engage in "legitimate" revenue collection.

- (2) Bundle strategy – If providing a related tax carrot proves too cumbersome or risky, an agreement on tax competition could be bundled with other issues or benefits not related to taxation (including trade, military, development aid).¹¹⁸
- (3) Combine deal making with power – The sophisticated understanding of the neoliberal views on cooperation and regime formation in the international arena recognizes that power is not irrelevant, but rather that cooperation develops where there are inefficiencies that can be improved upon through the deal. However, more than one deal may be possible and the ultimate selection among those choices may turn substantially on relative power among the states.¹¹⁹ For example, in a gain sharing solution, although the allocation to the competing states must be sufficient to garner their support (i.e. make them better off than competing), the developed countries might be able to achieve this while still retaining a larger portion of the total tax pie.

C. Seeing Beyond the Sovereignty

Just because the global system operates with sovereign states as dominant players and just because the states set tax policy and collect and use the resulting revenue, it is critical never to lose sight of the fact that sovereignty is about the international relationships among states. In that setting, states act as a monolith and must present a single view and speak with one voice. Either the country will or will not sign the treaty; either it will or will not impose withholding taxes. Only one official, national position

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

118. See, e.g., Ring, *supra* note 115 at 101 (considering the use of bundling and issue linkage in reaching agreement)

119. See, e.g., *id.* at 100-101 (discussing, for example, the battle of the sexes game or other scenarios with multiple potential cooperation points).

can operate at a single moment in time (assuming the government has functional control).

The state, however, is not a monolith of views. If we open the lid of the nation and look inside we find multiple, competing, and contradictory views on all of the important international issues. The democratic political process within the state sorts through these competing positions and arrives at a single view that it then advocates on behalf of the state. Although that process may validate the selection of one view among many, it does not negate the reality that there were many voices and that a different voice may rise to the top at a later date. Within tax competition we saw this most dramatically in the evolution of the official U.S. position on the OECD project during the period January 2001- May 2001 as the Bush administration came into office. In this case the reality that states are not a monolith worked against the OECD harmful tax practices agenda, however, the same observations can be used affirmatively to push for cooperation (perhaps in conjunction with some of the approaches outlined in Part IV.B. above). If the OECD members are not monoliths, then neither are the havens. The challenge is determining where a useful and reasonable fissure on the tax competition issue lies.

One possibility is a case described in Part II, of a haven that may have miscalculated in deciding that competition was beneficial. If there was a miscalculation, the haven's administration may resist revisiting the issue and admitting error, but perhaps other segments of the population or business sector could be persuaded that a shift would be in their own and their national interests. Another possibility is a country in which the benefits of competition are not widely disbursed and are concentrated at the top. In this case, it could be strategic to identify the ways in which the competition serves a small segment of the population but provides little or no benefit to the majority of the people. For example, a "paper" haven in which the foreign investors have minimal presence and investment in the country does generate business for locals who facilitate that paper existence but may provide little income or investment for the state more broadly.

V. CONCLUSION

Sovereignty permeates the tax competition controversy – both in the characterization of the problem and the crafting of cooperative solutions. It helps explain the limits of efficiency and equity arguments against harmful tax competition. Market failure ideas, which generally support intervention and regulation, adapt less readily to an inter-state market which lacks the requisite supra-state above the individual nation-states. Similarly, the complex equity arguments are inextricably intertwined with both the practical constraints of a sovereign state system and the theoretical values embodied in the modern democratic sovereign state. Certain challenges to

tax competition (appeals to charity, self-interest, and human rights) remain available despite the absence of a sustainable vision of global economic justice and redistribution with which to critique specific competition practices. Moreover, armed with a heightened appreciation for the place of sovereignty in tax competition we can reconsider possible sovereignty based arguments, engage in deal-making, and capitalize on the distinction between sovereign states and monoliths. Finally, although a frank and honest conversation about what we value through sovereignty and what we aspire to globally will not provide ready answers to long-standing dilemmas of philosophy and political reality, it will sharpen our focus and attention on the underlying issues of global justice and global governance in a dialogue linking philosophy, law, political science, and economics.