

SYMPOSIUM ON RUTH MASON, “THE TRANSFORMATION OF INTERNATIONAL TAX”

DIVERSE INTERESTS AND INTERNATIONAL LEGITIMATION: PUBLIC CHOICE THEORY AND THE POLITICS OF INTERNATIONAL TAX

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In her article, Mason concludes that politics – or “bargaining over national interests” — “will play a starring role in determining the outcomes” of the current digital tax project.¹ In this essay, I apply public choice theory to the politics of international tax and argue that two questions can shape our understanding of international tax negotiations and therefore help us predict the outcomes of future international tax reform projects. First, what interests are country delegates representing? Second, how are countries using their involvement in international negotiations to represent these interests? The first question highlights that country delegates are often not defending some agreed-upon “national interest” but are instead often protecting the interests of particular political parties, industries, or taxpayers, which in turn means that interests can change over time and that some voices are missing from debates. The second question highlights that country delegates can engage in international tax negotiations in a variety of ways. They can try to limit what, if anything, the negotiations achieve; they can try to push for more expansive results; and they can use the negotiations to provide international support for their own country’s laws. This essay focuses on one particular version of this third type of engagement, where delegates use their country’s involvement in an international project to validate and legitimate an idea or proposal that may previously have had little support. I refer to this involvement as “international legitimation,” and I argue that the Organisation for Economic Co-operation and Development (OECD)/G20 Base Erosion and Profit Shifting (BEPS) Project shows that delegates who took this approach may have achieved the most long-term success in that their inclusion of little-known provisions or concepts in the international outputs of the BEPS Project ended up leading to these provisions and concepts being adopted by countries around the world.

Whose Interests are Represented?

If politics involves countries acting on behalf of their national interests, then the first question to address is what those national interests are. In the tax context, sometimes a negotiation is a pure revenue contest, with one country wanting to raise revenue at the expense of another. But often the politics are not that clear-cut. As public choice theory highlights, discussions of national interests should acknowledge that individual actors face different incentives and preferences, and this is as true in international tax negotiations as in other interactions.² In some international tax negotiations, the delegates sent by a country may, for example, be representing the interests of their political party but not necessarily the country as a whole. Prior to the BEPS Project, this dynamic occurred with the United States’ involvement in the

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¹ Ruth Mason, *The Transformation of International Tax*, 114 AJIL 353, 393 (2020).

² Neomi Rao, *Public Choice and International Law Compliance: The Executive Branch is a “They,” Not an “It”*, 96 MINN. L. REV. 194, 225 (2011).

OECD's work on harmful tax practices,³ and members of the U.S. Congress argued that a similar dynamic occurred in the context of the BEPS Project, with the Obama administration's representatives representing only the interests of the Democratic executive branch and not the Republican interests that the legislature represented.⁴

In other negotiations, country delegates may act on behalf of only certain taxpayers. Such actions could be motivated by a desire to protect revenue indirectly by ensuring that the interested taxpayers continue to invest in the country, or they could be motivated by narrower political concerns, such as ensuring campaign donations or electoral support from the interested taxpayers. During the BEPS Project, some observers charged that certain countries were acting on behalf of their large corporate taxpayers who wanted to continue to engage in tax avoidance rather than on behalf of the rest of their electorate who might have been more opposed to tax avoidance.⁵ Well before the BEPS Project, Julie Roin argued that this dynamic is often at play in negotiations over international tax harmonization, where legislators are often beholden to lobbyists that oppose any such harmonization.⁶

Alternatively, and in a way that complicates criticisms of international tax's lack of "democratic accountability,"⁷ some countries may have the opposite dynamic occur, where elected representatives are beholden to certain taxpayers domestically but country delegates are able to act against those taxpayers' interests in a less salient international setting and therefore act on behalf of less politically connected voters. This is arguably one reason why countries needed the BEPS Project to address corporate tax avoidance—at the domestic level, at least some elected representatives may have felt that they had to respond to politically powerful corporate taxpayers even if there was general opposition amongst the electorate to corporate tax avoidance.⁸

It may be impossible for observers to identify which of these situations is motivating which countries in a particular negotiation, but it is worth considering that, even when countries are acting "politically" through the actions of their international delegates, the interests those delegates represent may differ across time, across different issues, and across different negotiations. If these interests differ across time, such as when interests change with a change in political leadership, this may lead other countries to be less willing to engage in negotiations since they distrust the other country's ability to make a long-term commitment to the outcomes of the negotiation. Alternatively, even if country delegates are consistently representing a certain set of interests, these interests may exclude certain stakeholders (such as taxpayers or beneficiaries of the social services funded with tax revenue) if those stakeholders are more diffuse and therefore less able to have their interests represented.⁹ These and other consequences need to be considered when contemplating the politics of international tax and the various interests that delegates are representing under the guise of representing national interests.

How Do Countries Use International Engagement to Advance These Interests?

There are many ways that countries can engage politically with international negotiations to protect the interests discussed above. They can use their involvement to limit what can be achieved, they can use their involvement to

³ See, e.g., Diane Ring, *Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation*, 9 FLA. TAX REV. 555 (2009).

⁴ See [Letter from Orrin G. Hatch and Paul D. Ryan to U.S. Treasury Secretary Jacob Lew](#) (June 9, 2015).

⁵ See, e.g., Reuven Avi-Yonah & Haiyan Xu, *Evaluating BEPS*, 10(1) ERASMUS L. REV. 3, 9 (2017) (referring to the BEPS Monitoring Group, which made such claims).

⁶ Julie Roin, *Taxation Without Coordination*, 31 J. LEGAL STUD. S61 (2002).

⁷ [Mason](#), *supra* note 1, at 383, n. 208.

⁸ See, e.g., Yariv Brauner, *What the BEPS*, 16 FLA. TAX REV. 55, 59 (2014) (stating that "[c]ountries, even those with the strongest economies, are not powerful enough to satisfactorily enforce their tax laws pursuant to the current regime.").

⁹ See [Roin](#), *supra* note 6.

push for more expansive results (e.g., those that apply to more countries or that impose more demanding requirements), and they can use their involvement to promote their country's laws relative to those of other countries. The BEPS Project provides illustrations of all of these types of engagement, but this essay focuses primarily on what I refer to here as "international legitimization," where delegates use the results of international negotiations to provide legitimacy to proposals or ideas that were previously unknown or otherwise considered unlikely to become law.

The BEPS Project was made up of fifteen so-called "Actions," each of which focused on a particular area of corporate tax and each of which resulted in a final report.¹⁰ These final reports set out one of three possible results: some, such as Action 1, led to neither recommendations nor minimum standards; some, such as Actions 2 and 4, led to recommendations that did not have to be adopted but were viewed as best practices; and four of the fifteen Actions resulted in minimum standards that all participating countries were required to implement. The final reports were hundreds of pages long, and, along with setting out best practices or minimum standards, they provided detailed descriptions of the tax issue in question and possible avenues for addressing it. As part of these descriptions, many of the final reports listed country rules as examples of possible models that other countries could adopt. An example of an Action where this occurred is Action 3, where the final report listed many countries' very different controlled foreign company (CFC) rules as possible models, despite not reaching a conclusion that any one model should be viewed as a best practice.¹¹

The structure of the BEPS Project described above means that country delegates could limit the result for an Action by demanding that it result only in a statement of best practices and not in a required minimum standard. Alternatively, they could push for a more expansive result by demanding that an Action impose a minimum standard. The BEPS Project also illustrates a third type of involvement, where delegates pushed to include their laws in the reports that were published for each Action. A version of this third approach that has not previously been discussed occurred when delegates pushed to include in the recommendation rules or design concepts that had not yet been adopted as domestic law. Examples of this type of involvement include Action 1, which addressed the tax challenges of the digital economy, and Action 3, which addressed CFC rules. The 2015 Action 1 Final Report considered several possible new digital tax rules that did not yet exist in any country, including a significant economic presence rule that would create a permanent establishment in a country where a taxpayer did not have a physical presence¹² and an "equalisation levy" that would tax the gross revenue of remote sellers or other digital companies.¹³ And the 2015 Action 3 Final Report included discussion of an excess profits rule, which had been proposed several times in the United States by the Obama administration but had not become law.¹⁴

Perhaps surprisingly, the effect of including ideas or proposed rules in an OECD publication was to legitimate them even before they became law in the country that had originally considered them, and this ended up having important consequences in both Action 1 and Action 3. The digital rules mentioned in the 2015 Action 1 Final Report were not even recommended by the OECD, and yet countries in the wake of the BEPS Project began to implement more and more rules that were modeled on them. By 2018, when the OECD published an interim

¹⁰ Note that Actions 8–10 resulted in one combined final report.

¹¹ See Org. for Econ. Co-Operation & Dev. (2015), [Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report](#) 20, n. 14 (citing Denmark's CFC rules); 30, n. 3 (citing the United States's CFC rules); 30, n. 4 (citing New Zealand's CFC rules); 30, n. 5 (citing the United Kingdom's CFC rules); 53, n. 11 (citing the United States's CFC rules); 53, n. 12 (citing the United Kingdom's CFC rules); 53–54, n. 13 (citing South Africa's CFC rules); 55, n. 21 (citing Japan's CFC rules) [hereinafter Action 3 Final Report].

¹² Org. for Econ. Co-Operation & Dev., [Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report](#) 107–113 (2015).

¹³ *Id.* at 115–117.

¹⁴ [Action 3 Final Report](#), *supra* note 11, at 49–50.

progress report on the continued work on Action 1, it could point to several versions of the substantial economic presence test and several equalisation levies that had been passed in the wake of the 2015 Final Report.¹⁵ After 2018, the pace of countries adopting these rules increased, with France, the United Kingdom, Italy, and other countries proposing or implementing digital services taxes, which were a version of equalisation levies.¹⁶ And when the Inclusive Framework then moved forward with its two-pillar digital tax project, much of Pillar One appeared to be modeled after the substantial economic presence test from the 2015 Final Report.¹⁷

The excess profits rule mentioned in Action 3 also evolved from merely a theoretical rule to actual law in only a few years. In the United States, the Obama administration had proposed versions of such rules several times, and yet Congress never passed them into law. Only a few years later, however, the fate of excess profits rules looks very different: the U.S. implemented two versions of this rule in its 2017 tax reform bill, with the Global Intangible Low-Taxed Income provision¹⁸ relying on this concept to determine which companies to subject to minimum taxation and the Foreign-Derived Intangible Income provision¹⁹ relying on the same concept to determine which companies to provide with a deduction. The OECD is also now seriously considering a minimum tax based on the excess profits model as part of Pillar Two of its digital tax work.

I therefore refer to this type of involvement as “international legitimization.” One way to think of this is as a political feedback loop. Country delegates use their involvement in international negotiations as an opportunity to include proposals and new ideas in the reports that result from those negotiations. This in turn legitimates those ideas and leads to them ultimately becoming law—in their country and perhaps in other countries as well—after the publication of reports. There are a variety of reasons that may explain why international legitimization occurs. First, it may shift the Overton window of which policy options are seen as politically feasible.²⁰ By including ideas that were previously not considered to be serious proposals in an international report, delegates may succeed in making them seem more feasible and including them in ongoing policy discussions. Second, it may remove the political or national affiliations that were previously associated with a proposal. Domestically, had the Trump administration and the Republican-majority U.S. Congress considered the excess profits rule only as an Obama administration proposal, they may have been less likely to adopt it as part of their tax reform bill than when it was seen as an apolitical international concept. Internationally, had countries considered excess profits rules to be a purely American concept, they may have been less willing to adopt them than when they were seen as the suggestion of the OECD. Third, this could be a further example of Katerina Linos’s idea of diffusion through democracy, where voters in one country may be more willing to adopt a policy if it has been adopted in another country or supported by an international organization.²¹ Finally, inclusion in an OECD report may reassure domestic policy-makers that they are less likely to get pushback from other countries if they adopt a provision that was previously seen as radical. In the case of the excess profits rule, a U.S. minimum tax may have previously been seen as extra-territorial, but its inclusion in the Action 3 report may have shielded it from such criticism. And many countries

¹⁵ Org. for Econ. Co-Operation & Dev., [Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS](#) (2018).

¹⁶ Lilian V. Faulhaber, [Taxing Tech: The Future of Digital Taxation](#), 39 VA. TAX REV. 145 (2019).

¹⁷ For more on the digital tax project and its evolution from Action 1, see [id.](#)

¹⁸ 26 U.S.C. 951A.

¹⁹ 26 U.S.C. 250.

²⁰ The Overton window refers to the range of policy options considered during policy debates. See Nathan J. Russell, [An Introduction to the Overton Window of Political Possibilities](#), MACKINAC CTR. PUB. POL’Y (Jan. 4, 2006).

²¹ See Katerina Linos, [Diffusion Through Democracy](#), 55 AM. J. POL. SCI. 678 (2011). Linos focuses on the education of voters, which may be less true in the context of technical rules on international tax, but the diffusion concept may be relevant in the context of educating lobbyists and certain groups of corporate taxpayers.

may have felt more comfortable adopting various digital tax rules after the Action 1 report considered them, even if these rules have ultimately led to international resistance.²²

International legitimization likely occurs due to some combination of these reasons, and the reasons may vary depending on the international project or topic. This essay merely aims to introduce the concept of international legitimization, and a deeper discussion of the reasons for it is a subject for future work.

Lessons for the Future of International Tax

What do these lessons from public choice theory tell us about what we can expect the future of international tax to hold? The BEPS Project has shown us that the countries involved in international tax negotiations will always be representing a variety of interests and that countries engage in international tax negotiations in a variety of ways. But one lesson is that one of the significant long-term impacts of engagement in international negotiations can be the international legitimization of proposed or aspirational rules or design concepts. The international tax landscape several years after the BEPS Project suggests that this type of international legitimization may lead to those rules and design concepts being considered as potential options in future international tax projects. Therefore, one possible take-away from the BEPS Project is that the current digital tax project is likely not to be the last international tax project. In 2015, Action 1 and Action 3 may have seemed to have resulted in little of significance. And yet they ended up having major impacts on the international tax landscape within only a few years, with Action 1 expanding into the current digital tax project and Action 3 acting as the model for the U.S. Global Intangible Low-Taxed Income and Foreign-Derived Intangible Income rules and Pillar Two of the digital tax project. For observers looking for hints for the next big international tax project, therefore, the first place to look may be the current digital tax project, where at least some country delegates may be trying to grant legitimacy to the ideas and concepts that will end up forming the basis of future international tax negotiations.

²² See [Faulhaber](#), *supra* note 16.