# The Trouble with Tax Competition: From Practice to Theory

LILIAN V. FAULHABER*

## I. Introduction

Politicians,[1] policymakers,[2] commentators,[3] and academics[4] worldwide debate harmful tax competition and decry the "race to the bottom" regarding corporate tax rates. These terms—"harmful tax competition" and "race to the bottom"[5]—refer to efforts by individual countries to change their corporate income tax systems to attract investors, revenue, or other resources away from other countries. These

* Associate Professor of Law, Georgetown University Law Center. Thank you to Christine Allie, Lily Batchelder, Jake Brooks, William Buzbee, Stephen Cohen, Brian Galle, David Gamage, Itai Grinberg, Daniel Hemel, Khrista McCarden Johnson, Michael Knoll, Benjamin Leff, Jason Oh, Eloise Pasachoff, Adam Rosenzweig, Kirk Stark, David Super, Larry Zelenak, Eric Zolt, and participants in workshops at Duke University School of Law, Georgetown University Law Center, Tulane University Law School, UCLA School of Law, and University of Toronto Faculty of Law for helpful conversations and comments on earlier drafts, and to Charles Bjork and Cassandra Vangellow for excellent research assistance. From September 2013 through August 2015, I was an Advisor to the Base Erosion and Profit Shifting Project at the Organisation for Economic Co-operation and Development (OECD), and I continue to work as a consultant to the OECD. The views and opinions expressed in this Article are mine alone and do not reflect the official policy or position of the OECD. All discussions and arguments in this Article are based on publicly available information.

[1] See, e.g., George Parker, George Osborne Puts Corporation Tax Cut at Heart of Brexit Recovery Plan, Fin. Times (July 3, 2016), https://www.ft.com/content/d5aedda0-412e-11e6-9b66-0712b3873ae1 (referring to EU finance ministers decrying the United Kingdom's participation in the "race to the bottom").

[2] See, e.g., Margrethe Vestager, Fair Competition and a Level Playing Field, Huffington Post, http://www.huffingtonpost.com/margrethe-vestager/fair-competition-and-a-le_b_11971432.html (last visited Nov. 17, 2017).

[3] See, e.g., Oxfam, Tax Battles 2 (2016), https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/bp-race-to-bottom-corporate-tax-121216-en.pdf.

[4] See Part II.

[5] This Article does not adopt the term "race to the bottom" as a technical term and uses it here only to familiarize readers with the issue being discussed. As shown by the debates between Richard Revesz, Kirsten Engel, Daniel Esty, Joshua Sarnoff, and Peter Swire, and others, the term "race to the bottom" is a term that is the subject of significant debate. See, e.g., Kirsten H. Engel, State Environmental Standard-Setting: Is There a "Race" and Is It "to the Bottom"?, 48 Hastings L.J. 271, 274-78 (1997); Richard L. Revesz, Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom" Rationale for Federal Environmental Regulation, 67 NYU L. Rev. 1210, 1210-12 (1992).



Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

efforts range from providing low corporate tax rates to treating certain taxpayers more favorably than others.

Despite the ubiquity of these terms, however, there is no accepted definition of harmful tax competition. Moreover, not only is the definition a subject of debate, but so too is everything else related to tax competition. Is tax competition sometimes helpful rather than harmful? What types of tax competition are "harmful," and what types are not? Is anything even wrong with tax competition? Although academics and policymakers have tried to answer these questions, results have been limited.

The lack of agreement on harmful tax competition has not prevented countries from trying to stop it. This Article looks to recent developments in the fight against tax competition in order to reverse-engineer the concept of harmful tax competition as understood by governments and international organizations. If governments are designing rules to fight harmful tax competition, a study of what those rules target can tell us what those countries consider to be harmful tax competition.[6] In other words, this Article applies lessons from the practice of limiting so-called harmful tax competition to inform the theory surrounding this concept.

Reverse-engineering a definition of harmful tax competition leads to three important insights. First, countries and international organizations have not settled on one definition of harmful tax competition or one explanation for why or when tax competition becomes harmful because they do not in fact want to eliminate tax competition entirely. Instead, the goal is to constrain tax competition in a way that favors the country or countries (in the case of international organizations) involved. This means that there is no generally accepted baseline of acceptable tax competition against which to define harmful tax competition. The baseline is whatever the party defining tax competition considers will make it most competitive; rules that shift the competition away from this baseline therefore are deemed harmful. This lesson is important not just for individual countries but also for the European Union, whose anti-tax-competition measures may have been designed to make the EU more appealing to investors and voters in the face of anti-EU sentiment and Brexit.

Second, the distinction between tax avoidance and tax competition is much less clear than is generally understood. Tax competition is competition among governments, while tax avoidance consists of ef-

[6] This is similar to the approach other authors have taken in using current practice to inform theories of optimal taxation. See, e.g., Benjamin B. Lockwood & Matthew Weinzierl, De Gustibus Non Est Taxandum: Heterogeneity in Preferences and Optimal Redistribution, 124 J. Pub. Econ. 74, 75 (2015).

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

forts by taxpayers to avoid the taxes imposed by governments. However, tax avoidance today relies on tax competition since most international tax avoidance transactions are only valuable to taxpayers if the country on the other side of the transactions provides a low rate or preferential treatment. Countries are complicit in tax avoidance schemes—and taxpayers (often multinational corporations) are complicit in tax competition. Recent efforts to curtail tax avoidance therefore can be described as efforts to limit tax competition.

Finally, and most crucially, since anti-avoidance measures target international tax competition, and measures targeting international tax competition are efforts to shift competition in favor of the country or countries passing the anti-tax-competition measure, both recent anti-tax-competition and anti-avoidance measures are themselves forms of tax competition. In other words, even when countries seem to be trying to limit tax competition, they are in fact competing.

These lessons are of fundamental importance to policy debates about international taxation. Because policymakers frequently use the prevention or limitation of tax competition as a justification for their own policies, highlighting that anti-tax-competition measures are in fact their own form of competition complicates the idea that only some countries are involved in tax competition and underscores the need for more nuanced conversations about what countries intend to achieve with their tax systems.

This Article proceeds in four parts. Part II highlights the lack of agreement on what is or is not tax competition and sets out the general arguments in the academic literature for and against tax competition.

Part III discusses efforts to curtail tax competition over the past several decades and uses these efforts to identify what countries understand to constitute "harmful" tax competition. A consensus over the definition of "harmful tax competition" grew out of work done by the Organisation for Economic Co-operation and Development (OECD) and the EU at the end of the 1990's. This was followed by more recent developments, including the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, the European Commission's state aid decisions, the EU's proposals for an anti-avoidance directive and a common corporate tax base, and several unilateral efforts. These more recent developments reveal how beliefs about what is harmful about tax competition have changed over the past two decades.

Part IV draws three lessons from these developments.

Part V proposes a typology of tax competition. Acknowledging that politicians are unlikely to forgo terms like harmful tax competition entirely, the proposed typology provides tools for more nuanced and

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

deliberate discussions of tax competition, which in turn may lead to greater transparency regarding how countries use their tax systems to increase their competitiveness.

This Article identifies what countries target with their anti-tax-competition measures and what politicians really mean when they rail against tax competition. It highlights that using the term "harmful tax competition" masks a much more complex debate, and that this term incorporates normative judgments that vary depending on the speaker. Just as Richard Revesz previously argued in the context of interjurisdictional competition over environmental regulations that we should eliminate the term "race to the bottom" and replace it with discussions that "focus instead on the underlying causes of the socially undesirable results[,]"[7] this Article argues that the term harmful tax competition causes more trouble than it is worth, and that debates over international tax policy and competition between jurisdictions should focus on what countries actually intend to accomplish when they use this term.

## II. What Is International Tax Competition?

The appropriate first step in an article discussing international tax competition would seem to be to define the term harmful tax competition. There is, however, no generally accepted definition. Although the literature on tax competition generally and harmful tax competition more specifically has grown significantly over the past several decades,[8] recent works by Michael Devereux and Simon Loretz, and

---

[7] Revesz, note 5, at 1253.

[8] See Michael Keen & Kai A. Konrad, The Theory of International Tax Competition and Coordination 59 (Max Planck Inst. for Tax Law & Pub. Fin., Working Paper 2012–06, 2012) ("Thirty years ago. . . there was almost no formal literature on international tax competition and coordination. Its growth since then has been spectacular, and it has produced a range of elegant, and in some cases powerful, results."). For more on this literature, see, e.g., Wallace E. Oates, Fiscal Federalism (1972); James R. Hines Jr., Corporate Taxation and International Competition, in Taxing Corporate Income in the 21st Century 268-95 (Alan J. Auerbach, J.R. Hines Jr. & Joel Slemrod eds., 2007) [hereinafter Corporate Taxation]; Reuven S. Avi-Yonah, Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State, 113 Harv. L. Rev. 1573 (2000); David F. Bradford & Wallace E. Oates, The Analysis of Revenue Sharing in a New Approach to Collective Fiscal Decisions, 85 Q.J. Econ. 416 (1971); Michael P. Devereux & Simon Loretz, What Do We Know About Corporate Tax Competition?, 66 Nat'l Tax J. 745 (2013); James R. Hines Jr., Will Social Welfare Expenditures Survive Tax Competition?, 22 Oxford Rev. Econ Pol'y 330 (2006) [hereinafter Social Welfare Expenditures]; Michael Littlewood, Tax Competition: Harmful to Whom?, 26 Mich. J. Int'l L. 411 (2004); Jeffrey Owens, the David H. Tillinghast Lecture, Tax Competition: To Welcome or Not?, 65 Tax L. Rev. 173 (2012); Diane Ring, Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation, 9 Fla. Tax Rev. 555 (2009); Julie Roin, Competition and Evasion: Another Perspective on International Tax Competition, 89 Geo. L.J. 543 (2001); Adam H. Rosenzweig, Why Are There Tax Havens?, 52 Wm. & Mary L. Rev. 923 (2010) [hereinafter Tax

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

Michael Keen and Kai Konrad, have highlighted that there is very little consensus on what the terms mean.[9] There is no agreement in the economic or legal literature as to what is meant by tax competition, whether tax competition is taking place, what (if anything) is harmful about tax competition, whether tax competition should be limited, and, if so, how it could or should be limited.

The literature on tax competition builds on the literature discussing interjurisdictional competition more generally.[10] That more general literature, characterized by early work by Charles Tiebout and Wallace Oates, often considers competition between states within a federal system.[11] To simplify significantly, different strands of the literature conclude that certain types of competition lead to maximization of social welfare,[12] while others conclude that competition leads to an overall decrease in social welfare due to negative externalities or a disconnect from the democratic preferences of state-level voters.[13]

The international tax competition literature differs from the interjurisdictional competition literature due to the lack of a federal or supranational regulatory body in the international context.[14] In the international tax competition literature, therefore, if tax competition is found to reduce social welfare, another round of inquiry opens up, which is who or what can limit such competition.[15]

As a general matter, the term international tax competition refers to competition between jurisdictions based on their corporate income tax systems.[16] Beyond that, however, there is little consensus over what this term means and when a country's setting of its corporate tax

---

Havens]; Adam H. Rosenzweig, Defining a Country's "Fair Share" of Taxes, 42 Fla. St. U. L. Rev. 373 (2015) [hereinafter Fair Share]; John D. Wilson, A Theory of Interregional Tax Competition, 19 J. Urb. Econ. 296 (1986); John Douglas Wilson, Theories of Tax Competition, 52 Nat'l Tax J. 269 (1999); George R. Zodrow & Peter Mieszkowski, Pigou, Tiebout, Property Taxation and the Underprovision of Local Public Goods, 19 J. Urb. Econ. 356 (1986).

[9] See Devereux & Loretz, note 8, at 746; Keen & Konrad, note 8, at 2 n.2.

[10] See, e.g., Wallace E. Oates & Robert M. Schwab, Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?, 35 J. Pub. Econ. 333 (1988); Richard L. Revesz, The Race to the Bottom and Federal Environmental Regulation: A Response to the Critics, 82 Minn. L. Rev. 535 (1997); Charles M. Tiebout, A Pure Theory of Local Expenditures, 64 J. Pol. Econ. 416 (1956).

[11] See Oates, note 8, at 126-45; Tiebout, note 10, at 418-20.

[12] See Revesz, note 10, at 538 (concluding that Oates and Robert Schwab's economic model "shows that interjurisdictional competition leads to maximization of social welfare").

[13] See, e.g., Oates, note 8, at 46-47.

[14] See, e.g., Ring, note 8, at 595 (pointing out the difference between tax competition and other types of competition due to the lack of a supra-state to address or regulate market failure).

[15] See, e.g., Littlewood, note 8, at 417-18.

[16] Although there are some instances of tax competition focusing on the individual income tax, those are not normally the focus of tax competition discussions, particularly at

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

rates or definition of its corporate tax base becomes tax competition. As Devereux and Loretz state in a paper reviewing the empirical literature on tax competition, "[f]ew definitions [of tax competition] have been offered in the literature."[17] Even the definitions that have been proposed differ in terms of how they define tax competition: Some focus only on the "uncooperative setting of tax rates;"[18] other definitions focus on the setting of both tax rates and tax bases;[19] others focus just on using rates to attract mobile income;[20] and others focus on using the tax system to attract not just income but also other spillovers such as resource flows.[21]

The definition of tax competition does, however, generally build on the concept of competition in a private market (referred to here as "market competition").[22] Many authors considering tax competition have used the vocabulary of market competition, positing that tax competition can be analogized to models developed in the context of market competition.[23] For example, Julie Roin noted, "When one substitutes 'the government' for producers, 'taxes' for prices, and 'investment' for consumers, the potential for countries to compete for investors based on low tax rates is clear."[24] Policymakers also often rely on this analogy.[25]

the international level. This Article focuses entirely on international competition over corporate taxes.

[17] Devereux & Loretz, note 8, at 746.

[18] See Dalibor Rohåè, Evidence and Myths About Tax Competition, 2 New Persp. on Pol. Econ., no. 2, 2006, at 86, 87.

[19] See id. at 88.

[20] See, e.g., Roin, note 8, at 546 (stating that "[t]ax competition occurs when one country seeks to entice investment within its borders (and possibly enhanced tax revenues) through the expedient of reduced business taxation").

[21] See Jan K. Brueckner, Strategic Interaction Among Governments: An Overview of Empirical Studies, 26 Int'l Regional Sci. Rev. 175, 176–82 (2003). Note that even when commentators attempt to define tax competition as broadly as possible, they often miss elements that other commentators or countries believe to be necessary in the definition of tax competition. See, e.g., Ring, note 8, at 561-62 (stating that "[i]n its broadest conception the phrase ["tax competition"] captures a country's use of any feature of its tax system to 'enhance' its competitive advantage in the marketplace for capital, investment, and/or nominal business presence[,]" thereby not including competition for externalities or substantial business presence).

[22] Other authors have also noticed this overlap. See, e.g., Revesz, note 5, at 1212 (not critiquing the overlap); Ring, note 8, at 570-75 (critiquing the overlap).

[23] See, e.g., Devereux & Loretz, note 8, at 747-50. But note that even Tiebout acknowledged in his model that jurisdictional competition is not directly analogous to market competition when he referred to this as a market-type solution. See Tiebout, note 10, at 416, 419-20.

[24] Roin, note 8, at 552.

[25] Owens, note 8, at 173 (stating that "[t]ax competition, like other forms of competition, improves the function of our economies and provides an incentive for governments to provide a tax environment that is conducive to growth").

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

Yet the analogy quickly breaks down under any real scrutiny, which may be one reason for the weakness of existing definitions of tax competition. Market competition, in its most basic sense, is competition among firms for profits, and the generally accepted free market view of competition is that an open market where multiple firms are competing will lead to the equilibrium prices and quantities that maximize welfare. Tax competition, however, is a competition that uses some element of tax policy to attract something other than just profits. The lack of agreement both as to what specific tool jurisdictions are using to compete and what jurisdictions are trying to attract creates a circular problem where using the term "competition" both raises and answers the questions that underlie the entire concept. Are countries just using statutory tax rates to compete? Or are they using other tools such as effective rates, rates on specific types of income, definitions of the base, or an ability to escape information-sharing requirements? As for what countries are trying to attract, is it just revenue? Or are they trying to attract something other than pure tax revenue by competing for resource flows (such as capital, investors, firms, profits, people, skills, and jobs) or cross-border spillovers (such as greater information or environmental improvements)?

Furthermore, using the term competition often presupposes that unfettered tax competition is a good thing that will lead to an increase in welfare. Discussions of tax competition that export the market competition model into the tax sphere thus bring with them a normative tilt: If market competition is an economic good, and if tax competition is just another version of market competition, then tax competition must itself be normatively good. But, while competition for tax rates or bases may have the same downward effect on taxes as competition for customers has on prices, decreased tax revenues do not necessarily lead to an increase in welfare.[26]

The term tax competition therefore raises significant problems in and of itself. No one can agree on what it is, and it is something of a misnomer since it suggests a stronger link to market competition than may in fact exist. Yet the term continues to be used by policymakers and academics despite these weaknesses.[27] In the past two decades,

---

[26] See Keen & Konrad, note 8, at 42 (highlighting that national governments are not focused on maximizing revenues but instead on maximizing "national welfare"). This is not the only normative assumption underlying discussions of tax competition. As Adam Rosenzweig has recently noted, "the vast majority of international tax literature has failed to" articulate the normative considerations underlying the different sides of the tax competition debate. See Rosenzweig, Fair Share, note 8, at 398.

[27] See, e.g., Foo Yun Chee, EU's Vestager Says Not Penalising U.S. Firms or U.S. Tax System, Reuters (Feb. 29, 2016), https://www.reuters.com/article/uk-eu-usa-tax/eus-vestager-says-not-penalising-U-S-firms-or-U-S-tax-system-idULS8N1685SW (describing how Vestager asserts that the Commission aims to establish "fair tax competition within the

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

countries and commentators have implicitly addressed these problems by shifting their focus from tax competition to so-called "harmful tax competition."[28] However, there is also no accepted definition of harmful tax competition,[29] nor is there any agreement on what, if anything, is harmful about tax competition.[30] The term itself is circular, in that, as a practical matter, any user of the term has already determined that some version of international tax competition is harmful. In order to consider what different speakers could perceive to be harmful, the following Sections briefly lay out the most common arguments for and against international tax competition.

### A. *Arguments for International Tax Competition (or Against Limiting International Tax Competition)*

Some arguments in favor of tax competition focus primarily on the actions of taxpayers and emphasize the similarities between tax competition and market competition.[31] One such argument builds on the work done by Charles Tiebout in the 1950's, pursuant to which competition between jurisdictions can make governments more efficient and more responsive to the preferences of their citizens.[32] The Tiebout model focused on competition between local jurisdictions, but commentators have used it to defend international tax competition between countries, arguing that such competition ensures that business activities are located in the country that will lead to the most

European Union"); Parker, note 1; Owens, note 8, at 173; Wolfgang Schön, Tax Competition in Europe: General Report, Eur. Ass'n of Tax L. Professors, http://www.eatlp.org/uploads/Members/GeneralReportSchoen.pdf (last visited Jan. 20, 2018).

[28] There are, of course, also political reasons for this shift because focusing on harmful tax competition fits with the recent view that tax competition in general is not a problem. Note that there are other narrower definitions of tax competition other than harmful tax competition that also have been used in the literature. See, e.g., Pasquale Pistone, Smart Tax Competition and the Geographical Boundaries of Taxing Jurisdictions: Countering Selective Advantages Amidst Disparities, 40 Intertax 85, 86 (2012) (coining the term "smart tax competition" to refer to situations where EU Member States "create tax biases at the intersection between fundamental freedoms and the prohibition of state aids").

[29] See, e.g., Allison Christians & Marco Garofalo, Using Tax as an Investment Promotion Tool (Apr. 15, 2016), https://papers.ssrn.com/5013/papers.cmf?abstract_id=2796126 (highlighting that there is no agreement on the difference between "fair but fierce" competition and harmful competition).

[30] See, e.g., Keen & Konrad, note 8, at 60 ("[The literature] has not answered the basic question that has loomed over policy debates since [the 1998 Report]: How can one distinguish tax competition that is 'harmful' from that which is not? Progress has been made, but not yet enough to confidently determine whether, for instance, the presumption should be against or in favor of preferential regimes.").

[31] See Wilson, note 8, at 298 (stating that Tiebout and others who view competition as a good treat interjurisdictional competition and market competition analogously, while those who view it as a problem do not).

[32] Roin, note 8, at 545.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

efficient production of income and use of spillovers.[33] One criticism of this strand of argument, however, is that Tiebout's model relies on assumptions that are even less accurate in the context of international tax competition than in the context of competition between local jurisdictions. Most notably, Tiebout assumed that individuals can easily move between competing jurisdictions in order to express their preferences, which may be less accurate with respect to countries.[34]

A second argument in favor of tax competition that builds on similarities between market competition and tax competition is based on the Leviathan concept, under which governments, rather than being benevolent entities acting on behalf of their citizens and voters, are in fact interested only in maximizing government revenue.[35] If this is the case, then tax competition, by putting downward pressure on taxation, can limit the ability of self-interested governments to grow.[36] This argument, however, has broad appeal only if governments are in fact Leviathans, and research has suggested that the Leviathan argument is only persuasive when there are very high levels of government waste.[37]

Other arguments in favor of tax competition do not rely on the supposed link between tax competition and market competition. According to one such argument, the right to raise revenue through taxation is one of the fundamental elements of sovereignty. Countries therefore view the setting of tax rates and the definition of the tax base as falling within their right to tax, and any challenge to this is often presented as an impermissible interference in the affairs of a sovereign state.[38] This argument is particularly weak when the countries are themselves part of the international organization tackling tax competi-

[33] Id. at 546.

[34] Avi-Yonah, note 8, at 1611; see generally Tiebout, note 10, at 419 (listing the assumptions of perfect mobility, full knowledge on the part of voters, large number of potential jurisdictions for voters to live, irrelevance of employment opportunities, lack of externalities, optimal community size for every pattern of community services, and reaction of communities to optimal community size, all of which are arguably inaccurate descriptions of the environment in which international tax policy is set).

[35] Avi-Yonah, note 8, at 1614; Charles E. McLure, Tax Competition: Is What's Good for the Private Goose Also Good for the Public Gander?, 39 Nat'l Tax J. 341 (1986).

[36] Avi-Yonah, note 8, at 1614.

[37] Id. at 1616; Jeremy Edwards & Michael Keen, Tax Competition and Leviathan, 40 Eur. Econ. Rev. 113 (1996). Some commentators may still find this argument compelling even if governments are not in fact Leviathans if they believe that governments do not have any right to a portion of a taxpayer's pretax income. This argument, however, is impossible to support or refute empirically and is instead premised on a normative preference for private capital ownership over public capital ownership.

[38] See, e.g., Jon Stone, It's Our Sovereign Right To Set 0% Corporation Tax Rate, UK-Protected Tax Haven Bermuda Says, The Independent (Dec. 12, 2016), http://www.independent.co.uk/news/uk/politics/tax-havens-bermuda-worst-zero-per-cent-corporation-tax-rate-a7469386.html.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

tion or when the challenge to tax competition takes the form of a treaty or other exercise of sovereignty by the country that is subject to challenge.[39] Even when this argument is made in the context of challenges to tax competition that target individual countries without their input,[40] it relies on a simplistic view of sovereignty[41] that countries are often willing to violate in other contexts.[42]

A further argument builds on the work of Peter Diamond and James Mirrlees, which claims that the optimal corporate income tax rate in a small open economy is zero.[43] This argument posits that tax competition that involves reducing rates on corporate income is beneficial because it pushes countries toward the optimal level of corporate income taxation. This only applies, however, to small open economies, which are more likely to be price takers than price makers[44] and so may not be as true for larger countries. A further weakness with this argument is that it does not address forms of tax competition other than the reduction of the corporate income tax rate to zero.

Alternative arguments in favor of eliminating the corporate income tax emphasize that consumption taxes are preferable to income taxes due to the efficiency costs of taxing capital income[45] and that taxation in a globally open economy should focus on immobile factors such as consumption and individual residence (rather than more mobile factors such as corporate residence).[46] While these arguments may support the legislative repeal or replacement of the corporate income tax, it does not necessarily follow that they support unfettered jurisdic-

[39] See Stephen D. Krasner, Sovereignty: Organized Hypocrisy 146-51 (1999).

[40] See, e.g., Stone, note 38.

[41] Note that this view of sovereignty ignores the ways that this concept has evolved over time. See Ring, note 8, at 557-58, 561 (describing how sovereignty evolved in the twentieth century and could continue to evolve in the twenty-first century).

[42] See Krasner, note 39, at 186 (highlighting that countries often violate norms of sovereignty when cost-benefit analysis favors this); Ring, note 8, at 581 (stating that it is not clear that imposing penalties based on a country's tax rate is an actual violation of sovereignty).

[43] Peter A. Diamond & James A. Mirrlees, Optimal Taxation and Public Production I: Production Efficiency, 61 Am. Econ. Rev. 8 (1971); Peter A. Diamond & James A. Mirrlees, Optimal Taxation and Public Production II: Tax Rules, 61 Am. Econ. Rev. 261 (1971); see Hines, Social Welfare Expenditures, note 8, at 333-34; Wilson, note 8, at 281-82.

[44] Hines, Corporate Taxation, note 8, at 270.

[45] James R. Hines Jr., Taxing Consumption and Other Sins, J. Econ. Persp., Winter 2007, at 49, 63 (summarizing literature describing the higher efficiency costs associated with taxing capital income compared with taxing consumption).

[46] See, e.g., George R. Zodrow, Capital Mobility and Capital Tax Competition, 63 Nat'l Tax J. 865, 884-85 (2010) (stating that "the basic tax competition model as well as several of its extensions suggest that if capital is mobile tax rates on capital income should be relatively low and indeed in some cases should be zero or even negative"). But see id. at 885 (stating that these "rather stark results" are tempered by a variety of additional considerations).

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

tional competition that could result in piecemeal reduction or modification of the corporate income tax.

One final argument in favor of tax competition is less of an argument than a form of acceptance. Several commentators have recently argued that tax competition is either inevitable or a natural and necessary response to the structure of an international tax system focused on encouraging capital mobility.[47] Although this may not be the strongest rallying cry in favor of international tax competition, it is an argument against efforts to limit such competition.

### B. *Arguments Against International Tax Competition (or for Limiting International Tax Competition)*

On the other side of this debate, most arguments against tax competition focus on the fundamental differences between tax competition and market competition. Taxes are not merely prices for a good or service but are also used by jurisdictions to provide other goods and services to their citizens and to redistribute wealth. As suggested by Wallace Oates in the 1970's, if tax competition leads governments to raise less in tax revenues than they otherwise would, then governments will also not be able to provide the amount of public goods that they would have provided in the absence of tax competition.[48]

In the context of more developed countries, this argument often focuses on tax competition undermining the ability of countries to provide citizens with the full benefits of a social welfare state.[49] In the context of less developed countries, tax competition is harmful because it leads to reduced revenue for social assistance and other types of government spending that would decrease human suffering.[50] This argument, however, relies on the assumption that the tax level that would be set in the absence of tax competition would be preferable.[51] Devereux and Loretz have pointed out that, due to the lack of a

---

[47] See Julie A. Roin, Can Income from Capital Be Taxed?: An International Perspective, in Taxing Capital Income 211, 217-34 (Henry J. Aaron, Leonard E. Burman & C. Eugene Steuerle eds., 2007).

[48] See Oates, note 8, at 142-43.

[49] Avi-Yonah, note 8, at 1578. Note that this is essentially the reverse of the pro-competition sovereignty argument because countries that make this point are arguing that they are being limited in their domestic sovereign right to provide the protections that their citizens demand. Ring, note 8, at 573-75.

[50] See, e.g., Thomas Pogge & Krishen Mehta, Introduction: The Moral Significance of Tax-Motivated Illicit Financial Outflows, in Global Tax Fairness (Thomas Pogge & Krishen Mehta eds., 2017); William Hoke, Consider Human Rights in Tax Avoidance Discussions, Oxfam Director Says, Worldwide Tax Daily (Sept. 23, 2016), http://www.taxnotes.com/worldwide-tax-daily/tax-avoidance-and-evasion/consider-human-rights-tax-avoidance-discussions-oxfam-director-says/2016/09/23/18609481.

[51] Roin, note 8, at 553, 570.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

counterfactual, it is impossible to know whether governments would have provided the welfare-maximizing (or even just a welfare-improving) level of public goods in the absence of tax competition.[52] Others, such as Keen and Konrad, have noted that, even if tax competition theoretically could lead to underprovision of public goods, it is not clear what type of tax competition has this result, and some of the recent efforts to police tax competition may themselves do more harm than good.[53] James Hines has also argued that, even if suboptimal spending on social welfare theoretically could result from tax competition, recent data suggests that such a reduction in spending is not in fact taking place, at least in developed countries.[54]

A related argument is that tax competition forces jurisdictions to rely on revenue sources that are both more distortionary and more regressive than the corporate income tax.[55] Commentators that make this argument point out that, because international tax competition generally is focused on corporate income taxation, it forces jurisdictions that can no longer raise sufficient revenue by taxing capital to rely more on labor taxation.[56]

A further argument in favor of limiting tax competition is that competition between jurisdictions leads to an inefficient global allocation of capital. Tax competition may lead investors to allocate capital to locations where they would not otherwise choose to invest.[57] The response to this argument has been, first, that this assumes that the allocation of capital that would occur in an environment with multiple higher tax systems would itself be efficient, and, second, that any such reallocation of capital may be normatively good if it allows less devel-

[52] Devereux & Loretz, note 8, at 747, 751.

[53] Keen & Konrad, note 8, at 44-46 (explaining why limiting preferential regimes may actually increase tax competition); Michael Keen, Preferential Regimes Can Make Tax Competition Less Harmful, 54 Nat'l Tax J. 757, 757-62 (2001).

[54] Hines, Social Welfare Expenditures, note 8, at 336-46 (noting that corporate tax revenues as a proportion of GDP have remained at the same level, and they remain a small portion of the overall revenue raised by countries, which suggests that social welfare expenditures do not depend entirely on the corporate income tax). But see Michael Keen & Alejandro Simone, Tax Policy in Developing Countries: Some Lessons from the 1990s, and Some Challenges Ahead, in Helping Countries Develop: The Role of the Fiscal Policy (Sanjeev Gupta, Benedict Clements & Gabriela Inchauste eds., 2004) (finding that corporate tax revenues did not stay constant in developing countries).

[55] Roin, note 8, at 546, 549.

[56] Avi-Yonah, note 8, at 1625.

[57] OECD, Harmful Tax Competition: An Emerging Global Issue (1998), http://dx.doi.org/10.1787/9789264162945-en [hereinafter the 1998 Report] (referring to "potential distortions in the patterns of trade and investment" and the "diver[sion of] real investment from one country to another").

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

oped countries or other countries that would not otherwise be attractive to investors to attract capital.[58]

### C. *Areas of Agreement on International Tax Competition*

The lack of agreement over what tax competition is and whether it should be encouraged or discouraged has not prevented academics from continuing to research tax competition.[59] Unsurprisingly, however, the results of this research have not led to many agreed-upon conclusions. As Devereux and Loretz observed, despite "a flurry of activity to provide evidence for the existence of tax competition[,] so far the findings have at best been inconclusive."[60] For example, although there has been some recent work suggesting that countries reduce their tax rates in response to a reduction in neighboring countries' tax rates,[61] other recent work at the local level has challenged this finding.[62] There is also no agreement over which countries act as leaders in setting tax rates and which act as followers,[63] nor is the effect of greater openness on tax revenues clearly predictable.[64] Given the lack of consensus over what is harmful about tax competition, there is also little clear empirical guidance on what—if anything—to do to prevent or limit tax competition. While some advocate for greater cooperation between countries or the implementation of a minimum tax across multiple countries, others have ac-

---

[58] Roin, note 8, at 554 (suggesting that eliminating tax competition might actually hurt developing countries).

[59] Note that this disagreement is shared by the articles and studies considering tax competition. Some focus on the base of competition, that is, competition over statutory rates, competition over effective rates, or competition in the form of preferential regimes. Some focus instead on what the competition is for, that is, general overall regimes and their effect on investment, residence, or other resources.

[60] Devereux & Loretz, note 8, at 745. But see Hines, Corporate Taxation, note 8, at 292 (concluding that data on corporate tax policy illustrates competition between countries to attract foreign investors); Mihir A. Desai, Are We Racing to the Bottom? Evidence on the Dynamics of International Tax Competition, in 1998 Proceedings of the 91st Ann. Conf. on Tax'n, Nat'l Tax Ass'n 176 (Howard Chernick ed.).

[61] See, e.g., Scott J. Basinger & Mark Hallerberg, Remodeling the Competition for Capital: How Domestic Politics Erases the Race to the Bottom, 98 Am. Pol. Sci. Rev. 261 (2004); Friedrich Heinemann, Michael Overesch & Johannes Rincke, Rate-Cutting Tax Reforms and Corporate Tax Competition in Europe, 22 Econ. & Pol. 498 (2010).

[62] Robert S. Chirinko & Daniel J. Wilson, Tax Competition Among U.S. States: Racing to the Bottom or Riding on a Seesaw? (Fed. Reserve Bank of San Francisco, Working Paper 2008-03, 2017), http://www.frbsf.org/economic-research/files/wp08-03bk.pdf (finding that state taxes had a negative reaction function, meaning that state tax rates increased as other states decreased their rates).

[63] See Devereux & Loretz, note 8, at 763 (stating that most recent contributions see the EU as the driving force of tax competition with some identifying small countries located in central Europe as key drivers of tax competition and others finding a domino effect of strategic interaction initiated by new member states.).

[64] Id. at 760.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

knowledged the political impracticality of these suggestions and have searched for other models.[65]

This is not to say that there is absolutely no agreement in the tax competition literature. Many studies have shown that international investment is strongly influenced by tax policy and that foreign investors are responsive to changes in tax policy.[66] Although the degree of responsiveness of foreign investment to statutory tax rate changes is up for debate, there is agreement that foreign investment increases as statutory corporate income tax rates decrease.[67] There is also agreement that both statutory corporate income tax rates and effective corporate income tax rates have decreased over the past few decades, with effective rates dropping even more sharply than statutory rates.[68] Finally, many studies that have focused on tax competition have agreed that small countries are the most likely to benefit from competition.[69]

Yet there remains little agreement on the fundamentals of tax competition, ranging from what it is to what is harmful about it. International tax competition therefore is more complicated than it may at first appear, given how casually policymakers and commentators use this term.[70]

But this lack of agreement over what constitutes tax competition has not stopped countries and multinational or international organizations from criticizing tax competition and implementing measures to limit tax competition. On the non-governmental side, the Tax Justice Network argues that tax competition is a major problem that needs to be stopped, and they go so far as to refer to this as a "tax war" with

---

[65] See, e.g., Comm'n of the European Communities, Conclusions and Recommendations of Independent Experts on Company Taxation 151, COM (1992).

[66] See Hines, Corporate Taxation, note 8, at 270-75 (providing an overview of the literature on this issue).

[67] See Hines, Social Welfare Expenditures, note 8, at 333 (setting out range of possible elasticities from -0.6 to -3.5).

[68] See Hines, Corporate Taxation, note 8, at 278-80.

[69] See, e.g., James R. Hines, Jr., Do Tax Havens Flourish?, 19 Tax Pol'y & Econ. 65 (2005). Hines builds on the Diamond and Mirrlees finding that the optimal corporate tax rate for small open economies is zero because it means that small countries may benefit most from tax competition because their optimal rate is zero. Diamond & Mirrlees, note 43; see also Hines, Social Welfare Expenditures, note 8, at 333-34; Hines, Corporate Taxation, note 8, at 270; Keen & Konrad, note 8, at 19-20. Note that there is some debate as to whether small countries are most likely to engage in tax competition, however. See Hines, Corporate Taxation, note 8, at 277-78 (summarizing debates over this question). But see Dhammika Dharmapala & James R. Hines Jr., Which Countries Become Tax Havens?, 93 J. Pub. Econ. 1058 (2009) (suggesting quality of local governance influences whether or not a country becomes a tax haven).

[70] Academics have noted that tax competition is a complicated concept. See Wilson, note 8, at 298 (stating that "[c]ompetition among governments is now seen as a less straightforward phenomenon than perhaps originally envisioned.").

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

"no redeeming features."[71] On the governmental side, countries are working both unilaterally and as part of larger organizations to curtail the forms of tax competition that they view as problematic.[72]

The next Part catalogues some of the ways in which countries are trying to stop tax competition. In doing so, this Article flips the existing discussion of tax competition on its head. Rather than setting out a definition of what tax competition is and designing tools to combat its harmful features, this Article uses what countries are already doing to reverse-engineer what they think is wrong about tax competition. In response to concerns expressed by others that the world is moving faster than the theory of tax competition,[73] this Article uses the practice of countries and international organizations to inform the debates about the theory of international tax competition.

## III. Recent Efforts to Limit International Tax Competition

Countries have two options when they face what they perceive to be tax competition. First, a country can attempt to win the competition itself, whether by lowering rates, implementing tax regimes that are more preferential than those of other countries, or reforming its tax system entirely to attract investors or other resources away from other jurisdictions.[74] This Article refers to such efforts as "offensive tax competition." Second, a country can implement measures to prevent other countries from competing. This Article refers to such defensive measures as "anti-tax-competition measures." This Part focuses on such anti-tax-competition measures and uses them to reverse-engineer what the countries that implement or propose them consider to be harmful about tax competition. While the division between offensive tax competition and defensive anti-tax-competition measures is not always clear, this Article defines the latter as measures that are either publicly advertised as responding to harmful tax competition or that are directly focused on eliminating the *ability* of other countries to implement offensive tax competition measures.

---

[71] Tax Competition, Tax Justice Network, http://www.taxjustice.net/faq/tax-competition/ (last visited Feb. 1, 2018).

[72] See Part III.

[73] See Keen & Konrad, note 8, at 60 (stating that "[w]hile much of the theory in this area predated the greatly increased policy importance of the issues, the risk now is that the world will move more quickly than the theory.").

[74] This is, for example, what the House Republican Blueprint claims to do by introducing a destination-based cash flow tax in the United States. See A Better Way: Our Vision for a Confident America, Tax, (June 24, 2016), https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

The use of tax policy to compete for investors and other resources has existed for centuries.[75] Limiting the ability of other countries to engage in tax competition, however, has only been a major focus of governments for the past few decades. Before the 1980's, most large countries had been able to set rates without focusing on the need to attract mobile investments and therefore did not feel significant pressure to reduce tax rates in response to rate reductions by other countries.[76] To the extent that there was any focus on curtailing tax competition from other countries, it took the form of changing domestic laws to discourage the use of so-called "tax havens," which were defined based on their low or non-existent overall corporate income tax rates.[77] In the 1960's and 1970's, the United States was the large economy that was most focused on preventing tax competition, while European countries were more supportive of tax competition.[78]

In the 1980's and 1990's, however, tax competition became a greater concern to more countries. During this time, as both foreign direct investment (FDI) and portfolio investment increased dramatically,[79] countries at all stages of development started using their tax systems to attract investments.[80] In response, governments became more concerned with tax competition, and many developed countries in Europe and beyond started to implement blacklists of individual tax havens that would be subject to defensive measures.[81] These blacklists focused on entire countries, and they listed countries based on low tax rates combined with a lack of information exchange or transparency. These blacklists were compiled by individual countries, and there were no large-scale international efforts to tackle tax competition until the late 1990's.

At the end of the 1990's, the OECD[82] and the EU[83] responded to the changed investment environment by attempting to tackle tax com-

---

[75] See Keen & Konrad, note 8, at 2 (referring to a tax measure in Russia favoring foreign manufacturers passed in 1763 by Catherine the Great).

[76] See Hines, Corporate Taxation, note 8, at 292.

[77] See Rosenzweig, Tax Havens, note 8, at 926 nn.1-2, 927 n.11, 974-82 (setting out the history of U.S. efforts to limit tax havens from the 1960's onward).

[78] See Roin, note 8, at 547.

[79] Hines, Social Welfare Expenditures, note 8, at 332 (stating that "FDI increased rapidly in the 1980s and 1990s."); Mitchell A. Kane, Strategy and Cooperation in National Responses to International Tax Arbitrage, 53 Emory L. J. 89, 129 (2004) (highlighting the increased amount of portfolio investment in this period); Owens, note 8, at 180 (stating that, within the OECD, "[i]nward and outward portfolio equity investment grew from around 1% of GDP in 1990 to around 7% [in 2010.]").

[80] There were some exceptions as developed countries used their tax systems to discourage FDI. See Kane, note 79, at 130; Hines, Social Welfare Expenditures, note 8, at 334. These exceptions do not extend to portfolio investment, however.

[81] See, e.g., B.O.E. 1991, 167 (Spain).

[82] At the time, the OECD was made up of twenty-nine developed countries, which excludes the six countries that became members after 1999 (Chile, Estonia, Israel, Latvia,

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

petition cooperatively. Section A uses the efforts made by both entities to illustrate the consensus over harmful tax competition that emerged in the late 1990's and early 2000's.[84] Section B then introduces more recent developments that represent a change from that consensus.

### A. *The Development of a Partial Consensus Over Harmful Tax Competition*

In 1997, as part of "A Package to Tackle Harmful Tax Competition,"[85] the European Commission issued the Code of Conduct for Business Taxation (the "Code of Conduct"), identifying factors for assessing whether particular preferential tax regimes were harmful tax competition.[86] Preferential tax regimes were defined for this purpose to be provisions of law that gave preferential tax treatment (generally in the form of lower rates) to specific types of taxpayers or income. The EU Member States also created the Code of Conduct Group (Business Taxation) (the "Code Group"), which provided the locus for Member States to assess one another's preferential regimes.

At about the same time, the OECD issued its own report entitled "Harmful Tax Competition: An Emerging Global Issue," known as the "1998 Report."[87] The OECD divided its work into two parts: identifying harmful tax regimes and labeling tax havens. The work on harmful tax regimes did not specify any country by name but instead set out twelve different factors that would be used in the future to

Slovak Republic, and Slovenia). See OECD, List of OECD Member countries—Ratification of the Convention on the OECD, http://www.oecd.org/about/membersandpartners/list-oecd-member-countries.htm (last visited Feb. 1, 2018).

[83] At the time, the European Union had fifteen Member States, which excludes the thirteen countries that became Member States after 1999 (Bulgaria, Croatia, Cyrus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, and Slovenia). See European Union, About the EU, Countries, https://europa.eu/european-union/about-eu/countries_en (last visited Jan 25, 2018).

[84] Since several other articles have been written about these developments, I outline them only briefly. For more on the developments in the late 1990's and early 2000's, see, e.g., Hugh J. Ault, Reflections on the Role of the OECD in Developing International Tax Norms, 34 Brook. J. Int'l. L. 757 (2009); Allison Christians, Networks, Norms, and National Tax Policy, 9 Wash. U. Global Stud. L. Rev. 1 (2010); Littlewood, note 8; Ring, note 8.

[85] Towards Tax Co-ordination in the European Union: A Package to Tackle Harmful Tax Competition, Communication from the Commission to the Council 2, COM (1997) 495 final (Jan. 1, 1997) [hereinafter EU Tax Competition Package].

[86] Conclusions of the ECOFIN Council Meeting Concerning Taxation Policy, 1998 O.J. (C 2) 3 [hereinafter Code of Conduct Announcement].

[87] OECD, 1998 Report, note 57; OECD, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 (2015), http://dx.doi.org/10.1787/9789264241190-en [hereinafter Action 5 2015 Report].

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

identify harmful tax competition.[88] At the time that it published the 1998 Report, the OECD also created the Forum on Harmful Tax Practices ("FHTP"), which was made up of all OECD member countries and which was responsible for assessing preferential regimes in OECD countries.[89]

The projects undertaken by the EU and the OECD in the late 1990's adopt similar views of what constitutes harmful tax competition. Given the overlap between the membership of both entities, this similarity is not surprising.[90] Since these two entities represented well over 50% of worldwide GDP during this period,[91] this shared view provides an important insight into what developed countries considered to be harmful tax competition.

First, as a general matter, both the EU and the OECD focused on "harmful tax competition" instead of tax competition more generally. Tax competition was not in and of itself harmful; instead, there was some subcategory of tax competition that could be labeled harmful tax competition, and this was the only competition that should be targeted. Both entities explicitly acknowledged this shift, with the Commission stating that "[t]ax competition in itself is generally to be welcomed, as a means of benefiting citizens and of imposing downward pressure on government spending"[92] and the OECD stating that

[88] OECD, 1998 Report, note 57, at 19-37. These twelve factors were broken into four "key factors" and eight "other factors." Id. at 26-34. Before getting to these factors, any regime that would be challenged as harmful had to be both preferential and within the scope of the 1998 Report. Id. at 19-20. The first requirement meant that it had to provide benefits that only went to certain taxpayers. If it applied to all income earned by all taxpayers, it was not preferential. If it applied to only some types of income or only some taxpayers, however, it was preferential. Id. at 21. It also had to be in scope, which meant that the income to which it provided benefits had to be geographically mobile. Id. at 25-26. Once a regime was determined to be preferential and in scope, then it was assessed against the remaining twelve factors. The four key factors included whether the regime: (1) had a lower tax rate than the overall tax rate in the country, (2) was ring-fenced such that it provided benefits only to foreign investors, (3) lacked transparency, and (4) lacked effective exchange of information with other interested countries. Id. at 26-30. The 1998 Report also listed eight factors that could be indicative of harmfulness, although they were not on their own sufficient to identify harmfulness: (1) an artificial definition of the tax base, (2) failure to adhere to international transfer pricing principles, (3) foreign source income exempt from residence country tax, (4) negotiable tax rate or tax base, (5) existence of secrecy provisions, (6) access to a wide network of tax treaties, (7) regimes which are promoted as tax minimization vehicles, and (8) the regime encouraging purely tax-driven operations or arrangements. Id. at 30-34.

[89] Id. at 66.

[90] Compare OECD, note 82, with European Union, note 83.

[91] See World Bank Indicators: GDP, http://data.worldbank.org/indicator/NY.GDP.MKTP.PP.CD (last visited Feb. 1, 2017).

[92] EU Tax Competition Package, note 85, at 2.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

it "recognises the distinction between acceptable and harmful preferential tax regimes[.]"[93]

Second, both the EU and the OECD accepted that they could not target entire countries based just on the corporate tax rate. Instead, harmful tax competition involved narrower measures that applied only to certain taxpayers or certain items of income rather than to a country's sovereign decision to set a low corporate income tax rate or not to employ a corporate income tax.

Third, having determined that harmful tax competition did not take the form of country-wide tax rates, both the EU and the OECD considered tax regimes to be harmful when (1) they offered rates that were lower than the overall corporate rate in the jurisdiction, (2) they applied to geographically mobile income, (3) they targeted foreign taxpayers or activities as opposed to domestic taxpayers or activities ("ringfencing"), and (4) they lacked transparency or exchange of information with other jurisdictions.[94]

Thus, a high overall rate would not protect a country if it also had a narrower low-rate regime and it lacked transparency—but an overall low rate *would* protect a country if it did not have narrower regimes with even lower rates. A 10% rate on a certain subset of income would not be viewed as harmful tax competition if the country's overall rate were also 10%, but an even higher rate (say, 15%) could end up being found harmful if the country's overall rate were higher than that (say, 35%).

This view of tax competition therefore took a relative approach: Only if a regime provided a rate markedly lower than the overall tax rate would it be considered harmful tax competition. A rule focusing on relative rates represents a fundamentally different understanding of harmful tax competition than a rule focusing on absolute rates. Under a rule focusing on relative rates, a country has a sovereign right to collect only 10% of all income, including that of its own residents. If, however, that country imposes a higher rate on its own residents or certain types of nonmobile income and only imposes the low rate on income that can be easily moved away from other countries, then the preferential rate represents harmful tax competition.

The relative approach requires countries to give away revenue in order not to engage in harmful tax competition.[95] If countries are willing to collect less from their own residents, then they may apply that same low rate to any other income to which they can lay claim as

---

[93] OECD, 1998 Report, note 57, at 8.

[94] Code of Conduct Announcement, note 84; OECD, 1998 Report, note 57, at 25.

[95] See Keen & Konrad, note 8, at 46 (stating that the "intuitive attraction of imposing uniformity as a coordination measure is in making it more costly for countries to tax mobile capital by ensuring that this implies a revenue loss from less mobile capital").

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

well. If, however, they are willing to reduce the rate only on foreign income or income that is easily mobile, they will be engaged in harmful tax competition under this view.

At the same time, the EU was also pursuing an even broader view of harmful tax competition through its work on state aid. The prohibition on state aid, enshrined in Article 107 of the Treaty on the Functioning of the European Union (TFEU), prohibits "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods . . . in so far as it affects trade between Member States[.]"[96] This prohibition focuses on government measures that provide a so-called "selective advantage."[97]

Even before 1998, the Commission was using the state aid prohibition to challenge tax measures.[98] In 1997 and 1998, however, the EU explicitly linked illegal state aid and harmful tax competition, as the Council (one of the two decisionmaking bodies of the EU) issued the Code of Conduct and the Commission issued the 1998 State Aid Notice on the application of the state aid rules to measures relating to direct business taxation.[99] The vision of harmful tax competition enshrined in the state aid prohibition is much broader than the consensus on preferential regimes. The 1998 State Aid Notice states that "a tax measure whose main effect is to promote one or more sectors of activity constitutes aid."[100] The prohibition includes measures that favor "only national products which are exported" but it also extends to measures that target "all of the sectors that are subject to international competition" and different rates for "an entire section of the

---

[96] Consolidated Version of the Treaty on the Functioning of the European Union art. 107, Dec. 13, 2007, 2012 O.J. (C 326) 47. Article 107 has been renumbered throughout the history of the EU. In 1998, it had the same wording, but it was Article 92 at the time of the 1998 State Aid Notice. See Commission Notice on the Application of the State Aid Rules to Measures Relating to Direct Business Taxation, 1998 O.J. (C 384) 4 [hereinafter 1998 State Aid Notice].

[97] Id.

[98] See, e.g., Case 173/73, Italy v. Commission, 1974 E.C.R. 709.

[99] 1998 State Aid Notice, note 96. Commentators have stated that the 1998 State Aid Notice essentially provided the necessary enforcement tool for the Code of Conduct, since it gave warning that the Commission could—and would—pursue harmful tax regimes as illegal state aid if they were not eliminated under the Code of Conduct. Ruth Mason, Tax Rulings As State Aid FAQ, 154 Tax Notes 451, 458 (Jan. 23, 2017); see also Pistone, note 28, at 87 (explaining that recent decisions by the European Court of Justice have essentially aligned the "hard law prohibition of state aids" with the soft law of the Code of Conduct); Wolfgang Schön, Taxation and State Aid Law in the European Union, 36 Common Mkt. L. Rev. 911, 934-35 (1999) (illustrating situations where the state aid prohibition acts as an enforcement tool for the Code of Conduct as well as situations where the state aid prohibition could be narrower than the Code of Conduct).

[100] 1998 State Aid Notice, note 96, at 6.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

economy," even if that section of the economy produces non-geographically mobile income.[101]

By the early 2000's, therefore, there were two general views of what constituted harmful tax competition. According to the OECD and the EU Code of Conduct, harmful tax competition was only that competition that tried to attract geographically mobile income.[102] The Commission state aid regime, however, did not have this limited view of harmful tax competition. According to the 1998 State Aid Notice, any difference in treatment, whether in base or rate, that applied to a separate group of taxpayers could constitute state aid, even if the income receiving benefits were geographically immobile. According to this view of harmful tax competition, any special treatment was harmful to competition within the EU, and a regime that encouraged taxpayers to shift all their employees and activities to another jurisdiction was just as harmful as a regime that encouraged taxpayers to shift only their income to that jurisdiction.

While there were criticisms of these different approaches to tax competition from commentators who argued that any effort by developed countries to curtail tax competition was undermining the ability of developing countries to increase economic growth,[103] this was the closest that the international community came to consensus over what was and was not harmful tax competition. In brief, pure rate competition was definitely not harmful, while competition by way of preferential regimes that targeted geographically mobile income definitely was harmful. Competition by way of other preferential tax benefits could be harmful within the EU, but this view of harmful tax competition was not as broadly supported.

In other words, by the early 2000's, there was agreement within the EU and the OECD that competing for tax revenue based only on the location of the legal owner of assets that produced geographically mobile income was harmful tax competition. At the same time, the EU's much broader state aid prohibition viewed many more types of competition as harmful. These included using essentially any tax tool other than overall statutory rates, and they included competition designed to attract everything from revenue and legal ownership to the

[101] Id; see also European Commission Press Release IP/98/691, Commission Addresses Recommendations to Ireland Regarding Corporate Tax (July 22, 1998), http://europa.eu/rapid/press-release_IP-98-691_en.htm.

[102] Kane, note 79, at 114.

[103] See, e.g., Vaughn E. James, Twenty-First Century Pirates of the Caribbean: How the Organization for Economic Cooperation and Development Robbed Fourteen CARICOM Countries of Their Tax and Economic Policy Sovereignty, 34 Miami Inter-Am. L. Rev. 1 (2002); Christians, note 84.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

location of corporate headquarters and even employment and other activities that went along with foreign direct investment.

### *B. The Consensus Breaks Down: Recent Developments in the Fight Against Harmful Tax Competition*

During the fifteen years following the developments set out above, countries and commentators came to believe that their existing view of harmful tax competition was too narrow. Starting in 2012, amid growing tax avoidance by multinationals, politicians and news media started to point to offensive tax competition measures such as Ireland's 12.5% corporate rate,[104] the low or nonexistent corporate tax rates in the Cayman Islands, the Dutch Antilles, and Bermuda,[105] and administrative rulings that reduced effective tax rates close to zero.[106] Although focusing on multinational companies like Google, Amazon, and Apple,[107] the news media stories emphasized that it was low tax rates or special tax regimes enacted by governments that made these tax avoidance transactions profitable.

The OECD, the EU, and individual countries responded with a new round of anti-tax-competition measures. This Section outlines these recent developments to illustrate how the vision of harmful tax competition that existed in the early 2000's has evolved.

#### *1. Recent OECD Efforts to Curtail Harmful Tax Competition*

In 2015, the OECD formally changed its approach to harmful tax competition by initiating the BEPS Project.[108] As part of the Project, the OECD's FHTP was charged with "revamp[ing] the work on harmful tax practices" under two separate mandates.[109] First, the FHTP was to develop a method for requiring the spontaneous exchange of tax rulings related to preferential regimes; and, second, the FHTP was also to change its assessment of preferential regimes such that any

[104] See, e.g., Tax Torment, The Economist, Mar. 19, 2011, at 62 (citing the French Prime Minister's reference to the Irish rate as "fiscal dumping").

[105] See, e.g., Charles Duhigg and David Kocieniewski, How Apple Sidesteps Billions in Taxes, N.Y. Times, Apr. 29, 2012, at A1.

[106] See Major UK companies Cut Secret Tax Deals in Luxembourg, BBC News, May 11, 2012, http://www.bbc.com/news/business-17993945.

[107] See Starbucks, Google and Amazon Grilled Over Tax Avoidance, BBC News, Nov. 12, 2012, http://www.bbc.com/news/business-20288077; Duhigg & Kocieniewski, note 105.

[108] Note that the OECD had focused on tax competition for several years before this, but much of the focus had been on information exchange and the interaction between tax administrations and taxpayers. See Owens, note 8, at 192-97.

[109] OECD, Action Plan on Base Erosion and Profit Shifting 18 (2013) [hereinafter BEPS Action Plan].

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

regime that did not require "substantial activities" would be considered harmful.[110]

In response to the first mandate, the FHTP developed a framework that sets out when a country must automatically exchange information on a tax ruling with other countries that could be affected by the ruling.[111] As a general matter, tax rulings are written agreements between a country and a taxpayer that provide guidance on how a transaction or structure will be taxed or how income will be allocated in a multinational structure or transaction. Rulings are designed to provide taxpayers with certainty, but, as shown by the international reaction to the rulings that were released as part of LuxLeaks,[112] they also may allow taxpayers to benefit from tax rates that are significantly lower than a country's statutory rates.[113] Concerns about rulings allowing for hidden tax competition led the FHTP to require that countries exchange any ruling that "in the absence of compulsory spontaneous exchange of information could give rise to BEPS concerns," which it defined to include at least five distinct categories of rulings.[114]

This framework for spontaneous exchange of rulings is notable for two reasons. First, regardless of what rulings provide, the framework focuses on transparency and exchange of information. The framework assumes that exchange of information will be sufficient to eliminate harmful tax competition.[115] Second, the new focus on rulings shows a shift in the understanding of what constitutes harmful tax competition. Previously, the OECD focused on regimes that by their terms provided reduced rates to certain groups of taxpayers.[116] Now, the OECD has acknowledged that such regimes are not the only possible examples of harmful tax competition. Instead, administrative

---

[110] Id.

[111] Action 5 2015 Report, note 87, at 45-60.

[112] Int'l Consortium of Investigative Journalists, Luxembourg Leaks: Global Companies' Secrets Exposed, https://www.icij.org/project/luxembourg-leaks (last visited Feb. 2, 2018).

[113] For more on LuxLeaks, see Omri Y. Marian, Is Something Rotten in the Grand Duchy of Luxembourg?, 84 Tax Notes Int'l 281 (Oct. 17, 2016).

[114] Action 5 2015 Report, note 87, at 46. Rulings that raise BEPS concerns include "(i) rulings relating to preferential regimes; (ii) unilateral APAs or other cross-border unilateral rulings in respect of transfer pricing; (iii) cross-border rulings providing for a downward adjustment of taxable profits; (iv) permanent establishment (PE) rulings; (v) related party conduit rulings; and (vi) any other type of ruling agreed by the FHTP that in the absence of spontaneous information exchange gives rise to BEPS concerns." Id. The FHTP does not explain what is included in this sixth category or what is meant by "gives rise to BEPS concerns."

[115] This assumption is part of a larger trend favoring transparency and information sharing. See, e.g., Itai Grinberg, The Battle Over Taxing Offshore Accounts, 60 UCLA L. Rev. 304, 313 (2012).

[116] See notes 90-103 and accompanying text.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

rulings that are not made public and are provided to individual taxpayers may rise to the level of tax competition.

In response to the second mandate, the FHTP proposed a rule that would allow a jurisdiction to apply a preferential tax regime only to the extent that taxpayers were engaged in substantial activities within the jurisdiction. This rule was first designed for preferential regimes that provided benefits to intellectual property (IP) income (generally known as "patent boxes"), and the FHTP then planned to extend the rule to other types of preferential regimes.[117] After two years of negotiations and a publicly brokered compromise between the United Kingdom and Germany, the FHTP proposed the so-called "nexus approach,"[118] under which a jurisdiction may preferentially tax only that amount of IP income that is proportionate to the amount of research and development (R&D) expenditures incurred in the jurisdiction.[119] In other words, a regime is harmful if it allows income to receive benefits even though the substantial activity that contributed to the income was done elsewhere. For IP regimes, this means that income could not receive benefits if the R&D were undertaken elsewhere. For other types of regimes, the FHTP is still in the process of determining what constitutes substantial activities that cannot be done in a jurisdiction separate from the one providing preferential rates to the income arising out of those activities.[120]

Previously, even if a regime was low-tax and preferential and it provided benefits to geographically mobile income, it would not be found to be harmful if it provided for transparent sharing of information and was not ring-fenced (that is, only available to foreign taxpayers and therefore shielded from the domestic economy).[121] Now, even a regime that meets those requirements could be found to be harmful if it does not require that the income arise out of substantial activities

---

[117] Note that this was presented as merely an elaboration of the twelfth factor (that is, the eighth "other" factor). Action 5 2015 Report, note 87, at 23; see note 88.

[118] Press Release, German Fed. Ministry of Fin., Germany and UK Agree Joint Proposal for Rules on Preferential IP Regimes (Nov. 11, 2014), www.budesfinanzministerium.de/Content/EN/Pressemitteilungen/2014/2014-11-11-rules-on-preferential-ip-regimes.html [hereinafter German Press Release]; Press Release, HM Treasury, HM Revenue & Customs, and the Rt Hon George Osborne, Germany and UK Agree Joint Proposal for Rules on Preferential IP Regimes (Nov. 11, 2014), https://www.gov.uk/government/news/germany-and-uk-agree-joint-proposal-for-rules-on-preferential-ip-regimes [hereinafter U.K. Press Release].

[119] Because of the constraints of EU law, the FHTP had to come up with a work-around, but the intent behind this was to focus on expenditures within the jurisdiction, and many non-EU countries have designed their rules to comply with this focus on jurisdiction. See Lilian V. Faulhaber, The Luxembourg Effect: Patent Boxes and the Limits of International Cooperation, 101 Minn. L. Rev. 1641 (2017).

[120] See Action 5 2015 Report, note 87, at 37-40.

[121] See note 94 and accompanying text.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

within the jurisdiction. Thus, the FHTP has now narrowed its view of permissible preferential regimes. Regimes that were not harmful under the 1998 Report now could be harmful if "substantial activities" are located in a separate jurisdiction from the income benefiting from a reduced rate.[122]

### 2. *Recent EU Efforts to Curtail Harmful Tax Competition*

Since 1997, the European Commission has continued to challenge a variety of Member State tax regimes as harmful tax competition.[123] The Commission's Directorate-General for Competition (DG-COMP) has expanded its understanding of the state aid prohibition to include tax rulings provided to multinational companies. In its 1998 State Aid Notice, the Commission had explicitly stated that administrative tax rulings, pursuant to which Member State tax administrations provided interpretive guidance to taxpayers, could be considered to be illegal state aid if they allowed for administrative discretion that went "beyond the simple management of tax revenue by reference to objective criteria."[124] Following this notice, several regimes that provided for such rulings were found to be illegal state aid in 2002 and 2003,[125] and the European Court of Justice confirmed this finding in the context of Belgian coordination centers in 2006.[126]

[122] Although the Action 5 2015 Report focuses on which entity undertook the expenditures, as opposed to where the expenditures were incurred, the initial understanding of the FHTP was that the substantial activities factor was meant to align substance in one jurisdiction with income in the same jurisdiction. See Faulhaber, note 119, at 1659, 1674.

[123] See OECD, The OECD's Project on Harmful Tax Practices: 2006 Update on Progress in Member Countries 3 (2006), http://www.oecd.org/tax/harmful/37446434.pdf; Code of Conduct Group (Business Taxation), European Council, http://www.consilium.europa.eu/en/council-eu/preparatory-bodies/code-conduct-group/ (last visited Feb. 7, 2018) (noting that Ecofin adopted a code of conduct in 1998 that requires member states to "abolish their existing tax measures that constitute harmful tax competition").

[124] 1998 State Aid Notice, note 96, at 6.

[125] Commission Decision 2003/512 of 5 September 2002 on the Aid Scheme Implemented by Germany for Control and Coordination Centres, 2003 O.J. (C 2002) 3298; Commission Decision 2003/438 of 16 October 2002 on the Aid Scheme C 50/2001 (ex NN 47/2000)—Finance Companies—Implemented by Luxembourg, 2003 O.J. (C 2002) 3741; Commission Decision 2003/501 of 16 October 2002 on the State Aid Scheme C 49/2001 (ex NN 46/2000)—Coordination Centres—Implemented by Luxembourg, 2003 O.J. (C 2002) 3740; Commission Decision 2003/755 of 17 February 2003 on the Aid Scheme Implemented by Belgium for Coordination Centres Established in Belgium, 2003 O.J. (C 2003) 564; Commission Decision 2004/76 of 13 May 2003 on the Aid Scheme Implemented by France for Headquarters and Logistics Centres, 2004 O.J. (C 2003) 1483; Commission Decision 2004/77 of 24 June 2003 on the Aid Scheme Implemented by Belgium—Tax Ruling System for United States Foreign Sales Corporations, 2004 O.J. (C 2003) 1868.

[126] Case C-182/03, Kingdom of Belg. v. Comm'n, 2006 E.C.R. I-5584; Case C-217/03, Forum 187 ASBL v. Comm'n, 2006 E.C.R. I-5584.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

In 2014, the Commission issued a draft notice of state aid that was even more explicit in stating that administrative tax rulings could constitute illegal state aid.[127] Later in 2014, the Commission built on this notice to initiate investigations of tax rulings provided by the Netherlands, Ireland, and Luxembourg to Starbucks, Apple, Fiat, and Amazon.[128] In 2016 and 2017, the Commission found several of these rulings to be illegal state aid and demanded that the multinational companies pay back ten years of the taxes that they ostensibly owed to the countries that had provided the aid.[129]

These decisions were met with surprise and outrage in the United States, where many of these multinationals were incorporated.[130] Much of the criticism was directed at the recovery: The Commission had ordered the Netherlands to collect €20–€30 million (plus interest) from Starbucks and Ireland to collect over €13 billion (plus interest) from Apple.[131] From a U.S. perspective, the Commission's

[127] European Comm'n, Draft Commission Notice on the Notion of State Aid Pursuant to Article 107(1) TFEU 44 (2014), http://ec.europa.eu/competition/consultations/2014_state_aid_notion/draft_guidance_en.pdf. This notice was made available for consultations, and it was then finalized in 2016 as the 2016 Notice. Commission Notice on the Notion of State Aid as Referred to in Article 107(1) of the Treaty on the Functioning of the European Union, 2016 O.J. (C 262) 1 [hereinafter 2016 Notice].

[128] European Commission Press Release IP/14/1105, State Aid: Commission Investigates Transfer Pricing Arrangements on Corporate Taxation of Amazon in Luxembourg (Oct. 7, 2014), http://europa.eu/rapid/press-release_IP-14-1105_en.htm; European Commission Press Release IP/14/663, State Aid: Commission Investigates Transfer Pricing Arrangements on Corporate Taxation of Apple (Ireland) Starbucks (Netherlands) and Fiat Finance and Trade (Luxembourg) (June 11, 2014), http://europa.eu/rapid/press-release_IP-14-663_en.htm. A year later, the Commission announced a further investigation into rulings provided by Luxembourg to McDonald's. European Commission Press Release IP/15/6221, State Aid: Commission Opens Formal Investigation into Luxembourg's Tax Treatment of McDonald's (Dec. 3, 2015), http://europa.eu/rapid/press-release_IP-15-6221_en.htm. Around the same time, the Commission also opened investigations into ruling regimes, including those provided by Gibraltar and Belgium. Invitation to Submit Comments Pursuant to Article 108(2) of the Treaty on the Functioning of the European Union, State Aid SA.3491 (2013/C) (ex 2013/NN)—Gibraltar Corporate Income Tax Regime, 2013 O.J. (C 348) 6; European Commission Press Release IP/15/4080, State Aid: Commission Opens In-Depth Investigation into the Belgian Excess Profit Ruling System (Feb. 3, 2015), http://europa.eu/rapid/press-release_IP-15-4080_en.htm.]

[129] See Lilian V. Faulhaber, Beyond Apple: State Aid as a Model of a Robust Anti-Subsidy Rule, 48 Geo. J. Int'l L. 381 (2017); European Commission Press Release IP/17/3701, State Aid: Commission Finds Luxembourg Gave Illegal Tax Benefits to Amazon Worth Around €250 Million (Oct. 4, 2017), http://europa.eu/rapid/press-release_IP-17-3701_en.htm. For a more in-depth discussion of recovery, see, e.g., Mason, note 99, at 455-57; Faulhaber, supra.

[130] See, e.g., Europe's "Unfair" Apple Tax Ruling Sparks US Anger, BBC News (Aug. 30, 2016), http://www.bbc.com/news/business-37226101 (noting that Senator Charles Schumer called the Apple decision "a cheap money grab").

[131] European Commission Press Release IP/15/5880, Commission Decides Selective Tax Advantages for Fiat in Luxembourg and Starbucks in the Netherlands Are Illegal Under EU State Aid Rules (Oct. 21, 2015), http://europa.eu/rapid/press-release_IP-15-5880_en.htm; European Commission Press Release IP/16/2923, State Aid: Ireland Gave

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

actions were seen as a pure money grab, with U.S. companies being asked to pay the very countries that had been responsible for the state aid to begin with.[132] From an EU perspective, however, these investigations were seen as consistent with previous state aid investigations and a necessary part of the fight against harmful tax competition.

After the Apple decision was handed down, ministers in France and Germany voiced their support for the decisions.[133] Margrethe Vestager, the EU Commissioner for Competition, stated repeatedly that the rulings provided to U.S. companies were unfair and inconsistent with a level playing field between companies, and that recovery was necessary to guarantee fair competition between companies.[134] In other words, tax competition was harmful because of how it affected market competition between companies. If Apple and Starbucks were able to compete on an unequal footing with companies that did not receive similar tax rulings, then the rulings that they received were distorting the market within the EU.[135]

Questions remain as to whether the Commission diverged too far from its earlier selective advantage analysis in reaching its recent decisions.[136] The affected Member States (and some companies that received the aid) have appealed the decisions to the Court of Justice of the European Union (CJEU), and it will take several years to receive an ultimate decision on appeal.[137] Even so, the Commission's recent

---

Illegal Tax Benefits to Apple Worth up to €13 Billion (Aug. 30, 2016), http://europa.eu/rapid/press-release_IP-16-2923_en.htm; Commission Decision 2017/502 of 21 October 2015 on State Aid SA.38374 Implemented by the Netherlands to Starbucks, 2015 O.J. (L83) 102 (requiring interest).

[132] David Morgan & Jason Lange, EU Ruling on Apple Stirs Calls for U.S. Tax Reform, Reuters (Aug. 30, 2016), https://www.reuters.com/article/eu-apple-usa/eu-ruling-on-apple-stirs-calls-for-u-s-tax-reform-idUSL1N1BB1P1 (noting that House Ways and Means Chairman Kevin Brady called the Apple decision "a predatory and naked tax grab").

[133] See Apple: Tim Cook Dénonce la <<Stupidité Politique>> de Bruxelles, Ouest-France (Sept. 1, 2016), http://www.ouest-france.fr/high-tech/apple/apple-tim-cook-denonce-la-stupidite-politique-de-bruxelles-4445514; German Economy Minister Backs EU Decision to Make Apple Pay Ireland Billions in Tax, Reuters (Aug. 30, 2016), https://uk.reuters.com/article/uk-eu-apple-germany-gabriel/german-economy-minister-backs-eu-decision-to-make-apple-pay-ireland-billions-in-tax-idUKKCN1151AJ.

[134] See, e.g., Margrethe Vestager, Fair Competition and a Level Playing Field, WorldPost, https://www.huffingtonpost.com/margrethe-vestager/fair-competition-and-a-le_b_11971432.html (last visited Jan. 20, 2018).

[135] Id.

[136] See Treasury Dep't, The European Commission's Recent State Aid Investigations of Transfer Pricing Rulings 6 (2016), https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/White-Paper-State-Aid.pdf; Mason, note 99, at 453-54.

[137] Case T-892/16, Apple Sales Int'l v. Comm'n (Dec. 19, 2016), http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62016TN0892&from=ENG; Case T-636/16 Starbucks and Starbucks Manufacturing Emea v, Comm'n (Sept. 5, 2016), http://eur-lex.europa.eu/legal-content/en/TXT/PDF/?uriuriserv%3AOJ.C_.2016.462.01.0025.01.ENG; Case T-759/15, Fiat Chrysler Finance Europe v. Comm'n (Jan. 29, 2016), http://eur-lex.europa.eu/legal-content/en/TXT/PDF/?uri=uriserv%3AOJ.C_.2016.059.01.0049.01.ENG

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

investigations and decisions mark an important development in the EU's efforts to curtail harmful tax competition. While the Commission had previously used the state aid prohibition to challenge rulings and other tax provisions, the more recent actions showed the Commission's willingness to use state aid as a tool against tax competition even when the companies benefiting are not based in the EU and even when the measure provided is a ruling for a particular taxpayer rather than an entire regime.[138]

Thus, the state aid prohibition continues to define harmful tax competition more broadly than the FHTP, even after the FHTP broadened its own definition. While the FHTP now views tax rulings as potentially representing harmful tax competition, this is the case only for rulings that could "give[ ] rise to BEPS concerns," which include five enumerated categories of rulings and can only include other types of rulings if all countries in the FHTP agree.[139] The Commission has no such limitation on which types of rulings could represent harmful tax competition for state aid purposes, and it instructs in its guidance that rulings can rise to the level of impermissible state aid when they "misappl[y] national tax law," resulting in a reduced tax burden; when they are not available to all similarly situated taxpayers; or when other similarly situated taxpayers do not receive similarly favorable tax treatment[140]—a much broader scope of rulings that could represent harmful tax competition.

The Member States of the EU have also been updating the definition of harmful tax competition used by the Code Group, directly following the lead of the FHTP and expanding its definition of harmful tax competition to also focus on substantial activities as defined by the nexus approach.[141] Therefore, rather than developing two different approaches to assessing harmfulness in patent boxes, both the FHTP and the EU adopted the approach developed in the FHTP. The EU then assessed the IP regimes of the EU Member States in 2015 and 2016.[142]

---

[138] Note that many previous state aid investigations focused on individual measures, but some commentators argued that this was novel. See Treasury Dep't, note 136, at 6.

[139] Action 5 2015 Report, note 87, at 51. For a description of the rulings included in this definition, see note 114. The report leaves open the possibility that other rulings could also be found to raise BEPS concerns. Action 5 2015 Report, note 87, at 51.

[140] 2016 Notice, note 127, at 38.

[141] See Bob van der Made, EU: Update on Patent Boxes and the EU Code of Conduct Group (Business Taxation), Int'l Tax Rev. (Feb. 24, 2015), http://www.internationaltaxreview.com/Article/3430573/EU-Update-on-patent-boxes-and-the-EU-Code-of-Conduct-Group-Business-Taxation.html; Council of the European Union Press Release IP/16603/14, Outcome of the Council Meeting (Dec. 9, 2014), http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/146136.pdf.

[142] See Joe Kirwin, French Patent Box Rates Challenged in EU Conduct Group, Bloomberg BNA (Oct. 3, 2016), https://www.bna.com/french-patent-box-n57982077841/.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

A further EU development in the context of tax competition has been the Commission's recent announcement of two directives aimed at eliminating tax competition. The proposed Common Corporate Tax Base (CCTB) Directive would implement a common tax base for corporate taxpayers across the European Union, while the proposed Common Consolidated Corporate Tax Base (CCCTB) Directive would be implemented after the CCTB Directive and would impose a consolidation system on top of the common base.[143] Although these directives claim to focus more on concerns about tax avoidance and compliance costs, they will also, if implemented, have the effect of significantly limiting the ability of EU Member States to engage in tax competition.

Both arose out of discussions of an EU-wide common corporate tax base that formally began in 2001.[144] After several rounds of discussion,[145] the Commission proposed an earlier CCCTB Directive in March 2011,[146] which would have allowed companies to choose whether or not to use the common base or to continue to calculate their tax bases separately for all Member States in which they operated.[147] Countries that did use the common base would then opt into a consolidation system, pursuant to which EU-wide losses could be used against EU-wide income when calculating the taxable base.[148]

Due to both the difficulties of agreeing on a consolidation system and the optionality of the CCCTB, many EU Member States opposed the proposal, and it remained pending in the Council for over five years. In October 2016, the Commission issued the two new proposed directives,[149] which would require companies over a certain size to use the common base. These directives, however, would introduce the

---

[143] European Comm'n, Proposal for a Council Directive on a Common Corporate Tax Base 7-8, COM (2016) 685 final (Oct. 25, 2016) [hereinafter 2016 CCTB Proposal]; European Comm'n, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) 7-8, COM (2016) 683 final (Oct. 25, 2016) [hereinafter 2016 CCCTB Proposal].

[144] European Comm'n, Towards an Internal Market Without Tax Obstacles: A Strategy for Providing Companies with a Consolidated Corporate Tax Base for Their EU-Wide Activities, COM (2001) 582 final (Oct. 23, 2001).

[145] These discussions involved the 2004 issuance of a "non-paper." European Comm'n, Commission Non-Paper to Informal Ecofin Council, 10 and 11 September 2004: A Common Consolidated EU Corporate Tax Base (July 7, 2004), http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/company_tax/common_tax_base/cctbwpnon_paper.pdf.

[146] European Comm'n, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM (2011) 121 final (Mar. 16, 2011).

[147] Id. at 5.

[148] Id.

[149] European Commission Press Release IP/16/3471, Commission Proposes Major Corporate Tax Reform, for the EU (Oct. 25, 2016), Europa.eu/rapid/press-release_IP-16-3471_en.htm.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

consolidation regime only after the common base was implemented, so the creation of a full common consolidated base would take place in stages.[150]

If one or both of these common base proposals were implemented, they would significantly change the face of tax competition throughout the European Union since they would eliminate the ability of countries to compete on their bases and would instead focus competition purely on rate. Therefore, no longer would countries be able to provide any preferential regimes to specific types of income or taxpayers; instead, all income would be aggregated into the common base, and the only locus for competition would be the rate that each Member State applied to the portion of the base allocated to them.

A final EU-wide proposal for combating tax competition was the announcement by the European Commission in September 2016 that the EU would compile a list of noncooperative jurisdictions outside of the European Union.[151] The Commission established a "neutral scoreboard of indicators,"[152] which considered a jurisdiction's economic ties to the EU, its reliance on financial services exports, and its appeal to taxpayers engaged in tax avoidance.[153] This scoreboard also considered the jurisdiction's compliance with international transparency and exchange of information standards, the existence of preferential regimes in the jurisdiction, and the jurisdiction's corporate tax rate.[154] On December 5, 2017, the Council adopted a list of noncooperative jurisdictions for tax purposes.[155] This listing is essentially a return to the countrywide blacklists of the pre-1997 era, but rate is now only one of the factors to be considered, along with economic linkages to Europe, the role of financial services, the tax avoidance environment, and tax governance.

### 3. *Recent Efforts to Curtail International Tax Avoidance*

As mentioned above, many of these recent developments in the fight against tax *competition* came about due to news stories and political outrage about tax *avoidance* by multinational companies. Along-

[150] 2016 CCTB Proposal, note 143, at 3, 17.

[151] See European Commission Fact Sheet MEMO/16/2997, Questions and Answers on the Common EU List of Non-Cooperative Tax Jurisdictions (Sept. 15, 2016), Europa.eu/rapid/press-release_MEMO-17-5122_en.htm.

[152] Id.

[153] See European Comm'n, First Step Towards a New EU List of Third Country Jurisdictions: Scoreboard (Sept. 13, 2016), https://ec.europa.eu/taxation_customs/sites/taxation/files/2016-09-15_scoreboard-indicators.pdf.

[154] Id.

[155] Council of the European Union, Outcome of Proceedings 15429/17 (Dec. 5, 2017), https://www.consilium.europa.eu/media/31945/st15429en17.pdf.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

side the anti-tax-competition measures discussed above, the main response to such stories was to focus on international tax avoidance.

Much of the academic literature separates tax avoidance from tax competition. While tax competition focuses on actions by individual countries to change their tax systems in order to compete with other countries, tax avoidance focuses on actions taken by taxpayers to reduce the taxes they pay to one or more countries.[156] As with tax competition, tax avoidance lacks a clear definition or a clear line for when it becomes harmful, and the literature generally attempts to draw a distinction between permissible tax planning and illegal tax evasion.[157] Rules that were designed to prevent international tax avoidance focus not on limiting jurisdictional competition but instead on preventing taxpayers from aggressively interpreting existing law to reduce their tax burdens.

Perhaps the most significant recent development in the fight against tax avoidance was the OECD's BEPS Project. Although it was described briefly above as a tool against tax *competition*, most of the BEPS Project was focused explicitly on tax *avoidance*. The Project was presented as a way for governments to prevent taxpayers from taking advantage of discrepancies between domestic tax systems,[158] and many of the proposals and recommendations that came out of the Project were presented as tools for preventing or limiting aggressive tax planning by taxpayers.[159]

There were fifteen different Action Items that made up the BEPS Project, and the outputs that were produced under the majority of these Action Items were targeted at tax avoidance opportunities.[160] For example, Action 2 proposed anti-hybrid rules, which were designed to prevent taxpayers from taking advantage of different treatment of the same transaction or entity in two different jurisdictions to receive deductions in both jurisdictions or to combine a deduction in one jurisdiction with an exclusion in another.[161] Action 3 proposed

---

[156] See, e.g., Joel Slemrod & Shlomo Yitzhaki, Tax Avoidance, Evasion, and Administration, in 3 Handbook of Public Economics 1423, 1425 (Alan J. Auerbach & Martin Feldstein eds., 2002).

[157] See, e.g., Shannon Weeks McCormack, Tax Shelters and Statutory Interpretation: A Much Needed Purposive Approach, 2009 U. Ill. L. Rev. 697, 699; Marco Greggi, Avoidance and Abus de Droit: The European Approach in Tax Law, 6 eJournal Tax Res. 23, 27-28 (2008) (outlining attempts in the early twentieth century to distinguish between tax avoidance and tax evasion).

[158] BEPS Action Plan, note 109, at 13.

[159] See OECD, OECD/G20 Base Erosion and Profit Shifting Project: Executive Summaries 13 (2015), https://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf.

[160] BEPS Action Plan, note 109, at 14-24.

[161] OECD, OECD/G20 Base Erosion and Profit Shifting Project: Neutralising the Effects of Hybrid Mismatch Arrangements 26 (2015), http://www.oecd-ilibrary.org/taxation/neutralising-the-effects-of-hybrid-mismatch-arrangements_9789264218819-en.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

controlled foreign company (CFC) rules, which were designed to prevent taxpayers from shifting income outside of a jurisdiction or deferring taxation by establishing a wholly-owned foreign subsidiary.[162] Action 4 proposed interest limitation rules, which were designed to prevent taxpayers from taking excess interest deductions.[163] Other Action Items set out rules to prevent taxpayers from taking advantage of treaty provisions,[164] to limit the ability of taxpayers to change their tax liabilities by engaging in transfer pricing transactions between related parties,[165] and to require taxpayers to report on certain types of tax avoidance transactions.[166]

For all of these Action Items, the OECD issued a report that set out recommended rules or required minimum standards.[167] While commentators have questioned how much these reports will change the international tax environment,[168] many countries have modified their domestic tax rules to reflect the BEPS outputs,[169] and others have signed on to international agreements to implement certain minimum standards.[170]

---

[162] OECD, OECD/G20 Base Erosion and Profit Shifting Project: Designing Effective Controlled Foreign Company Rules 9 (2015), http://www.oecd-ilibrary.org/taxation/designing-effective-controlled-foreign-company-rules-action-3-2015-final-report_9789264241152-en.

[163] OECD, OECD/G20 Base Erosion and Profit Shifting Project: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments 11 (2015), http://www.oecd-ilibrary.org/taxation/limiting-base-erosion-involving-interest-deductions-and-other-financial-payments-action-4-2015-final-report_9789264241176-en.

[164] OECD, OECD/G20 Base Erosion and Profit Shifting Project: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances 13-14 (2015), http://www.oecd.org/tax/preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstances-action-6-2015-final-report-9789264241695-en.htm.

[165] OECD, OECD/G20 Base Erosion and Profit Shifting Project: Aligning Transfer Pricing Outcomes with Value Creation 147-49 (2015), http://www.oecd.org/ctp/aligning-transfer-pricing-outcomes-with-value-creation-actions-8-10-2015-final-reports-9789264241244-en.htm.

[166] OECD, OECD/G20 Base Erosion and Profit Shifting Project: Mandatory Disclosure Rules 9 (2015), http://www.oecd.org/tax/mandatory-disclosure-rules-action-12-2015-final-report-9789264241442-en.htm.

[167] The four Action Items that resulted in minimum standards are Action 5 (the nexus approach for IP regimes and spontaneous exchange of rulings), Action 6 (either a limitation-on-benefits provision or a principal purpose test), Action 13 (country-by-country reporting), and Action 14 (mutual agreement procedures). OECD, OECD/G20 Base Erosion and Profit Shifting Project: Frequently Asked Questions (2015), https://www.oecd.org/ctp/beps-frequently-asked-questions.pdf.

[168] See Itai Grinberg, The New International Tax Diplomacy, 104 Geo. L.J. 1137, 1195-96 (2016).

[169] See, e.g., HM Revenue & Customs, Corporation Tax: Patent Box—Compliance with New International Rules (Dec. 9, 2015), https://www.gov.uk/government/publications/corporation-tax-patent-box-compliance-with-new-international-rules/corporation-tax-patent-box-compliance-with-new-international-rules.

[170] OECD, Press Release, A Boost to Transparency in International Tax Matters: 31 Countries Sign Tax Co-operation Agreement to Enable Automatic Sharing of Country by

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

After the OECD announced the outputs of the BEPS Project in October 2015,[171] the EU Council agreed in June 2016 to the Anti-Tax Avoidance Directive (ATAD).[172] The Commission billed the ATAD as a set of "concrete measures to prevent aggressive tax planning, boost tax transparency and create a level playing field for all businesses in the EU,"[173] and Member States of the European Union will be required to implement its provisions in their domestic legislation by January 1, 2019.[174] There are five required provisions. Three of them are similar to outputs under the BEPS Project: The ATAD requires that Member States implement anti-hybrid rules, CFC rules, and interest limitation rules that are consistent with the BEPS recommendations.[175] The ATAD also requires that Member States implement an exit tax, pursuant to which taxpayers who leave one Member State must pay a supplementary tax to ensure that they do not escape taxation by moving,[176] and that Member States implement a general anti-abuse rule, pursuant to which tax administrations will be able to prevent artificial arrangements designed to avoid taxation.[177]

Separate from both the OECD and the EU developments, several individual countries also recently implemented rules intended to prevent international tax avoidance. In 2015, the United Kingdom implemented the diverted profits tax (DPT),[178] which was billed in the press as the "Google tax" due to its focus on multinational companies such as Google that had been criticized in the U.K. press for paying low effective rates of tax.[179] The DPT imposes a tax of 25% on the profits earned by a multinational that were diverted from the United King-

Country Information (Jan. 27, 2016), http://www.oecd.org/tax/a-boost-to-transparency-in-international-tax-matters-31-countries-sign-tax-co-operation-agreement.htm.

[171] See OECD, note 159.

[172] Council Directive 2016/1164 of 12 July, 2016, Laying Down Rules Against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market 2016 O.J. (L 193) 1 [hereinafter ATA Directive]; see also European Comm'n, Taxation and Customs Union, The Anti Tax Avoidance Directive (2016), https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en (stating that the Council adopted the Directive on June 20, 2016).

[173] European Comm'n, Taxation and Customs Union, Anti Tax Avoidance Package (2016), http://ec.europa.eu/taxation_customs/business/company-tax/anti-avoidance-package_en.

[174] European Comm'n, note 172; ATA Directive, note 172, at 13.

[175] ATA Directive, note 172, at 2-4.

[176] Id. at 3.

[177] Id. at 3-4.

[178] See HM Revenue & Customs, Diverted Profits Tax: Guidance 3 (Nov. 30, 2015), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/480318/Diverted_Profits_Tax.pdf [hereinafter DPT Guidance] (stating that the measure was introduced in 2014 and became effective as of April 1, 2015).

[179] See, e.g., Robert Peston, Who Wins from Google Tax?, BBC (Dec. 10, 2014), http://www.bbc.com/news/business-30420571.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

dom.[180] The DPT determines such profits by looking at two situations: (1) where there should have been a permanent establishment in the United Kingdom and (2) where there was not enough substance in another jurisdiction to justify the income being allocated to that jurisdiction rather than the United Kingdom.[181] In 2016, Australia implemented a similar rule, known as the multinational anti-avoidance law (MAAL).[182] The MAAL also applies to multinational companies, but, rather than imposing a tax on profits, it doubles the tax avoidance penalties that the Australian authorities can impose on the taxpayer.[183] The MAAL applies if one of the principal purposes of a transaction was to obtain a tax benefit and if, even though a foreign entity is providing goods or services to Australian customers through an Australian entity, sufficient income has not been allocated to a permanent establishment in Australia.[184]

At the same time, the United States also proposed two unilateral measures to target tax avoidance. First, the Treasury under the Obama Administration amended the U.S. Model Treaty to limit treaty benefits if a taxpayer benefits from a so-called "special tax regime."[185] While double tax treaties such as the U.S. Model Treaty set default rules, the new version reverses some of these default rules if a taxpayer is benefiting from "any statute, regulation or administrative practice . . .that results in . . . a preferential rate of taxation" or "a permanent reduction in the tax base.][186] This development, which went into effect in 2016, expands on the FHTP's view of harmful tax regimes to include preferential regimes that apply "preferential treatment to interest, royalties, or guarantee fees as compared to income from sales of goods or services."[187] Preferential treatment is defined to include a preferential rate, as well as a "*permanent* reduction in the

---

[180] DPT Guidance, note 178, at 5 (DPT1030). It applies a higher rate to income from ring-fenced activities.

[181] Id. at 4 (DPT1000).

[182] Explanatory Memorandum, Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015, (Cth) 7 (Austl.) [hereinafter MAAL Guidance]. A similar rule is currently under consideration by the New Zealand government. See N.Z. Inland Revenue Dep't, BEPS—Transfer Pricing and Permanent Establishment Avoidance: A Government Discussion Document 3-5 (2017), http://taxpolicy.ird.govt.nz/sites/default/files/2017-dd-transfer-pricing-pe.pdf.

[183] MAAL Guidance, note 182, at 54.

[184] Id. at 24.

[185] See, e.g., 2016 U.S. Model Income Tax Convention, art. 11.2 (Interest), art. 12.2 (Royalties), Feb. 17, 2016, 1 Tax Treaties (CCH) [hereinafter 2016 Model Treaty] (limiting the benefits granted by these articles if the taxpayer benefits from a special tax regime); see also Preamble to the U.S. Model Income Tax Convention (Feb. 17, 2016), 1 Tax Treaties (CCH) [hereinafter 2016 Model Treaty Preamble] (explaining the purpose of the special tax regime provisions added to the 2016 U.S. Model Income Tax Convention).

[186] 2016 Model Treaty, note 185, art. 3.1(l).

[187] 2016 Model Treaty Preamble, note 185.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

tax base with respect to such income" and "a preferential regime for companies that do not engage in an active business in the residence state."[188]

Second, in 2015 and 2016 the Obama Administration proposed that the United States impose a minimum tax, pursuant to which all U.S. taxpayers would be subject to a minimum tax rate of 19%.[189] If U.S. taxpayers paid an overall effective rate of less than 19% on their worldwide income, they would be required to pay the difference in taxes to the United States. This proposal was never enacted, but, like the DPT and the MAAL, it represents a new development in tools that jurisdictions could use to combat international tax avoidance.

There are of course many other rules that target tax avoidance. Jurisdictions across the world, for example, have interest limitation rules and general anti-avoidance rules such as substance-over-form or economic substance tests.[190] The developments listed in this Subsection are, however, the proposals and rules that have received the most international attention in the past few years and are explicitly focused on *international* tax avoidance.

#### 4. *Changes from the Previous Consensus*

In the late 1990's, the OECD and European Commission generally agreed that harmful tax competition consisted of preferential tax regimes applying relatively lower rates to geographically mobile income, either provided only to foreign taxpayers or shrouded in secrecy. At the same time, the Commission had a broader state aid-based view of harmful tax competition, under which any preferential tax regime was harmful, no matter who or what type of income benefited. This broader view, however, was still in the process of being applied and interpreted, so its divergence from the existing OECD/EU consensus was not yet clear.

Over the past several years, governments and international organizations developed new views of and new responses to harmful tax competition and tax avoidance. Given that there is no agreement in the academic literature about what constitutes harmful tax competition or where the line between tax planning and impermissible tax

---

[188] Id.

[189] Treasury Dep't, General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals 19-22 (2015), https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf; Treasury Dep't, General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals 9-12 (2016), https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2017.pdf.

[190] See 2016 National Reports, EATLP, http://www.eatlp.org/138-uncategorised/262-national-reports (providing a series of country-specific reports on measures that countries have taken to address tax avoidance and aggressive tax planning).

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

avoidance falls, what do these developments tell us about what countries consider to be harmful tax competition?

Under the FHTP's nexus approach, which was then adopted by the EU's Code Group, harmful tax competition is a reduced rate on geographically mobile income when the jurisdiction providing the rate does not also require that the jobs creating the income be located in the jurisdiction.[191] Under the prohibition on state aid, it is a reduced rate on any income when that same rate is not provided to other taxpayers.[192] Under the framework for spontaneous exchange of rulings and the prohibition on state aid, it is a reduced rate on income provided by administrative rulings.[193] Under the common tax base proposals, it is any difference in corporate tax bases across countries.[194] Under the EU's list of noncooperative jurisdictions, it is an overall tax system of a country that is linked to the EU, but which does not follow good tax governance principles and may have preferential regimes.[195]

At the same time as jurisdictions were passing the anti-tax-competition measures, they were also designing and implementing rules that focused not on other jurisdictions but instead on taxpayers who were avoiding taxation. The BEPS Project recommended domestic rules that individual countries could adopt to limit such tax avoidance. The EU's ATAD went further and required rules in EU Member States that would make it more difficult for taxpayers to reduce their taxes. The United Kingdom and Australia also implemented their own anti-avoidance rules, subjecting multinational corporations to heightened tax rates or doubled penalties if such taxpayers engaged in certain types of transactions intended to reduce or eliminate taxes. Finally, the United States amended its model treaty to incorporate the FHTP and Code of Conduct vision of harmful tax competition into an anti-avoidance rule, and it proposed a minimum tax that would have incorporated the pre-1998 prohibition on rate competition into an anti-avoidance rule. Although all of these rules were presented as targeting taxpayers, rather than other jurisdictions, they were proposed or put into effect at the same time as the anti-tax-competition measures described above, and they were also presented as responses to the many examples of international corporate tax avoidance in the media at the time. As shown in Part III, although they do not represent particular visions of what tax competition is over or for, they were also not as separate from the anti-tax-competition measures as they may have at first appeared.

---

[191] See notes 118-22 and accompanying text.
[192] See notes 126-40 and accompanying text.
[193] See notes 111-16 and accompanying text.
[194] See notes 143-50 and accompanying text.
[195] See notes 151-55 and accompanying text.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

## IV. How Should the Policy of Tax Competition Inform the Theory of Tax Competition?

The recent unilateral and multilateral developments in the fight against tax competition represent different visions of what constitutes harmful tax competition. Given these differences, what can countries learn as they craft their own anti-tax-competition measures, and what can academics and policymakers learn about the international tax landscape? Part IV sets out three different insights that can be distilled from the developments set out in Part III.

### A. *Shifting the Playing Field*

One lesson is that, no matter what politicians may say, most countries' definitions of harmful tax competition are informed by how the countries believe themselves to be most competitive. In other words, fighting international tax competition is not about leveling the playing field; it is about shifting the playing field to focus competition on areas in which a country believes itself to have an advantage and away from those areas in which it lacks an advantage.

Before the increase in foreign direct and portfolio investment in the 1980's and 1990's, large countries generally did not feel the need to pass anti-tax-competition measures because their size was sufficient to make them competitive.[196] In the 1980's and 1990's, however, as size alone stopped being sufficient, larger countries started to feel the effect of tax competition. Although their rates were dropping during this period, large countries generally still retained higher rates than small countries until the late 1990's,[197] so their solution was to define harmful tax competition as low corporate rates.[198] They could not compete based on rates, so they eliminated the ability of smaller countries to do so. By the late 1990's, however, large and small countries alike had overall low rates, so the statutory corporate rate was now a playing field on which large countries could compete.[199]

Where they could not compete, however, was on effective corporate rates, which by this time had plummeted below statutory rates,[200] so the playing field shifted again, this time permitting countries to compete based on overall statutory rates, but not on special rates for foreign taxpayers. Whereas larger and more politically powerful

[196] See notes 76-81 and accompanying text.

[197] Hines, Corporate Taxation, note 8, at 292.

[198] See notes 76-81 and accompanying text; see, e.g., B.O.E. 1991, 167 (Spain) (providing for countries and territories designated as Spanish tax havens).

[199] From 1982 to 1999, the average statutory corporate rate dropped from 45.9% to 32.9%. Hines, Corporate Taxation, note 8, at 279 tbl.1.

[200] Id.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

countries had previously viewed rates as a competitive field on which they could not win, they now accepted competition for rates, but they realized that they could only compete on rates if these were generally applicable rates. Requiring all countries to lower their rates only to a level that they could apply to all taxpayers would prevent them from attracting foreign investment by providing low rates only to foreign taxpayers while also raising revenue through overall higher rates. This explains the shift in focus to preferential regimes rather than rates.

This historical perspective also explains the simultaneous focus on the lack of transparency and information exchange as indicators of harmful tax competition. The larger developed countries that made up the majority of EU and OECD countries in the late 1990's were shifting toward being able to compete based on overall rates, but some countries that previously would have been considered tax havens based on rates were also shrouded in secrecy. By disallowing such secrecy, which the majority of EU and OECD countries no longer protected to the same extent, they could again shift the area over which they were competing and move it in their favor. Furthermore, eliminating secrecy was necessary to ensure that countries knew whether and how preferential regimes applied to foreign taxpayers.

Readers may argue that this story ignores the United States, which retained a relatively high statutory corporate income tax rate throughout this period even as other countries reduced their rates. If the U.S. rate stayed high and yet the international tax system no longer viewed rate competition as harmful, is that not inconsistent with the view that countries only permitted tax competition where they themselves could prevail?

No, because the U.S. story requires consideration of the different political interests at play in the country during this period. During the Democratic administration of President Clinton, the U.S. government did view competition over the general corporate rate as harmful and thus participated in efforts to characterize countries that lowered that general rate substantially below the U.S. level as engaging in harmful tax competition.[201] With the Republican administration of President Bush, however, the U.S. position shifted.[202] General corporate rates significantly lower than the U.S. rate were no longer judged to be harmful tax competition, probably because a significant Republican agenda item was to produce an equivalent reduction in the general

[201] Chris Edwards & Daniel J. Mitchell, Global Tax Revolution: The Rise of Tax Competition and the Battle to Defend It 165 (2008).

[202] For more on the behind-the-scenes lobbying that contributed to this shift in policy, see Ring, note 8, at 567-68, 580 n.75.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

corporate rate in the United States. The U.S. story therefore shows that sometimes entities within countries use definitions of harmful tax competition to shore up their own position, which is a domestic example of using efforts to limit harmful tax competition in order to shift the playing field in one's favor.

The insight that countries use anti-tax-competition measures in order to shift competition to a field where they are more competitive can be seen even more clearly in the context of the BEPS Project. The nexus approach shifted the playing field for harmful regimes away from rates granted to domestic taxpayers, which had previously been permitted, and instead towards competition for jobs, infrastructure, and education. Under the nexus approach, a country could only have a patent box if that country could also support the R&D necessary to create the IP assets that contributed to the income benefiting from the patent box. The United Kingdom and Germany, with large economies and significant investments in infrastructure and education, publicly supported the nexus approach.[203] These two countries could not compete based purely on rates, so they pushed for a view of harmful tax competition that would shift the competition to an area where they believed they could compete more successfully: jobs, infrastructure, and education.

The renewed focus on rulings also illustrates this shift toward an area where the OECD countries felt they were more competitive. The BEPS Action 5 spontaneous exchange requirement views certain types of secret administrative rulings as harmful tax competition. Some OECD countries believed that they could compete more successfully by removing secret discretionary rulings from the playing field altogether. That said, as shown by recent state aid investigations, several OECD member countries (including Belgium, Ireland, Luxembourg, and the Netherlands) did issue secret discretionary rulings. If they were competing successfully on this playing field, why would they allow the playing field to shift away from where their comparative advantage lay? The Action 5 Report says nothing about eliminating rulings altogether, nor does it require that any rulings other than those listed in the Report be exchanged, nor does it prescribe any defensive measures once rulings are exchanged. In other words, while Action 5 eliminates some of the benefit of granting rulings, it does not take away the benefit entirely. Thus, countries that previously provided rulings may continue to do so, which means that they at least partly retained their competitive advantage even though countries without rulings thought that they were gaining an advantage by limiting secrecy.

[203] See German Press Release, note 118; U.K. Press Release, note 118.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

The anti-tax-competition developments in the EU further support this view of anti-tax-competition measures shifting the playing field, but they add a separate lesson of their own. The EU's current fight against tax competition is much broader than other efforts to curtail tax competition. While the OECD has now expanded the definition of harmful tax competition to include both secret tax rulings and preferential rate competition that is not combined with competition for jobs, the EU's recent actions have represented an even more expanded view of what constitutes harmful tax competition. Any regime that differs from a Member State's normal tax system can be considered to be illegal state aid, and thus harmful tax competition.[204] Also, as shown by the CCTB and CCCTB proposals, any variation in tax bases could in the future be seen as harmful tax competition. The EU therefore at first seems to be undermining the argument that a jurisdiction's anti-tax-competition measures are designed to shift the playing field toward an area where that jurisdiction can best compete, since the EU measures appear designed to eliminate all differences between Member States and therefore eliminate tax competition entirely.

But the EU is attempting to eliminate only the competition among its own Member States. The long-term goal is to position the EU so that it can compete more successfully as an entire bloc with other jurisdictions. Most of the EU's tax competition concerns are about intra-EU competition: Different Member States are policing one another and competing with one another. The goal of the recent proposals and the Commission's reinvigorated state aid activity, however, is to eliminate this competition entirely in order for the EU as a whole to compete with countries outside the EU.

### B. *The Interdependence of Tax Competition and Tax Avoidance*

A second lesson is that tax avoidance and tax competition are in fact reliant on one another, which in turn means that one of the main

---

[204] See European Commission Press Release IP/16/3606, State Aid: Commission Finds Hungarian Advertisement Tax in Breach of EU Rules (Nov. 4, 2016), http://europa.eu/rapid/press-release_IP-16-3606_en.htm (finding that a tax with progressive rates was impermissible state aid that favored companies with low or no profits); European Commission Press Release IP/16/3104, State Aid: Commission Opens In-Depth Investigation into Poland's Tax on the Retail Sector (Sept. 19, 2016), http://europa.eu/rapid/press-release_IP-16-3104_en.htm (stating that a progressive tax rate could constitute state aid if it favors small retailers over large retailers); European Commission Press Release IP/16/2404, State Aid: Commission Finds Hungary's Food Chain Inspection Fee and Tax on Tobacco Sales in Breach of EU Rules (July 4, 2016), http://europa.eu/rapid/press-release_IP-16-2404_en.htm (finding that a turnover tax with progressive rates was impermissible state aid that favored companies with low turnover over companies with high turnover).

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

tools against tax competition is a set of rules that target taxpayers rather than jurisdictions. This lesson can be seen in the BEPS outputs that were *not* targeted at tax competition, the EU's ATAD, the U.K. and Australian rules targeting the diverted profits of multinationals, and the Obama Administration's measures to limit international tax avoidance. Although Action 5 of the BEPS Project explicitly targeted tax competition, the majority of BEPS Action Items, and the BEPS Action Plan itself, were focused on taxpayers. In the first two pages of the BEPS Action Plan, for example, the OECD identified the fundamental problem facing the international tax system as the existence of "opportunities for MNEs to greatly minimise their tax burden" and identified governments as one of the victims of this tax avoidance.[205] Yet most of the targeted tax avoidance transactions or arrangements existed only because of tax competition between jurisdictions. For example, CFC rules are most important when the foreign subsidiary is established in a jurisdiction with a low corporate tax rate.[206]

Moreover, preventing taxpayers from benefiting from these arrangements would also reduce the benefit that jurisdictions receive from having preferential regimes or reduced overall rates. If CFC rules are effective at subjecting such subsidiaries to the parent jurisdiction's higher rate, then multinationals will have less of an incentive to establish subsidiaries in lower-tax jurisdictions, thereby undermining the benefit to these jurisdictions of having a low rate.

This lesson—that tax competition is often dependent on tax avoidance, and vice versa—can also be seen in the EU's ATAD, the U.K.'s DPT, the Australian MAAL, the U.S. special tax regime provision, and the U.S. minimum tax proposal. By requiring Member States to implement CFC rules and interest deductibility rules, the ATAD again limits the benefits of tax competition. Furthermore, as pointed out in earlier work by Mitchell Kane, many hybrid mismatch arrangements are made possible by the opportunism of individual governments, not the taxpayers themselves,[207] and eliminating such arrangements, as both the ATAD and Action 2 of the BEPS Report do, again makes it less beneficial for jurisdictions to keep their rates low. The DPT and MAAL are also premised on the idea that the jurisdiction to which a multinational diverts its profits has a lower rate than either the United

[205] BEPS Action Plan, note 109, at 8.

[206] This does not mean that all forms of tax avoidance are dependent on tax competition. Purely domestic tax avoidance, for example, is generally not dependent on tax competition because the benefits from wholly domestic transactions are unlikely to arise from low rates or other preferences provided by other jurisdictions. This lesson focuses instead on tax avoidance where part of the benefit arises from low rates, narrower base definitions, or other tax treatment provided by a jurisdiction that is on only one side of the transaction.

[207] See Kane, note 79, at 159-65.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

Kingdom or Australia. By subjecting taxpayers who engage in such diversion of income to either a significantly higher rate or increased penalties, both laws make it less appealing for countries to have low tax rates.

The recent U.S. anti-avoidance proposals also target taxpayers, but they identify the taxpayers to target by using different visions of tax competition. Under the special tax regime provision, a taxpayer benefiting from a preferential regime is engaging in tax avoidance. Under the minimum tax, in contrast, any taxpayer benefiting from an effective rate of less than 19% is engaging in tax avoidance. In other words, this proposal would target taxpayers based on the tax competition engaged in by the jurisdiction in which they earn income. Other examples of the interdependence of tax competition and tax avoidance include the rulings that were at the heart of both the Action 5 spontaneous exchange requirement and the Commission's recent state aid cases.[208] Although these rulings are provided to individual taxpayers and are essentially a stamp of approval for a taxpayer-designed arrangement, they only exist because a tax administration is willing to provide preferential treatment to certain taxpayers.

This lesson about the interdependence of tax avoidance and tax competition is important for at least three reasons. First, taxpayers are not the only parties involved in tax avoidance. Countries are also complicit in encouraging and allowing tax avoidance, and the value of many international tax avoidance arrangements depends on at least one country providing a system that effectively applies a low rate, either because the jurisdiction's overall statutory rate is low or because some other element in the tax system (for example, the definition of the base, the treatment of different entities, or individual rulings provided to taxpayers) leads to effective low taxation. Kane previously noted that tax arbitrage exists because of government opportunism,[209] and this Article argues that many other types of tax avoidance at the heart of recent anti-avoidance projects also exist because of government opportunism. Jurisdictional competition is what makes possible many existing tax avoidance strategies, and these strategies would be significantly less appealing if jurisdictions were not competing with each other.

Second, the symbiosis between tax avoidance and tax competition also shows that, just as taxpayers are not the only parties involved in tax avoidance, jurisdictions are also not the only parties involved in tax competition. Taxpayers are also encouraging and demanding tax competition. For example, taxpayer demands for rulings formed the

---

[208] See notes 111-14 and 124-31 and accompanying text.

[209] See Kane, note 79, at 116-65.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

basis of the state aid investigations.[210] More generally, multinational corporations have been the focus of many recent efforts to curtail both tax avoidance and tax competition. Previously, tax competition was presented as a competition between jurisdictions for investors (among other things), which meant that, while investors played a role in tax competition, they were not necessarily leading the charge. That has changed as multinational corporations play a larger role in the global economy, and as their business models become progressively more dependent on income and assets that are more responsive to taxation.

As discussed previously, the global landscape for foreign investment has changed from foreign direct investment to foreign portfolio investment, which in turn means that geographically mobile income is earned by nonresident taxpayers who can easily move it out of jurisdictions with high tax rates. At the same time, intangible assets, which are easier to shift between jurisdictions, make up an increasing proportion of business assets. As shown by some of the anti-avoidance and anti-tax-competition measures that have recently been implemented,[211] jurisdictions may consider tax competition to be harmful when some market producers are more able than others to demand lower rates or more favorable treatment than other market producers. Thus, harmful tax competition is now integrally tied to market competition, not because the two are directly analogous but because some jurisdictions believe that certain producers are able to influence tax competition and thereby also influence the competition between themselves and other, less powerful, competitors.[212]

This impact of multinationals on tax competition was manifest in the U.S. Treasury Department's White Paper that defends U.S. companies targeted by Commission state aid investigations.[213] The influence of multinational corporations was also evident as governments were unwilling to eliminate patent boxes entirely, despite economic

[210] See European Commission Press Release IP/15/5880, note 131 (reporting that tax rulings issued by Luxembourg and the Netherlands for taxpayers were the basis for state aid investigations launched by the European Commission in 2014); see also European Commission Press Release IP/17/3701, note 129 (explaining that a tax ruling issued by Luxembourg in favor of Amazon prompted the European Commission to launch a state aid investigation in 2014).

[211] See e.g., notes 182-84 and accompanying text (describing the MAAL); notes 178-81 and accompanying text (describing the DPT); notes 128-38 and accompanying text (describing the recent state aid investigations).

[212] See Vestager, note 2 (discussing the influence of Apple and other multinational corporations on the implementation of various countries' tax regimes).

[213] See Treasury Dep't, The European Commission's Recent State Aid Investigations of Transfer Pricing Rulings 1 (2016), https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/White-Paper-State-Aid.pdf.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

studies demonstrating that they are not economically efficient.[214] Thus, governments were acting on behalf of taxpayers benefiting from tax competition, either in other jurisdictions, as was the case with the White Paper, or in the jurisdictions that assisted the taxpayers, as was the case with patent boxes. Awareness of this interaction between multinationals and tax competition can also be seen in the MAAL's explicit focus on multinational corporations, as well as the DPT's implicit focus on the same taxpayers. Both Australia and the United Kingdom acknowledged in passing these rules that they were targeted directly at multinationals, which were creating a demand for lower tax rates and favorable regimes that in turn were viewed as harmful tax competition.[215]

Third, the interdependence of tax avoidance and tax competition suggests that many efforts to combat tax avoidance are in fact disguised efforts to fight tax competition. As the earlier sections of this Article highlighted, countries in the OECD and the EU were recently able to agree to an expanded view of harmful tax competition, but that view still ignored overall rates and focused only on certain types of income. By focusing on tax avoidance, however, and presenting multinational taxpayers as the target of their efforts, countries could indirectly adopt a broader vision of harmful tax competition, even going so far as to make overall rate differences less beneficial. Future reforms that focus on tax avoidance may be the most successful ways to combat tax competition, particularly given the EU's blacklist, which has received significant criticism and may be less effective than the other parts of the EU's anti-avoidance package.

Countries may already have learned this lesson about the interdependence of tax avoidance and tax competition. The U.S. special tax regimes provision, for example, borrows the concept of preferential regimes from the context of tax competition, but its response to these regimes is not to penalize the country with the regime but instead to deny treaty benefits to the taxpayer benefiting from the regime.[216] Both the MAAL and the DPT also penalize the taxpayer for engaging in tax avoidance and not the jurisdiction engaging in tax competition, even though the underlying issue that these rules target is at least in

[214] See Faulhaber, note 119, at 1651-52 (noting that countries continue to implement patent boxes despite studies suggesting that although they increase IP income, tax revenue in total is decreased).

[215] See DPT Guidance, note 178, at 3, 4, 5 (DPT1030); MAAL Guidance, note 182, at 7; N.Z. Inland Revenue Dep't, note 182, at 3-5; see also ATA Directive, note 172, at 3-4; Peston, note 179.

[216] Allison Christians & Alexander Ezenagu, Kill-Switches in the U.S. Model Tax Treaty, 41 Brook. J. Int'l L. 1043, 1052 (2016).

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

part competition from other jurisdictions.[217] Finally, the reason for much of the outrage about the Commission's recent state aid investigations was that the Commission penalized the taxpayers benefiting *from* the tax competition rather than the countries engaging *in* tax competition. These developments illustrate that countries (and supranational bodies) have realized that one of the more effective ways of addressing tax competition is to target the taxpayers that are benefiting from such competition through tax avoidance transactions.

### C. *Defensive Anti-Tax-Competition and Anti-Avoidance Measures as Offensive Tax Competition*

One further lesson from recent developments is that many countries are essentially using their anti-tax-competition and anti-avoidance measures as a different kind of offensive tax competition. Countries that face tax competition from other jurisdictions have two main options: to engage in competition themselves or to pass defensive measures against other jurisdictions. By limiting the ability of other jurisdictions to compete and shifting the locus of competition to an area in which they themselves are more likely to win, countries with anti-tax-competition measures are in fact using these measures as offensive tax competition measures. For example, by requiring that an IP regime only grant benefits when a taxpayer has undertaken the underlying R&D in the jurisdiction providing the regime, the nexus approach allows the OECD countries with stronger R&D environments to compete with other jurisdictions that do not have such environments. The requirement that previously hidden rulings be shared with other jurisdictions allows countries that do not have secrecy provisions or that do not give rulings to compete more effectively against those that previously did. The EU's recent proposals and investigations could, if they are implemented and upheld, allow the EU to compete more effectively against other jurisdictions outside the EU.

Recent anti-avoidance rules, such as the Australian MAAL and the U.K. DPT, are *also* effectively offensive tax competition measures. Although these rules were portrayed as targeting tax avoidance by multinationals, they are also being used by Australia and the United Kingdom to compete with other jurisdictions. Soon after the United Kingdom introduced the DPT, for example, Amazon announced that

---

[217] See, MAAL Guidance, note 182, at 9 (stating that MAAL penalties are imposed on significant global entities that enter into tax avoidance or profit-shifting schemes); DPT Guidance, note 178, at 5 (DPT 1000) (noting that "DPT is set at a higher rate than corporation tax to encourage those businesses with arrangements within the scope of DPT to change those arrangements and pay corporation tax on profits in line with economic activity").

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

it would start booking its online sales profits to the United Kingdom, rather than Luxembourg, where it had previously claimed to be earning its income for the past eleven years.[218] The DPT allowed the United Kingdom to undercut competition from Luxembourg, and Australia's similarly designed rule is likely intended to undercut competition as well.

Similarly, under the Obama Administration, when there seemed to be little chance of corporate tax reform, the United States' only significant deviation from the OECD consensus on tax competition was to propose a minimum tax, which shifted the acceptable competition away from rate.[219] The recent U.S. unilateral effort to curtail tax avoidance was also an effort to shift the competitive space in a direction that was more favorable to its own tax system. At the time, the United States had a top statutory corporate tax rate of 35%—and most observers thought that this was unlikely to change in the near future. As countries around the world dropped their corporate rates well below 35%,[220] the U.S.' response was to view competition just based on rate as harmful, thereby attempting to shift competition to any other area where the United States was more likely to be able to compete.[221]

But what about multilateral efforts sold as being targeted at tax avoidance? Were they also designed to be offensive tax competition and to shift the playing field for competition so that the countries involved could prevail? Some of them were, in the sense that they undermined rules that allowed certain countries to attract investors through differences in the tax base. Anti-avoidance rules produced by the BEPS Project eliminated the benefits of having rates significantly lower than the rates of the countries implementing the rules. The BEPS rules on CFCs, interest deductibility, and transfer pricing made low rates less beneficial to countries. They did not attempt to limit the ability of countries to implement such low rates, as anti-tax-competition measures would have, but they made such rates less likely to produce an advantage. The same was true of the CFC rule and interest deductibility rule in the EU's ATAD.

---

[218] Simon Bowers, Amazon to Begin Paying Corporation Tax on UK Retail Sales, The Guardian (May 22, 2015), https://www.theguardian.com/technology/2015/may/23/amazon-to-begin-paying-corporation-tax-on-uk-retail-sales.

[219] See note 189 and accompanying text.

[220] The drop in average statutory corporate income tax rates continued to drop from 2000 through 2015 to 25%. OECD, Tax Policy Reforms in the OECD 2016, at 39 (2016), https://read.oecd-ilibrary.org/taxation/tax-policy-reform-in-the-oecd-2016_9789264260399-en#page7.

[221] The United States then reduced its own corporate rate to 21% at the end of 2017, thereby entering into the rate competition. Tax Cuts and Jobs Act, Pub. L. 115-97, § 13001, ___ Stat. ___ (2017).

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

Consider the anti-hybrid rules from Action 2.[222] Hybrid mismatch arrangements were often the result of governmental opportunism.[223] Rules eliminating these mismatches therefore undermine this opportunism and eliminate the ability of the countries that benefitted from creating arbitrage opportunities to continue to do so.[224] In the ATAD, the anti-hybrid rule had the same effect.[225]

These recent anti-avoidance rules therefore shift the competition in several different directions. Some discourage rate competition, thereby moving the focus to jobs, infrastructure, or other resources on which higher rate countries can compete more easily. Those that reduce the benefits of differential rules, however, point in the opposite direction and support rate competition by making it easier for countries to compete directly on the statutory corporate rate rather than on base-narrowing measures that differ across countries. Still other anti-avoidance rules, such as the ATAD's exit tax and general anti-avoidance rule, were not favoring any certain type of jurisdiction and were instead focused on making expatriation of a company or avoidance in general more costly, regardless of the corporate tax rate or system of the country involved.

To summarize, all the recent anti-tax-competition measures and unilateral anti-avoidance rules outlined in this Article act as forms of offensive tax competition. They do not just eliminate options for competition—they also open up new areas for competition, and these areas are ones in which the countries implementing the anti-tax-competition measures or anti-avoidance rules are more proficient.

The nexus approach, for example, shifts competition from rates to jobs. A minimum tax shifts competition from effective rates to anything else, including infrastructure, rate of return, legal protection, or other elements on which an investor might base its investment decisions. A common base shifts competition away from base-definition and toward statutory rates. A state aid prohibition that eliminates all differences favors countries with low statutory corporate rates and no preferential regimes over those with high statutory corporate rates and preferential regimes, but it also has the long-term effect of mak-

[222] See note 161.

[223] See Kane, note 79, at 94-95, 159-65 (noting that an underlying reason for international tax arbitrage is governmental opportunism arising from conflicting policy considerations and the conflicting U.S. policies on hybrid entities).

[224] Other examples include Action 6 (limiting the ability of jurisdictions to attract investors by allowing them to benefit from treaties without being subject to tax); Action 7 (limiting the ability of jurisdictions to attract investors by allowing them to escape taxation under treaties); and Action 12 (limiting the ability of jurisdictions to attract investors by not requiring them to provide information about possibly abusive transactions). See OECD, note 167.

[225] See note 175 and accompanying text.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

ing the entire EU a low-rate entity that can compete with third countries on both rate and other bases.

Recent developments in the fight against tax competition therefore have revealed at least three fundamental lessons. First, because there is no accepted definition of harmful tax competition, countries generally define this term not to eliminate tax competition completely but instead to disallow only those types of competition where they believe they could not prevail. Rather than leveling the playing field entirely, they use anti-tax-competition measures to shift the playing field to locations where they believe they can prevail. Second, international tax competition and international tax avoidance depend on each other. Eliminating international tax competition entirely would make it harder for taxpayers to benefit from international tax avoidance, while eliminating international tax avoidance would make international tax competition less attractive to jurisdictions. Third, many countries are therefore using both their anti-tax-competition and their anti-avoidance measures to engage in offensive tax competition themselves.

It should be noted that these lessons do not necessarily mean that policymakers are acting maliciously or hypocritically when they implement measures to combat tax competition and tax avoidance. As pointed out in Part II, there is no agreement regarding what type of tax competition is harmful. In the absence of any neutral view of what constitutes harmful tax competition, countries naturally will revert to their own view, and they will perceive any regime or tax system that appears to be attracting resource flows or spillovers that they believe should be their own as competing unfairly. In other words, without any neutral definition, tax competition is in the eye of the beholder, and each country is going to behold harmfulness in any situation where it believes itself to be losing ground against other countries.[226]

### D. *What Should Be Done?*

Ideally, academics and policymakers would avoid the term "harmful tax competition" whenever possible and instead explicitly define what they believe countries to be competing over and what tools they believe countries to be using to engage in this competition. As shown in Part II, there is no agreement in the academic literature about what harmful tax competition means. As then shown in Parts III and IV, there is also no agreement among countries and policymakers about

---

[226] This is, of course, also not saying that some countries are not acting hypocritically when they curtail harmful tax competition. If some countries are doing so, however, it would be consistent with the vision of sovereignty arguments as organized hypocrisy. See Krasner, note 39, at 220.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

what the term means. Although there was a short-lived consensus that harmful tax competition at least included preferential regimes that granted lower rates to geographically mobile income if those regimes were either secret or not open to domestic taxpayers, there was still no agreement over what else this term included, and the international community soon decided that this definition was too narrow. More recently, countries and international organizations have broadened their definitions of what constitutes harmful tax competition, but they still do not agree on what this term encompasses. Some think that any variation within a domestic tax system is harmful;[227] some think that any variation between tax systems is harmful;[228] some think that overall low rates are harmful;[229] some think that rates on their own are not harmful but that low rates applied to income from activities outside the jurisdiction are harmful;[230] and some think that secrecy and discretion on the part of tax administrations are harmful.[231]

The fact that countries and organizations use measures to combat tax competition as a way for them to compete more effectively explains why there is no agreement on what constitutes harmful tax competition. The term harmful tax competition cannot be defined because the term has no intrinsic meaning. Essentially, harmful tax competition is whatever a country wants to prevent in order to make itself more competitive, and using the term harmful tax competition allows politicians, policymakers, and academics to mask their normative preferences.

The problems with using the term harmful tax competition can be seen in the debate over patent boxes. Taxpayers and jurisdictions that had acquainted themselves with the work of the FHTP from the late 1990's understood the term to mean competition for the headquarters of companies that invested in geographically mobile passive assets and therefore saw patent boxes as not being harmful. And yet, with the BEPS Project, the term had evolved with the nexus approach to mean competition for income separate from activities, regardless of where a company was headquartered, which in turn meant that many patent boxes that would have complied with the term in the 1990's would now be considered harmful. The meaning of the term changed as cer-

[227] See note 204 and accompanying text (setting out harmful tax competition as envisioned by recent state aid investigations).

[228] See notes 204-05 and accompanying text (setting out harmful tax competition as envisioned by proposals for a CCTB and CCCTB).

[229] See notes 207-08 and accompanying text (setting out harmful tax competition as envisioned by the U.S. minimum tax proposals).

[230] See notes 185-88 and accompanying text (setting out harmful tax competition as envisioned by the U.S. special tax regimes provision).

[231] See notes 203-04 and accompanying text (setting out harmful tax competition as envisioned by the Action 5 spontaneous exchange of rulings requirement).

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

tain countries came to see it as permitting other countries to attract revenue away from them.

Therefore, ideally, instead of using the term harmful tax competition, policymakers and others should focus on what the competition is actually for. Eliminating the use of the term would also force politicians and policymakers to be more explicit about what they think other countries are doing wrong and how they believe their countries are more competitive, which in turn could make debates over measures more open and could possibly lead to more well-designed rules. Currently, politicians make vague references to level playing fields, fairness, and competition, which allow them to mask their actual concerns. Again in the context of patent boxes, if the debate were explicitly focused on the fact that high-tax jurisdictions believe that they can attract R&D with their infrastructure, education, and environment for jobs but that they cannot attract R&D with just their tax rates, that could lead to more awareness on the part of taxpayers of why rates in that jurisdiction may be higher than in the jurisdictions offering only low or no rates and no infrastructure.

It is unlikely, however, that policymakers will stop referring to harmful tax competition, given that its vagueness and lack of definition are exactly what makes the term so appealing. As an alternative, this Article proposes a typology of harmful tax competition, pursuant to which academics, policymakers, and politicians can continue to use the term while also being more explicit about their concerns. This typology focuses on two elements of harmful tax competition: which tools jurisdictions are using to compete and what jurisdictions are attempting to attract. In terms of tools, are they competing by providing lower statutory rates, an overall narrower base, a selectively narrower base, a more favorable legal environment, greater secrecy, a more favorable employment environment, or something else? A tools typology could divide tax competition into (1) statutory rate competition, (2) preferential rate competition, (3) base competition, (4) secrecy competition, (5) legal competition, and (6) employment competition.

Statutory rate competition would be competition based on statutory rates. Preferential rate competition would be competition based on rates provided to preferential regimes. Base competition would be competition based on how the tax base is defined, which in turn has the effect of reducing the effective rate well below the statutory rate. Secrecy competition would be competition based on lack of transparency, information sharing, or, in the words of the Commission good tax governance. Legal competition would be competition based on the legal protections provided in the jurisdiction. Employment

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

competition would be competition based on the employment environment in the jurisdiction. Other similar types of competition that focus on the type of tool used by jurisdictions also could be defined.

An attraction typology could focus on what a jurisdiction is using its tax system to attract. In other words, it could focus on what jurisdictions are competing *for*. Such a typology could divide tax competition into at least four separate categories: (1) activity competition, (2) headquarters competition, (3) legal ownership competition, and (4) revenue competition.

Activity competition would be competition for foreign direct investment in the form of greater employment or similar activities in the jurisdiction providing the measure. Headquarters competition would be competition for companies to locate their headquarters in a jurisdiction, even if they did not also move a significant number of jobs and infrastructure with the headquarters. Legal ownership competition would be competition for portfolio investment in the jurisdiction providing the measure, based on legal ownership of passive or geographically mobile assets. Revenue competition would be competition for tax revenues regardless of the degree of foreign direct investment, portfolio investment, or headquarters in the jurisdiction.

Having both a tools typology and an attraction typology highlights that different anti-tax-competition measures consider different aspects of tax competition harmful. Some such measures are focused just on the tools being used to compete, such as rates and secrecy. Others focus less on the tools being used to compete and focus more on what other jurisdictions are trying to attract, regardless of how they are doing it.

Table 1 below applies these typologies to the developments discussed in Part III. The table applies either the tools typology or the attraction typology to each recent development. If the attraction typology provides information on both what type of tax competition is being prevented and what type of tax competition is allowed to continue, then the table uses that typology. If, however, the attraction typology would merely conclude that the anti-tax-competition measure is trying to prevent all types of tax competition, then that outcome suggests that the anti-tax-competition measure is focused less on preventing competition that attracts certain types of resource flows and is instead focused on preventing competition that uses specific types of tools to attract all resource flows. In such cases, the table applies the tools typology.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

TABLE 1
TYPOLOGY OF TAX COMPETITION

| | *What type of tax competition is this anti-tax-competition measure trying to prevent?* | *What type of tax competition does this anti-tax-competition measure allow to continue?* |
|---|---|---|
| Nexus approach | Revenue competition<br>Headquarters competition<br>Legal ownership competition | Activity competition |
| State aid prohibition | Between EU Member States:<br>Revenue competition<br>Headquarters competition<br>Legal ownership competition<br>Activity competition<br><br>Between the EU and other jurisdictions:<br>None | Between EU Member States:<br>None<br><br>Between the EU and other jurisdictions:<br>Revenue competition<br>Headquarters competition<br>Legal ownership competition<br>Activity competition |
| Spontaneous exchange of rulings | Secrecy competition | Statutory rate competition<br>Preferential rate competition<br>Base competition<br>Legal competition<br>Employment competition |
| CCCTB and CCTB | Between EU Member States:<br>Base competition<br><br>Between the EU and other jurisdictions:<br>None | Between EU Member States:<br>Statutory rate competition<br>Preferential rate competition<br>Secrecy competition<br>Legal competition<br>Employment competition<br><br>Between the EU and other jurisdictions:<br>Statutory rate competition<br>Preferential rate competition<br>Base competition<br>Secrecy competition<br>Legal competition<br>Employment competition |
| List of noncooperative jurisdictions | For countries other than EU Member States:<br>Statutory rate competition<br>Preferential rate competition<br>Secrecy competition<br><br>For EU Member States:<br>None | For countries other than EU Member States:<br>Base competition<br>Legal competition<br>Employment competition<br><br>For EU Member States:<br>Statutory rate competition<br>Preferential rate competition<br>Base competition<br>Secrecy competition<br>Legal competition<br>Employment competition |

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

As shown by Table 1, the value of having a typology of tax competition is less about identifying what type of tax competition another jurisdiction is engaged in and more about identifying what type of tax competition is still allowed after the application of anti-tax-competition measures. Table 1 highlights that the measures described in Part III are in fact examples of offensive tax competition in that they allow the types of competition in which jurisdictions believe themselves to be most likely to prevail. Table 1 also highlights the numerous types of competition that can be identified under the typology proposed in this Part, which supports this Article's broader argument about the many different meanings that are disguised by the use of the general term harmful tax competition.

Along with proposing the above typology, this Article also argues that discussions of tax competition should be more explicit about the interdependence of tax avoidance and tax competition. Currently, discussions of international tax avoidance and international tax competition seesaw between enemies: Either countries are behaving badly and engaging in harmful tax competition, which is stealing revenue, jobs, and other resources from innocent other countries,[232] or multinationals are behaving badly and engaging in tax avoidance, which is stealing revenue from those same innocent countries whose rules are being interpreted aggressively.[233] In reality, as the recent measures to combat both tax competition and tax avoidance show, all countries are engaged in tax competition to a certain degree, and the rules that they design to curtail the harmful behavior of other countries and taxpayers often contribute to this competition. Furthermore, international tax avoidance relies on international tax competition, and international tax competition benefits countries because of international tax avoidance.

Therefore, the popular stories about taxpayers stealing resources from innocent countries ignore the actual interactions between the countries and taxpayers involved. Focusing on the interaction between tax avoidance and tax competition therefore would force efforts to curtail either of these to acknowledge that even non-tax-haven countries often encourage tax avoidance and that taxpayers (particularly multinational corporations that can more easily shift investments) often encourage tax competition.

This acknowledgment would also shift discussions of tax competition toward considering whether there is a different link between mar-

[232] See, e.g., Marian, note 113, at 1 (outlining the privately negotiated advance tax agreements granted by Luxembourg's tax authorities who "rubber-stamped tax-avoidance to an industrial scale" thereby permitting the channeling of "hundreds of billions of dollars through Luxembourg [and saving] billions of dollars in taxes").

[233] See, e.g., Duhigg & Kocieniewski, note 105.

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

ket competition and tax competition than is traditionally acknowledged. As discussed in Part II, the analogy between market competition and tax competition has historically been at the root of the troubles with the term "tax competition" and has explained why debates over international tax competition cannot come to any agreement. Yet, as shown by the recent state aid investigations and unilateral anti-avoidance rules that targeted multinational corporations, at least some jurisdictions believe that tax competition and market competition have become more intertwined.

Under the view of harmful tax competition represented by these recent developments, taxpayers, in the form of large multinational corporations, now have the market power to demand rate reductions, tax rulings, or the like from jurisdictions, which means that they are spurring on tax competition in order to distort the market in which they compete.[234] If this is the case, then tax competition is not, as those who extrapolate from the Tiebout model to argue in favor of unfettered international tax competition would claim, just another version of market competition. Instead, in certain circumstances, international tax competition may be distorting market competition if it is taking place in the form of rulings or preferential regimes that allow certain taxpayers to shift the playing field in their favor *against* their market competitors. This in turn would mean that neoclassical models of market competition would argue in favor of curtailing it in some way. Whether this is in fact the case or how to identify and curtail the types of international tax competition that are distorting market competition are questions that would need to be answered. The first step toward asking these questions, however, is moving the debate over tax competition away from jurisdictions and toward taxpayers and acknowledging the interdependence of tax avoidance and tax competition.

To summarize, debates over harmful tax competition should be reframed with a typology of tax competition and by considering tax avoidance and tax competition together. Although these proposals at first may seem to be merely changes in rhetoric, they are the necessary initial steps to address a problem that itself at first seems to be merely a rhetorical issue. As this Article has argued, the term harmful tax competition masks both what policymakers and politicians are doing with their international tax systems and the role that taxpayers play in encouraging and supporting these activities. Furthermore, since there

[234] This insight fits into a general trend toward considering how different international tax policies affect different types of taxpayers, including multinational corporations. See, e.g., Daniel N. Shaviro, Fixing U.S. International Taxation 36-39 (2014) (explaining how various tax policies viewed under simple source-based taxation rules affect different taxpayers including MNEs).

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

is no agreed definition of this term, academics are often speaking at cross purposes when they use the term in different contexts.

By replacing these terms with more definite terms that focus on which tools are being used and what jurisdictions are attempting to attract and by shifting the focus of future discussions about tax competition to consider the interdependence of tax competition and tax avoidance, policymakers, academics, and politicians would set the stage for greater understanding of what jurisdictions are in fact using their anti-tax-competition measures to achieve. This greater understanding will then allow jurisdictions, international organizations, academics, and domestic policymakers to take further steps, which could involve defining the baseline against which harmful tax competition can be determined, agreeing to international rules that focus on multinational taxpayers,[235] or otherwise responding to an improved understanding and definition of tax competition.

[235] Note that some commentators question whether multinationals in fact hold significant political power in the tax context. See id. at 110 (challenging the view of multinationals as powerful political actors given their inability to convince the United States to shift to an exemption system).

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law

Electronic copy available at: https://ssrn.com/abstract=2912477
Imaged with the permission of Tax Law Review of New York University School of Law