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Tax Cooperation in an Unjust World, by Allison Christians and Laurens van Apeldoorn, (Oxford University Press, 2021), 208pp., £80, ISBN: 978-0-19-284867-3.

The intense negotiations to reform the international tax system have sparked controversies in political, academic and business circles. Some praise the merits of what can be perceived as a long-needed update of century-old international tax rules, while others show concern for its practical implications. What policy debates often omit, however, is a frank discussion about the fairness of the distributional consequences of the proposed changes. Given the potentially high stakes for most stakeholders in a world of great economic and social disparities, the consideration of the moral principles that should underlie any reform is critical. But how do we convince different stakeholders that we need a fairer international tax system? And for that matter, what does a fairer international tax system look like? Allison Christians and Laurens van Apeldoorn's short but powerful book, *Tax Cooperation in an Unjust World*, provides some helpful answers.

The fundamental question about international justice is what moral duties of justice, if any, exist beyond a state's borders. Some will argue that political or national affiliations are inconsequential for determining the scope of distributive justice. Such theorists, often referred to as cosmopolitans, typically hold that all human beings are entitled to equal consideration regardless of their political or national connections, and as such, duties of justice extend beyond the borders of a state. On the other end of the spectrum lie those who argue that egalitarian distributive obligations only take place between co-citizens. These theorists, commonly called statists (Christians and van Apeldoorn prefer the term "society-of-states model of international justice" to what I will refer as statism), submit that duties of distributive justice only exist within a nation or a state.

Most cosmopolitans would likely support the need for reforming the international tax system to reduce global poverty and inequality. Many statists, however, would find it difficult to concur that distributive justice considerations should have any sway in how to design international tax rules. Persuading the latter is the main goal of the book, which in my view is likely to succeed brilliantly. Christians and van Apeldoorn build their case carefully, taking the reader on an insightful analysis that considers at each step the different rationales, potential objections, and possible responses. They provide, layer by layer, straightforward and compelling arguments that should convince most scholars and policymakers with a large spectrum of views about international justice.

The book starts by establishing the two basic normative principles that should guide international tax policy, namely the entitlement principle and the equal benefit principle. On their face, these principles are not much of a departure from what most policymakers and tax experts would likely endorse. Briefly stated, they hold that each country is entitled to the wealth

produced in its territory (the entitlement principle), and whenever a given wealth results from the cooperation between two or more countries, each cooperating country should equally share in the ensuing benefit (the equal benefit principle). The most foundational concepts in international tax law, such as residence and source, and more sophisticated developments, such as the arm's length principle and transfer pricing methods, can all be said to build on the notions articulated by the entitlement and the equal benefit principles. Still, as the book reveals in later chapters, a more profound understanding of these two seemingly elementary principles suggests that the existing international tax system fails to fully implement them.

One of the main challenges in applying the equal benefit principle in practice is estimating the benefits resulting from cooperation (or, as the authors call it, the "cooperative surplus"). As the Musgraves long established in their seminal essay,[1] when foreign capital is invested in a state, some benefits will normally accrue to both the residence and the source countries. Whereas the residence state will benefit from the additional wealth resulting from the international capital mobility, the source state will often benefit from increased wages, technology transfer, and additional tax revenues. One crucial point of Christians and van Apeldoorn's argument is that among the aforementioned benefits to the source country, additional tax revenue is one of the most significant direct gains. As a result, in the absence of taxation at source, the residence state will receive a disproportionate share of the cooperative surplus arising from international investment. Source-based taxation is thus warranted as a corollary of the equal benefit principle:

> "A tax on income at source allows the state to enjoy the returns to which it is entitled, by receiving an approximately equal share in the surplus of productive gains created by international cooperation, that is, as we have defined it, the cooperative surplus."[2]

The fundamental problem in the current international tax system resides in this finding: several challenges prevent source states from taxing to the fullest extent all returns from investments in their jurisdictions. Christians and van Apeldoorn identify two main factors deterring source countries. The first, they submit, is tax competition. But here they steer away from the traditional, often poor narrative that sees tax competition as the sheer result of nefarious practices of "tax havens". They instead provide a more comprehensive examination of the effects of developed countries' policies on the developing world. Policy choices made by residence, capital-exporting states (often higher-income economies) potentially impact the range of choices available to prospective source, capital-importing states (often lower-income economies). The trend of capital-exporting countries to tax foreign income on a territorial rather than a worldwide basis is one of the major factors that leaves many lower-income countries with no choice but to reduce taxation at source to attract foreign investments:

> "If the major capital-exporting or residence states were to choose credit systems and tax any residual profits earned abroad, then firms' location decisions would be less sensitive to tax at source, at least so long as the source tax does not exceed the creditable amount. Conversely if residence states choose exemption systems, the possibility of residual taxes

[1] Richard Musgrave and Penny Musgrave, "Inter-nation Equity" in Richard Bird and John Head (eds), *Modern Fiscal: Issues Essays in Honour of Carl S. Shoup* (Toronto: Toronto University Press, 1972).
[2] Allison Christians and Laurens van Apeldoorn, *Tax Cooperation in an Unjust World* (Oxford: Oxford University Press, 2021), p.33.

> falls away and firms' location decisions will become much more sensitive to tax at source. In the latter case, firms will typically use all available means to reduce taxes at source, whether by engaging in direct negotiation with potential host governments to achieve individualized tax reductions, lobbying for more general tax reductions, or through tax avoidance. When residence states adopt territorial tax systems by exempting (or permitting indefinite deferral of taxation on) foreign income, they therefore create pressure on source states to compete for investment by also reducing taxes on income earned by foreign residents. … Accordingly, whether source states choose to tax depends in large part on the overall trend toward territoriality versus toward worldwide taxation within influential capital-exporting states."[3]

The second major impediment for lower-income states to tax at source is documented to some extent in the literature but is often neglected in policy discussions. Peer-pressure and soft law compel capital-importing countries to cede their taxing rights by accepting treaty terms that limit their withholding rates on portfolio investment returns and their tax bases through permanent establishment requirements. The result is that the global decline of corporate taxation produces different effects for developed and developing countries. The impact of corporate tax rate reductions has been limited in higher-income economies, given the lower relevance of corporate taxation as a share of their gross domestic product and the ability of these countries to broaden their tax bases and shift their tax mix to other factors such as labour and consumption. Conversely, lower-income countries rely more heavily on corporate taxation and are thus unable to equally compensate for the reduction in corporate tax rates.

Improving source-based taxation to give way to a more equitable division of the cooperative surplus from international trade between developing and developed countries requires two main changes. First, the world's largest residence states need to shift toward worldwide taxation and away from territorial taxation—the authors see momentum in this direction with the movement towards a globally agreed minimum tax rate. Secondly, the OECD tax treaty model requires revision with respect to the current limitations on rates (withholding tax rates) and bases (permanent establishment requirements) at source.

According to Christians and van Apeldoorn, these changes are demands resulting directly from the two basic principles (equal benefit and entitlement principles) in a theoretical scenario where all cooperating countries had the minimum resources required to fulfill their populations' basic needs (this theoretical realm is what the authors consider a "just world"). But what would these principles require in the real world, where extreme poverty persists (the "unjust world" that gives title to the book)? These requirements are the focus of Chapters 3 to 6 of the book. The authors work with different proposals depending on what commitments to some form of international justice the reader will endorse.

Most skeptics who reject the existence of a duty of justice at the international level concede that there is at least an international duty to assist foreign peoples suffering from subsistence rights deficits (these include authors closer to statism such as John Rawls, David Miller, Michael Blake, and even Thomas Nagel). The right to subsistence is a moral requirement but also a legal right established in the Universal Declaration of Human Rights. It entitles every human being

[3] Christians and van Apeldoorn, *Tax Cooperation in an Unjust World* (2021), p.44.

to the fulfilment of basic needs such as food, water, clean air, basic healthcare, shelter, clothing, physical security, and the opportunity to a living wage that allows the maintenance of a minimally decent life. Here the authors put forward a powerful argument: if one acknowledges that the duty of assistance is a duty of justice, one should concede that such a duty is logically prior to the distribution of holdings among states. As they argue,

> "it is not the case that each state is unconditionally entitled to the wealth of its territory. Instead, other states may have a greater moral claim to some of this wealth".[4]

A wealthy state that is required to provide assistance to foreign peoples suffering from subsistence rights deficits lacks an entitlement to the resources it is required to transfer.

Christians and van Apeldoorn argue that the persistence of widespread subsistence rights deficits across the globe is evidence that today's most affluent states, the primary holders of the duty of assistance, have failed their duty. This implicates the implementation of the entitlement principle: "[H]aving failed to fulfil their duty of assistance, states lack an unqualified right to the wealth in their territory. This, in turn, impacts what counts as fair cooperation."[5] The corollary is that today's higher-income countries should relinquish claims of entitlement by making room for source-based taxation by lower-income countries. (This is admittedly a strong statement, and the authors acknowledge that it may make some uneasy. For those who would refuse to assign such strength to the duty of assistance, the authors provide an alternative analysis in later chapters. I will discuss them in more detail below).

Two main approaches, to be pursued together, would satisfy higher-income countries' duty of assistance. The first requires capital-exporting states to expand their pass-through regimes. Such a policy would create a minimum level of corporate taxation serving as a backstop to discourage some forms of tax competition that currently prevent source states from exercising their tax entitlements. The second step requires higher-income countries to facilitate greater source-based taxation by accepting new forms of withholding taxes by capital-importing states. This policy would require capital-exporting countries to make those taxes compatible with their foreign tax credit systems so as to accommodate source countries' withholding taxation. The combination of these two policy approaches would allow source states to increase the rates of their existing withholding taxes and create additional forms of withholding taxation on other streams of income.

As I mentioned above, some might disagree that a duty of assistance should take logical priority over capital-exporting countries' entitlements, in which case the entitlement principle would not be conditioned on the fulfillment of lower-income countries' right to subsistence. This stronger statist position (some, such as Michael Blake, might call it "radical right institutionalism") would disavow conditioning capital-exporting states' taxing rights to their adoption of the policies described in the last paragraph. For those who take this stance, Christians and van Apeldoorn dedicate Chapters 5 and 6 to argue that even in the absence of a duty of assistance, a reform of the international tax system is still warranted to correct distortions that limit source-based taxation. In their view, the way the equal benefit and entitlement principles

[4] Christians and van Apeldoorn, *Tax Cooperation in an Unjust World* (2021), p.87.
[5] Christians and van Apeldoorn, *Tax Cooperation in an Unjust World* (2021), p.85.

are implemented today fails to account for the role of subsistence rights deficits in the division of benefits and burdens arising from international cooperation.

In a cooperative scheme, the subsistence rights deficits suffered by some states produce benefits to other states in the form of higher returns than they would have in the absence of such deficits. The authors provide two examples where international investment either causes or contributes to the production or perpetuation of subsistence rights deficits. Cross-border investment *causes* rights deficits when a foreign-owned company directly or indirectly employs workers in hazardous conditions, exposing them to potential occupational illness or death. Cross-border investment *contributes* to perpetuating rights deficits when a foreign-owned company pays its workers less than a living wage, preventing them from maintaining a minimally decent life. In these examples, the authors do not attribute sole responsibility for these deficits to the foreign-owned company or its state of residence. These deficits can in some cases result from a failure of the source state to adequately regulate working conditions in its territory. Nonetheless, the authors argue, the lack of more stringent regulation is not an independent political choice. Embedded in the cooperative scheme, it is a conscious choice by source states, which are left to choose between imposing stricter policies and foregoing the benefits of international investment or adopting laxer rules to remain competitive.

These foreign investments that contribute to perpetuating rights deficits for lower-income, capital-importing countries produce relevant global consequences. By reducing the costs to operate in the source country, they allow foreign investors to benefit from cheaper inputs and processes. Because these deficits are caused by or directly relate to foreign investments, they should be factored into the calculation of benefits and burdens of cooperation. Similar to other gains and costs that generally result from international cooperation (such as consumer market for the residence country and technology spillover for the source country), these rights deficits generate gains for the residence country (cost savings) at the expense of negative externalities afflicting the source country (for instance, hazardous labour). The consequence is that an accurate computation of tax entitlements should take these costs into account:

> "The logic is simple: an eliminated cost translates to more potential for gain. Of course, it is true that firms may not capture all of the gain—some might accrue to consumers in the form of reduced prices, while others might accrue to other members of society as positive spillovers. But as a rule of thumb, cutting costs is a common and uncontroversial profit-maximizing strategy."[6]

The implication is that international tax rules should incorporate these cost savings in the allocation of taxing rights. Christians and van Apeldoorn consider two main approaches for reassigning profits associated with subsistence rights deficits, which to some extent have already begun to be advanced by some countries. The first is to allow capital-importing states to raise withholding taxes on certain income flows that somewhat reflect the cost savings derived from subsistence rights deficits, namely withholding taxation of technical services fees (as added in Article 12A of the UN Model Tax Convention in 2017 for example) and withholding taxation

[6] Christians and van Apeldoorn, *Tax Cooperation in an Unjust World* (2021), p.134.

of digital advertising fees (in the form approved as Article 12B in 2021). This is how they justify these withholding taxes:

> "The principle of equal benefit provides a rationale for the UN's approach. In the case of firms that do not have a local presence in the form of business operations or a labour force, the possibility that investors might be profiting directly by underpaying workers or offloading pollution costs to communities is absent. Yet, just as in any other cross-border investment, involving a jurisdiction that suffers subsistence rights deficits, providers of digital and technical services derive profit by accessing a market that is impacted by such deficits on a grand scale. If they do not benefit directly by offloading those costs, they benefit indirectly by transacting with others that benefit from the kinds of costs savings described in Chapter 5. As such, withholding taxes on these fees might be necessary to ensure that residence states do not benefit from ongoing subsistence rights deficits in the source state."[7]

The second approach they put forward has its origins in China and India and is already gaining ground in the international tax system. It consists of incorporating cost savings resulting from subsistence rights deficits as a price or premium transfer pricing adjustment. One way to compute location savings would be to calculate them as an aggregate, single intangible to which profit would be attributed. They suggest that an aggregate location savings factor could be derived from the ongoing research on the costs to attain the sustainable development goals. The simplest approach, they argue, would be to use a flat rate, calculated on the basis of countries' annual development needs in relation to their annual GDPs. An alternative approach would be to compute location savings as a price adjustment on an item-by-item basis by measuring individual costs associated with each transaction. It would likely be more accurate but significantly more complex. This method would internalise cost savings based on independent economic analysis for each relevant factor similar to standard supply chain analysis for other kinds of costs. This approach, commonly referred to as "location specific advantage", would track the existing OECD and UN transfer pricing guidelines.

These discussions raise other fundamental issues. For instance, some may agree with the duty of assisting states lacking the economic capacity to address subsistence rights deficits (John Rawls calls them "burdened societies"),[8] but should the same apply to states that possess such capacity but fail to do so due to a negligent government (Christians and van Apeldoorn call them "negligent states")?[9] Assuming that the duty of assistance is warranted, should the problem not be addressed through technical and institutional assistance instead of an increase in taxing rights? Also, would giving these countries greater taxing rights not risk simply putting resources into the hands of negligent governments that perpetuate harm instead of effectively alleviating the conditions of those in need? And if the goal is to provide burdened societies with resources, why not simply use direct cash transfer instead of compounding the complexity of existing international tax rules? The book provides insightful responses to these and other relevant questions.

[7] Christians and van Apeldoorn, *Tax Cooperation in an Unjust World* (2021), p.152.
[8] John Rawls, *The Law of Peoples: With the Idea of Public Reason Revisited* (Cambridge, Massachusetts: Harvard University Press, 1999), p.106.
[9] Christians and van Apeldoorn, *Tax Cooperation in an Unjust World* (2021), p.119.

This much needed book provides a fresh look at how to improve the international tax system to ensure fair cooperation. What this review cannot capture—but readers will immediately observe as they go through the book—is how the authors carefully craft each argument, addressing at each step any potential criticism and discussing alternative solutions. Each of their proposals involves practical considerations supported by theoretical justifications in a manner which is readable enough to policymakers and sufficiently profound to spark and satisfy academic curiosity.

Ivan Ozai[*]

[*] Assistant Professor of Law, Osgoode Hall Law School, York University.