

THE RISE OF THE OECD AS INFORMAL 'WORLD TAX ORGANIZATION' THROUGH NATIONAL RESPONSES TO E-COMMERCE TAX CHALLENGES

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ABSTRACT

This paper assesses national and international responses to tax challenges presented by cross-border electronic commerce. Ten years after these challenges were first identified, a survey of national government reactions shows that many countries have not passed any significant tax legislation or administrative guidance with respect to the taxation of global e-commerce. This lack of action at the national level can be explained in large part by the leadership role taken by the Organization for Economic Cooperation and Development (OECD) in developing the guiding principles and, subsequently, the tax rules to confront the e-commerce tax challenges. The OECD's general success with e-commerce tax reform demonstrates the OECD's ability to act as a kind of informal (lower case) world tax organization, which emphasizes deliberation, consensus-building and the use of non-binding mechanisms such as the OECD model tax treaty. Moreover, the OECD's success suggests that calls for a more formal (upper-case) World Tax Organization, which could impose binding tax rules on participating nations, may be misplaced.

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INTRODUCTION

Beginning with a 1996 U.S. Treasury Department discussion paper, national tax authorities issued reports that queried whether international e-commerce developments would lead to revenue losses or other adverse outcomes such as an increased use of tax havens for tax evasion or tax avoidance purposes.¹ Tax observers similarly scrutinized whether traditional tax laws and principles would need to be reformed to take into account the new commercial environment.² All of the sound and fury, however, has led to very little action at the national level.³

This paper surveys steps taken by governments to address these challenges and shows that, as of December 2005, many governments have not yet passed any significant laws or administrative guidance with respect

¹ See OFFICE OF TAX POLICY, U.S. DEPT. OF THE TREASURY, SELECTED TAX POLICY IMPLICATIONS OF GLOBAL ELECTRONIC COMMERCE ¶ 7.2.3.1 (1996) [hereinafter Treasury Report] (discussing the difficulties in taxing commercial activity that takes place on the Internet); see also AUSTRALIAN TAX OFFICE, TAX AND THE INTERNET: DISCUSSION REPORT OF THE AUSTRALIAN TAX OFFICE ELECTRONIC COMMERCE PROJECT (Aug. 1997); MINISTER'S ADVISORY COMMITTEE ON ELECTRONIC COMMERCE, ELECTRONIC COMMERCE AND CANADA'S TAX ADMINISTRATION ¶ 2.4.3.3. (April 1998); INLAND REVENUE AND HM CUSTOMS AND EXCISE, ELECTRONIC COMMERCE: UK TAXATION POLICY ¶ 10 (Oct. 1998). See generally Arthur J. Cockfield, *Balancing National Interests in the Taxation of Electronic Commerce Business Profits*, 74 TUL. L. REV. 133, 167-212 (1999) (discussing policy challenges described within government reports along with reform options).

² See, e.g., David R. Tillinghast, *The Impact of the Internet on the Taxation of International Transactions*, 50 BULL. FOR INT'L FISCAL DOC. 524, 525 (1996) (warning that e-commerce developments could lead to tax revenue losses for developing countries); Charles E. McLure Jr., *Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws*, 52 TAX L. REV. 269, 313 (1997) (noting the need for radical reform in some circumstances); Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 TAX L. REV. 507, 532-541 (1997) (proposing a refundable withholding tax for certain e-commerce transactions); Richard L. Doernberg, *Electronic Commerce and International Tax Sharing*, 16 TAX NOTES INT'L 1013 (1998) (discussing reform alternatives in light of e-commerce challenges). The literature on international e-commerce taxation is now extensive and this article does not purport to offer a comprehensive examination of these writings.

³ Earlier discussions similarly found few legal changes in response to international e-commerce challenges. A recent review of four countries—Canada, the United States, Japan, Hong Kong and China—did not reveal any new laws or administrative guidance that resulted from e-commerce taxation concerns. See JINYAN LI, INTERNATIONAL TAXATION IN THE AGE OF ELECTRONIC COMMERCE: A COMPARATIVE STUDY (2003); see also RICHARD L. DOERNBERG, LUC HINNEKENS, WALTER HELLERSTEIN, & JINYAN LI, ELECTRONIC COMMERCE AND MULTIJURISDICTIONAL TAXATION (The Hague, 2001); INTERNATIONAL FISCAL ASSOC., TAXATION OF INCOME DERIVED FROM ELECTRONIC COMMERCE 60 (2001) [hereinafter IFA Report] (“The overwhelming impression from the national reports is that in all jurisdictions, taxpayers and tax administrators are still in the very early stages of addressing these issues.”).

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to the taxation of international e-commerce.⁴ The lack of action at the national level was influenced by the lead role undertaken by the Organization for Economic Co-operation and Development (OECD) in establishing the guiding principles and tax rules to govern the tax treatment of international e-commerce transactions. By acting for the first time as a kind of informal (lower case) world tax organization through the promotion of unprecedented international tax cooperation, the OECD effectively addressed international tax policy concerns.⁵ The OECD’s success also offers support for the view within the international tax literature that prefers multilateral tax cooperation and coordination over more formal processes such as the use of binding international agreements to harmonize tax bases and/or rates.

Part I discusses the e-commerce reform efforts undertaken by the OECD that resulted in changes or proposed changes to the OECD model tax treaty, including steps to amend provisions concerning: (a) the characterization of income; (b) permanent establishments; (c) corporate residence; (d) ‘group’ permanent establishments; and (e) cross-border service income. Moreover, the Part discusses unprecedented efforts by the OECD to promote consensus among the international tax community for Value-Added Tax reform efforts. Part II surveys national legislative, administrative and judicial action taken to confront international e-commerce tax challenges and reveals that governments have for the most part approached reform efforts with caution, often issuing pronouncements that refer back to the OECD reform efforts. The Part concludes by reviewing possible explanations, apart from OECD influence, for the lack of action at the national level.

Part III discusses lessons provided by the OECD’s e-commerce tax reform process and outcome. First, this process provided an unprecedented level of tax cooperation among OECD members states, non-member countries and industry representatives: the enhanced cooperation likely encouraged ‘buy in’ and broad acceptance of principles and rules, encouraging tax certainty and reducing the likelihood that e-commerce

⁴ The research methodology involved a literature review, database searches and discussions with analysts working or researching in the area of international e-commerce taxation.

⁵ Other global institutions such as the World Trade Organization, the United Nations, the World Bank and International Monetary Fund have shaped international tax rules, but the OECD is generally recognized as the most influential international organization with respect to international income tax developments. The OECD’s model tax treaty, first published in 1963, is used by both OECD and non-OECD countries for the negotiation, application and interpretation of bilateral tax treaties that coordinate national income tax regimes. For a discussion of the history of the OECD and its predecessor organizations, see Li, *supra* note 3, at 37-47, 46 (discussing the impact of the OECD model tax treaty with member and non-member countries); Michael J. Graetz & Michael M. O’Hear, *The “Original Intent” of U.S. International Taxation*, 46 DUKE L.J. 1021, 1066 (1997) (noting that the OECD model tax treaty is a “direct descendant” of the League of Nations model treaty developed in the mid-1920s).

transactions will lead to disputes among national tax authorities or international double taxation. Second, the OECD's success with e-commerce tax reform shows that calls for a formal (upper case) World Tax Organizations, which could impose binding tax rules on participating nations, may be misplaced. In particular, the OECD e-commerce reform process overcame hurdles presented by theoretical uncertainty surrounding appropriate principles to guide international tax policy as well as the desire by governments to maintain as much tax sovereignty as possible. The Part concludes by discussing how the OECD could be further legitimized as a truly *world* tax organization by strengthening ties with non-member countries to provide these countries with more opportunities to deliberate international tax reform efforts.

I. OECD E-COMMERCE REFORM PROCESS AND DEVELOPMENT OF NEW TAX RULES

A. PROCESS

The OECD is a Paris-based international organization that serves as an outlet for reform efforts in a number of policy areas, including international taxation, for its thirty member countries. The Committee on Fiscal Affairs is the main OECD body that drives international tax reform efforts, including revisions to the OECD model tax treaty.⁶ In 1997, the OECD members first discussed cross-border e-commerce tax challenges at a meeting held in Turku, Finland and issued a brief report setting out an agenda to confront these challenges.⁷ In October 1998, an OECD ministerial meeting on global e-commerce was held in Ottawa, Canada, where the members reached agreement on two important documents relating to the taxation of international e-commerce. First, the Committee on Fiscal Affairs endorsed a set of principles that would guide the OECD in its reform efforts with respect to the taxation of international e-commerce. Importantly, the so-called Ottawa Taxation Framework noted that traditional international tax principles should be applied to the new commercial environment promoted by the Internet and the increased sale of digital goods and services.⁸ Moreover,

⁶ See ORG. ECON. CO-OPERATION & DEV, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL (Paris, OECD, 2000) (hereinafter OECD MODEL TAX TREATY).

⁷ See ORG. ECON. CO-OPERATION & DEV, ELECTRONIC COMMERCE: THE CHALLENGES TO TAX AUTHORITIES AND TAXPAYERS (1997) [hereinafter OECD TURKU REPORT] (prepared by Robert N. Mattson). For review of the OECD reform work see ORG. ECON. CO-OPERATION & DEV, IMPLEMENTATION OF THE OTTAWA TAXATION FRAMEWORK CONDITIONS: THE 2003 REPORT (2003) [hereinafter OECD IMPLEMENTATION REPORT].

⁸ See ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT COMMITTEE ON FISCAL AFFAIRS, ELECTRONIC COMMERCE: TAXATION FRAMEWORK CONDITIONS (1998) [hereinafter OTTAWA TAXATION FRAMEWORK].

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[the] approach does not preclude new administrative or legislative measures, or changes to existing measures, relating to electronic commerce, provided that those measures are intended to assist in the application of the existing taxation principles. . . . [A]ny adaptation of existing international taxation principles should be structured to maintain the fiscal sovereignty of countries, to achieve a fair sharing of the tax base . . . and to avoid double taxation and unintentional non taxation.⁹

Other guiding principles include the need for: maintaining neutral tax treatment between e-commerce and traditional commerce, low compliance costs for taxpayers and low administrative costs for tax authorities, clear and simple tax rules to promote business certainty, reducing the risk of tax evasion and tax avoidance, and flexibility to keep pace with technological and commercial developments.

Second, the OECD members and industry representatives signed onto a lesser-known document that similarly advocated the use of traditional international tax principles in the formulation of any new rules for the taxation of e-commerce.¹⁰ These two documents were an important step toward developing consensus on international tax principles and could prove to be useful beyond e-commerce purposes as the principles could be reformulated for guidance with respect to future international tax challenges.

After this meeting, Technical Advisory Groups (TAGs) comprised of government and industry representatives were formed by the OECD to promote discussion and analysis.¹¹ In addition, the Committee on Fiscal Affairs directed its Working Parties to discuss and propose solutions with respect to discrete areas of policy concern (e.g., Working Party No. 1 reviewed whether the permanent establishment category within the OECD model tax treaty needed to be amended to take into consideration e-commerce developments). These fora provided the OECD members (and non-member countries in certain cases) with an opportunity to voice their concerns and to reach consensus on the types of reform that would be acceptable to move the reform process forward.

⁹ *Id.* at 3.

¹⁰ See ORG. ECON. CO-OPERATION & DEV., *Joint Declaration of Business and Government Representatives: Government/Business Dialogue on Taxation and Electronic Commerce* (Oct. 7, 1998), <http://www.oecd.org/dataoecd/62/60/1932547.pdf>.

¹¹ With respect to e-commerce tax reform efforts, the OECD set up the following Technical Advisory Groups: (1) Technology TAG (to monitor and evaluate Internet technology developments); (2) Consumption Tax TAG (to examine collection systems for digital transactions); (3) Professional Data Assessment TAG (to examine how tax professionals and tax administrations are using information technologies); (4) Business Profits TAG (to examine how current treaty rules should apply for cross-border e-commerce profits); and (5) Treaty Characterization TAG (to examine cross-border characterization issues). See OECD IMPLEMENTATION REPORT, *supra* note 7, at 13.

B. MODEL TREATY CHANGES

The most important OECD reform efforts have or will become entrenched in the OECD model tax treaty or its Commentary, which is used to assist with interpreting the treaty provisions. The model treaty and/or the Commentary are important because they are often recognized by courts as secondary sources of authority to assist with treaty interpretation.¹² In addition, many countries—both OECD and non-OECD member states—base their own bilateral tax treaties on the OECD model tax treaty (the United States employs its own model tax treaty, but this treaty largely tracks the provisions within the OECD model).¹³ OECD member states are presented with an opportunity to deliberate these treaty changes, reach consensus and, if needed, insert observations or reservations within the Commentary to the OECD model tax treaty when an individual country does not agree with proposed changes. The importance of the model tax treaty is underscored by a recent review of the way that governments and their courts interpret the model tax treaty's permanent establishment concept for domestic tax purposes: 33 of the 37 countries scrutinized generally followed the OECD model tax treaty in this area.¹⁴

¹² See, e.g., *Nat'l Westminster Bank, P.L.C. v. United States*, 58 Fed. Cl. 491, 498 (U.S. Ct. Fed. Claims, 2003) (“[b]oth this court and others have recognized that the [OECD tax treaty and its Commentary] serve as a meaningful guide in interpreting treaties that are based on its provisions.”); *Att’y Gen. of Can. v. R.J. Reynolds Tobacco Holdings, Inc.*, 268 F.3d 103, 119 n.15 (2d Cir., 2001) *cert. denied*: 2002 U.S.LEXIS 8081 (Nov. 4, 2002) (“[i]n the realm of international taxation, the OECD’s model convention ‘has almost acquired the status of a multilateral instrument’ because of the reliance placed on it by many countries in negotiating bilateral tax conventions. . . .”) *citing* AMERICAN LAW INSTITUTE, *INTERNATIONAL ASPECTS OF UNITED STATES INCOME TAXATION II: UNITED STATES INCOME TAX TREATIES* 3 (1992); *The Queen v. Crown Forest Industries*, 2 S.C.R. 802, #55, at 827 (Sup. Ct. of Can.1995) (indicating that the OECD model tax treaty is of “high persuasive value” in defining the parameters of the U.S.-Canada tax treaty).

¹³ See Victor Thuronyi, *Tax Cooperation and a Multilateral Tax Treaty*, 26 *BROOK. J. INT’L L.* 1641, 1641 (2001) (asserting that “virtually all” of the over 1,500 bilateral tax treaties throughout the world are based on the OECD model and thus exhibit significant uniformity in terms of their provisions); DANIEL SANDLER, *TAX TREATIES AND CONTROLLED FOREIGN COMPANY LEGISLATION* 2 (2d ed. 1998).

¹⁴ The review included non-OECD member states such as Thailand, Malaysia and Argentina, which at times follow both the OECD model tax treaty and the United Nations model tax treaty. See Todd M. Landau et al., *How to Minimize Global PE Risk*, *INTERNATIONAL FINANCIAL REVIEW* 1 (June 2002), available at <http://www.legalmediagroup.com/internationaltaxreview/default.asp> [hereinafter *Global PE Risk*] (“[t]his general acceptance of the OECD Model Treaty provides a valuable frame of reference for addressing particular problems when they arise in particular jurisdictions. General acceptance of the conceptual principles articulated by the OECD does not necessarily mean that local tax authorities or local court will always reach similar conclusions when interpreting the PE wording of a treaty that follows the language of the OECD model. In practice, interpretations that rely on what is invariably a fact-intensive analysis will still frequently differ from country to country.”).

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The following sections discuss several OECD reform efforts relating to e-commerce that have led (or may lead, in the case of proposals) to changes to the OECD model tax treaty or its Commentary.

1. Income Characterization

Tax rules under domestic laws as well as treaties impose different tax treatment on different types of cross-border income. For example, business profits are generally sourced to the country where the income-producing business is based and taxed on a net basis. Royalty income, on the other hand, is generally sourced to the country where the intellectual property was used (e.g., the country where the consumer of the intellectual property is resident) and may be subject to gross withholding taxes.

The digital world raises a number of problems with respect to income characterization issues. Cross-border transactions involving the transmission of digital goods or services often make it difficult to determine whether a transfer of a product has occurred, whether services have been performed, or whether an intangible product has been licensed. The problem is that transactions involving digital goods and services often blur the lines among different categories of income.

As a result of these difficulties, the OECD promoted reform efforts to guide national tax authorities with respect to the tax treaty characterization of income produced by the sale of e-commerce goods and services. For e-commerce transactions involving software, the OECD amended its Commentary to the OECD model tax treaty to distinguish between the underlying copyright in the program and software which incorporates a copy of the copyrighted program.¹⁵ The Commentary now makes it clear that e-commerce transfers of all digital products should attract the same treatment as software payments,¹⁶ and that the technological method of transfer (whether a purchase of a program on a disk or an e-commerce online transfer) is not relevant.¹⁷

A report sponsored by the OECD looked to twenty-eight categories involving potential e-commerce transactions to assist tax authorities and taxpayers in determining the appropriate income characterization for international e-commerce transactions.¹⁸ The findings of the report were subsequently adopted into the Commentary of the OECD model tax treaty. Generally speaking, the cross-border transmission of digital goods and services will result in the generation of business profits because “the

¹⁵ See OECD MODEL TAX TREATY, *supra* note 6, C(12) 12.2 at C(12)-5.

¹⁶ See OECD MODEL TAX TREATY, *id.* C(12) 17, at C(12)-8.

¹⁷ See OECD MODEL TAX TREATY, *id.* C(12) 14.1, at C(12)-7.

¹⁸ Technical Advisory Group on Treaty Characterization of Electronic Commerce Payments, *Tax Treaty Characterization Issues Arising from E-Commerce* (Org. Econ. Co-Operation & Dev., Fe. 1, 2001), <http://www.oecd.org/dataoecd/46/34/1923396.pdf> (hereinafter “OECD E-commerce Characterization Report”).

payment is essentially for the acquisition of data transmitted in the form of a digital signal and therefore does not constitute royalties.”¹⁹ Royalties, however, may result when digital goods are downloaded to commercially exploit the copyright relating to the digital goods.²⁰ The new rules strive to treat substantively similar economic activity the same way. For example, the cross-border shipment of a music CD to a foreign consumer or the Internet transmission of an MP3 file (a compressed digital music file) to another foreign consumer will both be taxed as business profits and not as royalty income under the new OECD rules.

2. Server/Permanent Establishments

Due to the advent of the Internet, cross-border commercial transactions can be enabled by computer servers (i.e., a computer that has been networked to the Internet) instead of traditional business intermediaries such as retail stores. For example, a consumer can now download digital music from a commercial web site whereas these consumers would normally have purchased this music in the form of a CD at a retail outlet prior to the rise of the Internet and digital goods. This development led to the view that the tax treaty definition of permanent establishment, which is typically defined as a “fixed place of business through which business is conducted,” should be extended to these computer servers (hereinafter “servers”).

As a result, the Commentary now indicates that a server will constitute a permanent establishment (a “server/PE”) if: (1) the server performs integral aspects of a cross-border transactions;²¹ (2) the server is owned or leased by the non-resident firm;²² and (3) the server is fixed in a location for a sufficient period of time.²³ The Commentary offers an example of a server/PE that performs functions including “the conclusion of the contract with the customer, the processing of the payment and the delivery of the product,” but notes that many countries would assert that a server/PE has been created even if only some of the functions described are performed via the server.²⁴ The new rules indicate that it is not necessary to have any human involvement with the server, which can be accessed and maintained from a remote location, to create a server/PE.²⁵ In contrast, the

¹⁹ See OECD MODEL TAX TREATY, *supra* note 6, C(12) 17.3, at C(12)-8.

²⁰ See OECD MODEL TAX TREATY, *id.* C(12) 17.4, at C(12)-8.

²¹ See OECD MODEL TAX TREATY, *id.* C(5) 42.8, at C(5) -

²² See OECD MODEL TAX TREATY, *id.* C(5) 42.8, at C(5) - . As a result, an e-commerce firm that enters into a hosting arrangement to lease space on a foreign server will reduce the likelihood that the foreign jurisdiction will assert that the server constitutes a permanent establishment.

²³ See Commentary on Article 5 at par. 42.4.

²⁴ See Commentary on Article 5 at par. 42.6.

²⁵ See Commentary on Article 5 at par. 42.6.

view that a web site, in and of itself, could constitute a permanent establishment has been rejected. Finally, the Commentary indicates that non-residents that use foreign-based servers maintained by Internet Service Providers (ISPs) will generally not constitute permanent establishments as the non-residents would not typically exert control over the ISPs.²⁶

As subsequently discussed in Part II.A., the responses by national tax authorities to the server/PE issue form a continuum of approaches: some tax authorities maintain that servers should never constitute permanent establishments, others agree with the OECD position, and finally certain countries take the view that web sites in and of themselves can constitute permanent establishments. Problems with the new server/PE rule in the OECD model tax treaty are discussed in Part III.A.3.

3. Changes to the Place of Effective Management Concept

The United States and many other countries enact tax the world-wide income of their residents (so-called residence-based taxation). In the context of taxing e-commerce earnings, a residence-based system raises a number of concerns.²⁷ Under the 'place-of-incorporation' test, a corporation is considered a resident in the country where it has been incorporated while corporations incorporated outside of the country are considered to be non-residents. Moreover, the place-of-incorporation test does not require a business to maintain an economic presence within the country: the simple act of filing articles of incorporation will suffice to fulfill the residency requirement. As such, residency can change by simply changing the country of incorporation. In recent years, there has reportedly been a rise in the number of Internet businesses that have chosen to incorporate their companies in tax haven jurisdictions.²⁸ Incorporating an online company in a tax haven may be motivated by tax reasons, but may also be influenced by permissive laws with respect to commercial activities such as gambling or pornography.²⁹

²⁶ See Commentary on Article 5 at par. 42.10.

²⁷ For discussion, see generally OECD TAG ON MONITORING THE APPLICATION OF EXISTING TREATY NORMS FOR THE TAXATION OF BUSINESS PROFITS, THE IMPACT OF THE COMMUNICATIONS REVOLUTION ON THE APPLICATION OF THE "PLACE OF EFFECTIVE MANAGEMENT" AS A TIE BREAKER RULE (Discussion Draft) (2001).

²⁸ Controlled Foreign Corporation (CFC) rules attempt to prevent parent companies from deferring taxation on certain forms of income that is generated by foreign affiliates, often based in tax havens, by taxing this income on a current basis. In some cases, e-commerce transactions challenge the efficacy of CFC rules. For discussion, see OFFICE OF TAX POLICY, DEPARTMENT OF THE TREASURY, THE DEFERRAL OF INCOME EARNED THROUGH U.S. CONTROLLED FOREIGN CORPORATIONS: A POLICY STUDY 75-81 (Dec. 2000).

²⁹ For example, Costa Rica is home to the world's largest online gambling company, World Sports International. In its FAQ, the company answers the question "Do I have to pay taxes on my winnings? With the following: "Paying taxes on your winnings depends upon the jurisdiction in which you reside. World Sports International does not provide details of

Countries also employ a ‘place of central management and control’ test to determine whether or not a company is a resident.³⁰ This test generally involves looking to where a company’s head office is located or where the board of directors meets on a regular basis. Traditionally, directors had to hold face-to-face meetings to make business decisions. Internet technologies that promote video conferencing and email exchanges may pose a challenge to the place of central management and control test. The need for a physical head office may be eliminated as senior managers and directors can attend meetings without leaving their desks. These managers and directors could maintain residences in different jurisdictions (including tax havens), making it harder for high tax countries to assert that corporations are residents of their jurisdictions.

An OECD Technical Advisory Group has proposed changes to the treatment of corporate residence issues within the OECD model tax treaty, in part as a way to alleviate the concerns noted above.³¹ The proposal involves the inclusion of a hierarchical tie-breaker rule similar to the one used for individuals. Proposed Article 4(3)(b) of the OECD model tax treaty reads: “if the State in which its place of effective management is situated cannot be determined or if its place of effective management is in neither State, it shall be deemed to be a resident only of the State [Option A: with which its economic relations are closer] [Option B: in which its business activities are primarily carried on] [Option C: in which its senior executive decisions are primarily taken].”³²

The OECD TAG indicates that, under Option A, the corporation would be resident in the state in which it is making greater use of economic resources as well as legal, financial, physical and social infrastructures.³³ This could involve an analysis of factors including the location of most of the firm’s employees and assets, revenues, senior management functions, headquarters, etc. Under Option B, residency would be determined by a functional analysis of the activities performed in the two countries. Finally, under Option C, a corporation would be a resident of the country in which the clear majority of senior executive decisions are taken and where the

individuals’ deposits, winnings, or losses to anyone. It is up to you to declare information to the proper authorities in your residential jurisdiction.” See World Sport’s International web site, at http://betwsi.com/online_sports_betting_frequently_asked_questions_.html (last visited Nov. 3, 2005).

³⁰ Canada, for instance, employs both the incorporation test and the place of effective management and control test to determine corporate residency. See VERN KRISHNA, *INCOME TAX LAW* 30-32 (1997). For a comparative discussion of several countries on this issue, see HUGH J. AULT & BRIAN ARNOLD, *COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS* 349-350 (2nd ed. 2004).

³¹ See OECD TECHNICAL ADVISORY GROUP, *PLACE OF EFFECTIVE MANAGEMENT CONCEPT: SUGGESTIONS FOR CHANGES TO THE OECD MODEL TAX CONVENTION*, (Discussion Draft, 2003). [“OECD Effective Management Report”].

³² *Id.* at 3.

³³ *Id.* at 5.

corporate headquarters are located. By emphasizing the need for substantive economic activities prior to a determination of residency, the new tests may make it harder to manipulate corporate residency in the context of e-commerce operations.

4. Services and Permanent Establishments

As part of its review of e-commerce tax reform issues, the OECD Business Profits TAG has proposed in a draft discussion that rules governing the taxation of cross-border service income be altered within the OECD model tax treaty.³⁴ Under the proposed changes, source countries would be able to tax income from services if a non-resident firm or its representatives is present in the source country for a period of time.³⁵ The proposal would replace the current permanent establishment requirement with a physical presence test that is similar to the one in the United Nations model tax treaty.³⁶ The rationale for the proposal is, in part, that service providers are very mobile and can generate significant income in foreign countries without the need to set up a physical facility or use a fixed base of operations.³⁷

The Information Technology Association of America has argued that the proposed changes would increase compliance costs for technology firms along with greater business uncertainty surrounding whether a foreign government can impose its income taxes on service providers.³⁸ Under this view, e-commerce companies may be exposed to tax liability in multiple jurisdictions even though these companies normally remotely provide services only through the Internet along with occasional maintenance or service visits to the foreign countries where they conduct business. The proposal, however, would appear to be consistent with recent changes to the OECD model tax treaty commentary on permanent establishments that indicate a permanent establishment will be created if, in the course of providing consulting or other services to a client, the foreign taxpayer or its employees use the client's premises for a "long extended period of time."³⁹

³⁴ See OECD BUSINESS PROFITS TAG, ARE THE CURRENT TREATY RULES FOR TAXING BUSINESS PROFITS APPROPRIATE FOR E-COMMERCE? ¶¶ 232-251, 349 (Public Discussion Draft, 2003) ["OECD Business Profits TAG Report"].

³⁵ *Id.* at ¶ 232.

³⁶ See United Nations Model Double Taxation Convention between Developed and Developing Countries, (New York, United Nations, 1980) ["United Nations model tax treaty"], at art. 5(3) & 14(1).

³⁷ See OECD Business Profits TAG Report, *supra* note 34, at ¶ 238-239.

³⁸ See ITAA Expresses Concern over Proposed Changes to OECD Model Treaty, 2004 TNT 42-23 (2004).

³⁹ See OECD model tax treaty, *supra* note 6, at Commentary on Art. 5 at ¶ 4.3.

C. OECD VAT REFORM EFFORTS

As mentioned, the OECD traditionally promotes reform efforts in the international income arena primarily via its model tax treaty and the Commentary to this treaty. All OECD members (other than the United States) employ federal consumption taxes alternatively referred to as Value-Added Taxes or Goods and Services Taxes (collectively referred to as VATs). Yet there are generally no model treaties or bilateral international agreements that cover VATs.⁴⁰ As a result, there is no apparent mandate for the OECD to promote reform efforts for VATs and, prior to the rise of e-commerce, the organization had never pursued any meaningful reform efforts in this area.

In 1998, however, the OECD members agreed through the Ottawa Taxation Framework to consider VAT reform efforts in the context of global e-commerce. Importantly, the Ottawa Taxation Framework resolved an ongoing debate among OECD member states surrounding the appropriate tax jurisdiction for cross-border VAT purposes: the OECD countries agreed that for business-to-consumer (B2C) supplies the place of consumption should be the jurisdiction in which the recipient has his or her usual residence and for business-to-business (B2B) supplies tax should apply in the jurisdiction in which the recipient has located its business presence.⁴¹ This development helped to legitimize the European Union efforts, discussed subsequently, to impose collection and remittance obligations on non-European Union consumers who have engaged in B2C transactions with European businesses.

After 1998, the OECD developed guidelines for tax collection mechanisms for cross-border VAT purchases and began to publish a 'Consumption Tax Guidance Series' to promote consensus on the application of VATs with respect to international transactions.⁴² More specifically, an effort has been undertaken to promote consensus on reform efforts to: verify the jurisdiction and status of customers; contemplate registration thresholds whereby companies with below-threshold sales would not need to register for VAT purposes; deploy technology-based collection mechanisms; develop international administrative cooperation; and review simplification options and initiatives. Importantly, the views of

⁴⁰ There are minor exceptions to this rule such as the non-discrimination provision within the Canada-United States tax treaty that covers federal consumption taxes such as Canada's Goods and Services Tax. See art. XXV(10) of the Canada-U.S. Tax Convention (1980). Moreover, multilateral trade agreements at times cover federal-level and subnational (e.g., state or provincial) consumption taxes. See, e.g., North American Free Trade Agreement (1994) at art. 3(a).

⁴¹ See OTTAWA TAXATION FRAMEWORK, *supra* note 8.

⁴² See OECD IMPLEMENTATION REPORT, *supra* note 7, at 19.

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business representatives and non-OECD governments were taken into consideration with respect to potential cross-border VAT reform efforts.⁴³

II. NATIONAL AND EUROPEAN UNION REACTIONS

This Part surveys the responses by individual countries to challenges presented by international e-commerce. The survey discusses reform efforts in seventeen different countries where, for the most part, the responses have been tepid, often confined to agreeing or disagreeing with positions taken by the OECD. More specifically, the survey uncovered: seventeen administrative pronouncements by national tax authorities; five cases; and two tax laws (including a European Union directive on value-added taxes) passed to address international e-commerce matters. The Part concludes by discussing possible explanations for the lack of reaction at the national level, apart from OECD influence, including the absence of evidence of source country income tax base erosion resulting from international e-commerce transactions.

A. NATIONAL LAWS, ADMINISTRATIVE GUIDANCE, AND JUDICIAL DECISIONS

1. Austria

With respect to the server/permanent establishment issue, the Austrian tax authorities will follow the OECD model tax treaty Commentary.⁴⁴ In 2000, the Austrian Constitutional Court held that a special withholding tax on e-commerce transactions may be constitutionally acceptable as long as the tax, among other things, is restricted to electronically performed activities and it is applied only to firms and not individual consumers.⁴⁵

2. Canada

In 2002, Canadian tax authorities issued an Interpretation Bulletin to assist with the enforcement of its VAT (called the Goods and Services Tax) on international e-commerce transactions.⁴⁶ The Canadian changes

⁴³ *Id.* at 36.

⁴⁴ See Global PE Risk, *supra* note 14, at 5.

⁴⁵ For discussion, see Jurgen Reiner, *Austria*, in IFA Report, *supra* note 3, at 265.

⁴⁶ See CCRA, TECHNICAL INFORMATION BULLETIN B-090 “GST/HST AND ELECTRONIC COMMERCE” (Bulletin B-090) [“GST E-commerce Bulletin”]; CCRA, EXCISE AND GST/HST RULINGS, POLICY AND LEGISLATION, “GST/HST AND ELECTRONIC COMMERCE: A DISCUSSION PAPER FOR PUBLIC COMMENT ON THE ADMINISTRATION OF THE GOODS AND SERVICES TAX/HARMONIZED SALES TAX IN AN ELECTRONIC COMMERCE ENVIRONMENT,” November 2001.

generally maintain the *status quo* with respect to collection obligations for non-resident firms and rejected the more aggressive views set out in the European Union e-commerce VAT directive. For example, the Canadian approach advocates a multi-factorial test (e.g., the place of contracting and the place where assets are located should be taken into consideration) to determine whether the non-resident business should register for GST purposes⁴⁷ while the EU approach mandates collection obligations for all non-EU firms with online sales to consumers residing within the European Union (see below).

In 1998, Revenue Canada (as it was then) refused to take a position when a U.S. company asked about the tax implications of storing proprietary information on a Canadian-based server.⁴⁸ At this writing, the Canada Revenue Agency has prepared draft Interpretation Bulletins that discuss the OECD positions on server/PEs and income characterization.⁴⁹

Under domestic Canadian law, a withholding tax of 15% applies on payments for services performed by a non-resident in Canada.⁵⁰ When these services are provided by a computer software hotline service, the Canadian tax authorities have taken the position that withholding is not required because the service provider was physically located outside of Canada.⁵¹ This position could be analogized with the provision of other cross-border electronic communications.

3. France

French tax authorities have gone on record with respect to the server/PE issue and have developed a slightly different version of server/PEs when compared to the approach adopted into the Commentary to the OECD model tax treaty. In 2001, the then-Finance Minister confirmed that as a general rule servers alone will not constitute a permanent establishment without human activity associated with the server's operation.⁵² However, in narrow circumstances where the business transaction within France involves the "complete and autonomous cycle of business transactions" then a permanent establishment may be formed.⁵³

⁴⁷ *Id.* at 29-31.

⁴⁸ See Revenue Canada, Internal Memo 981646 (Aug. 31, 1998).

⁴⁹ See also Canada Revenue Agency, Income Tax Technical News no. 33 (sept. 16, 2005) (noting that the Canada Revenue Agency determines the existence of a permanent establishment by "examining the specific facts of the situation in light of the particular words of a treaty, the jurisprudence, and the OECD Model Commentary.").

⁵⁰ See section 105 of the Regulations to the *Income Tax Act (Canada)*.

⁵¹ See CCRA Document No. 5-3857, Nov. 20, 1987, as reported in Robin J. MacKnight & Charles Ormrod, *Canada*, in IFA Report, *supra* note 3, at 307, 319-320.

⁵² See Ministerial reply 56961, Official Gazette of 22 January 2001, as reported in Marcellin N. Mbwa-Mboma, France, *OECD Take Different Views of Unstaffed Servers as Permanent Establishments*, 2002 WTD 102-5 (2002).

⁵³ *Id.*

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According to an observer, the difference between the French and OECD positions is that the OECD approach emphasizes that as a general rule a server alone *can* constitute a permanent establishment unless its functions are purely preparatory or auxiliary while the French position envisions a more restrictive test where the server needs to perform virtually all aspects of a business transaction before a permanent establishment is constituted.⁵⁴

4. Germany

Germany's tax authorities have issued regulations on the taxation of permanent establishments, but have not provided guidance with respect to the computer server issue. A directive issued by the Karlsruhe Regional Tax Office in 1998 indicates that servers can be considered to be fixed places of business but should generally not constitute permanent establishments because they normally perform activities of a preparatory or auxiliary character.⁵⁵

The first German tax court to address the issue of server/PE status held that a server based in Switzerland and owned by a German corporation would constitute a permanent establishment in Switzerland under the Germany-Switzerland tax treaty.⁵⁶ The German company transferred information content to the Swiss-based server, where it was accessed by Swiss customers who paid a fee via their televisions. The sums paid were collected by Swiss Telecom and forwarded to the German company, less a collection fee. The German company did not maintain any individuals in Switzerland to service or program the server. The German company deducted a fee for its services then forwarded the remaining amounts to a corporate affiliate that produced the content.

The German court held that Switzerland was entitled to tax profits attributable to the Swiss-based server although the quantum of these profits was not discussed. While an English translation of this case does not appear to be available, one report notes that the court would permit the Swiss tax authorities "to attribute a substantial amount of income" to the server.⁵⁷ The court based its decision in part on earlier precedents that held that underground oil pipelines could constitute permanent establishments even without the presence of personnel. Moreover, the court cited the OECD changes to the commentary of the OECD model tax treaty (then in draft form) as support for its position that the court should scrutinize on a

⁵⁴ *Id.*

⁵⁵ See KPMG, *Lower Court Sees Server as Permanent Establishment*, INTERNATIONAL TAX REVIEW (March 2002), available at <http://www.legalmediagroup.com/internationaltaxreview/default.asp?Page=3&SID=1834&M=3&Y=2002>.

⁵⁶ See Case No. I R 86/01 (Schleswig-Holstein Tax Court, Sept. 6, 2001)

⁵⁷ Tamu Wright, *German Court Considers Whether Computer Server Can Constitute PE*, 3 BNA NEWS (April 2, 2002).

“case-by-case” basis whether the server is performing auxiliary or preparatory activities. At this writing, the decision was under appeal to the Federal Tax Court.

5. Greece

Greece, like Portugal and Spain, has inserted an observation into the OECD model tax treaty Commentary that it may not follow the OECD’s recent Commentary changes to create a server/PE category.⁵⁸

6. Hong Kong (China)

In 2001, the Hong Kong tax authorities issued a Departmental Interpretation and Practice Note (DIPN) that indicates that Hong Kong tax authorities will apply neutral tax rules to e-commerce so that no particular business will have a tax advantage over another.⁵⁹ A DIPN is not binding authority and can be overturned by a court or administrative board of review.

The DIPN rejects the OECD’s view that servers alone can constitute permanent establishments in certain circumstances: “[T]he Department will generally accept that the mere presence of a server does not constitute a PE.”⁶⁰ This view is based on the fact that the definition of permanent establishment within Hong Kong’s domestic tax law implies the need for a physical place as well as personnel.⁶¹ With respect to determining profits attributable to a server based in Hong Kong (along with personnel), the “proper approach is to focus more on what and where the underlying physical operations were carried out by the taxpayer to earn the profits in question than on what had been done electronically.”⁶² This view departs to a certain extent from the OECD view that would scrutinize the functions performed by the server to determine profits attributable to the computer equipment.

With respect to cross-border income characterization issues, Hong Kong’s views comport with the recent changes to the Commentary to the OECD model tax treaty in that they emphasize scrutinizing the substance of the electronic transfer to see if payment should be subject to withholding taxes: “If the payment is in truth a payment for a product or service, it will [not be subject to withholding]. On the other hand, if it is a payment for the use of, or the right to use, copyrighted material, it is deemed to [be subject

⁵⁸ See OECD model tax treaty, *supra* note 6, at Commentary on art. 5, ¶ 45.6.

⁵⁹ See INLAND REVENUE DEPT. (HONG KONG), DEPARTMENTAL INTERPRETATION & PRACTICE NOTES NO. 39: PROFITS TAX TREATMENT OF ELECTRONIC COMMERCE (July 2001).

⁶⁰ *Id.* at ¶ 11.

⁶¹ *Id.* at ¶¶ 11 and 12.

⁶² *Id.* at ¶ 14.

to withholding as a royalty payment.]”⁶³ Under this view, e-commerce transactions such as cross-border sales to consumers of shrink-wrapped software will generate business and not royalty income, which would be subject to withholding.⁶⁴

7. India

India is likely the most active non-OECD member with respect to developing positions on the taxation of international e-commerce. In 2001, a report prepared by the Indian Revenue Department’s Foreign Tax Division advised the abandonment of the traditional permanent establishment concept in light of e-commerce developments:

The Committee is of the view that applying the existing principles and rules to e-commerce does not ensure certainty of tax burden and maintenance of the existing equilibrium in sharing of tax revenues between countries of residence and source. The Committee is also firmly of the view that there is no possible liberal interpretation of the existing rules, which can take care of these issues, as suggested by some countries. The Committee, therefore, supports the view that the concept of PE [permanent establishment] should be abandoned and a serious attempt should be made within OECD or the UN to find an alternative to the concept of PE.⁶⁵

In addition, the report disagreed with the OECD’s view on withholding taxes, in particular the tax authorities maintained that software downloads should generally fall within definition of royalties found within Indian tax treaties and should be subject to withholding. The report noted that the Indian tax rules that classify cross-border income coincided with only 15 of the 28 categories set out within the OECD’s income characterization paper.

In 2002, the Indian government announced in its annual budget that it would not immediately implement the Foreign Tax Division’s recommendations due to the ongoing international discussions of e-commerce taxation issues.

In one case, Indian tax authorities assessed taxes on the profits attributable to an Indian-based server owned by VISA (a U.S.-based multinational firm).⁶⁶ VISA requested a resolution by U.S. and Indian tax

⁶³ *Id.* at ¶21.

⁶⁴ *Id.* at ¶ 23.

⁶⁵ See Ministry of Finance (India), *Report of the High Powered Committee on E-Commerce and Taxation* 11-12 (2001).

⁶⁶ For discussion, see Richard L. Doernberg, *Electronic Commerce: Changing Income Tax Treaty Principles a Bit?*, 89 TAX NOTES 1625, 1627-1630 (2000).

authorities under the competent authorities provision of the U.S.-India tax treaty. The settlement remains confidential although it has been reported that the U.S. and Indian competent authorities agreed the server will constitute a permanent establishment (the amount of profits attributable to this server remains unclear).⁶⁷

There are additional reports that India assessed withholding taxes on foreign e-commerce firms.⁶⁸ However, India's Income Tax Appellate Tribunal (ITAT) reportedly declined to assess withholding taxes on payments for periodic subscription fees paid by an Indian company to a U.S. company for electronic access to published materials.⁶⁹ The materials were maintained on a database within a server located outside of India and the payments were held to be payments for business profits rather than royalties and thus not liable to tax in India in the absence of a permanent establishment. The ITAT found that the payment to the non-resident company was for the use of copyrighted material and not for the transfer of the copyright itself. Moreover, the ITAT indicated that payment for access to an electronic database cannot be said to be consideration "for use of information concerning industrial, commercial or scientific experience" so as to fall under the definition of royalty under article 12(3)(a) of the India-U.S. tax treaty.⁷⁰ The ITAT's ruling appears to be consistent with the OECD's views, noted previously, on the characterization of royalty and business income with respect to cross-border e-commerce subscription payments.

In 2004, Indian tax authorities issued a Circular that sets out how foreign businesses (Business Process Outsourcing Units or BPOs) are to be taxed when they outsource aspects of their operations to individuals and businesses residing within India.⁷¹ When foreign companies outsource activities to Indian-based technology centers (which constitute a permanent establishment) and these activities enable the foreign firms to carry on core business activities abroad, the Circular maintained that India should be entitled to tax profits attributable to sales generated abroad (provided that the Indian permanent establishment has been charged an arm's length fee by its foreign parent). According to the Circular, "a considerable portion" of

⁶⁷ See Jonathan Rickman, *Indian, U.S. Authorities Agree Server Constitutes PE*, 32 TAX NOTES INT'L 134 (2003).

⁶⁸ For discussion, see Rashmin C. Sanghvi, *India*, in IFA Report, *supra* note 3, at 455; Siva Subramaniam & Sri Rajan, *Server as PE in India*, 15 J. INT'L TAX. 14 (2004) (concluding that "Indian tax authorities are likely to continue raising tax assessments against e-commerce transactions through dedicated servers based in India.").

⁶⁹ See Sanjay Sanghvi & Rajesh Bhagat, *Indian Tribunal Holds Subscription Fees Paid to Foreign Company Not Taxable in India*, 2005 WTD 22-5 (Jan. 2005).

⁷⁰ *Id.*

⁷¹ See CENTRAL BOARD OF DIRECT TAXES CIRCULAR NO. 1/2004, Jan. 2, 2004.

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the profits derived by non-residents from international sales would be taxable by India.⁷²

This Circular led to a controversy where it was alleged that India was being overly aggressive with respect to the taxation of non-resident firms. As a result, the Circular was withdrawn and replaced with another Circular.⁷³ The new Circular simply restates the provisions of profit attribution and transfer pricing found within Indian tax treaties. Indian tax authorities appear to be suggesting that traditional tax rules will determine the appropriate tax treatment: “[I]n determining the profits attributable to an IT enabled BPO unit constituting a Permanent Establishment, it will be necessary to determine the price of the services rendered by the Permanent Establishment to the Head Office ... on the basis of “arm’s length principle.””⁷⁴ The arm’s length price in turn is determined by reference to Indian domestic tax law.⁷⁵ The key area of contention appears to be the appropriate quantum of profit attribution to Indian-based BPOs.

8. Ireland

The Irish tax authorities have indicated that the mere presence of a server will not constitute a permanent establishment.⁷⁶

9. Mexico

Mexico is an OECD member and supported the recent changes to the OECD model tax treaty. In addition, Mexican income tax regulations specify that this model tax treaty should be used in interpreting Mexico’s income tax treaty obligations; hence the model treaty changes surrounding, *inter alia*, the characterization of cross-border income and the server/PE rule have been expressly adopted into Mexican tax law.⁷⁷

At times, however, Mexico bases its negotiation position on the United Nations model tax treaty. For these reasons, the U.S.-Mexico tax treaty contains a so-called restricted force of attraction provision that permits the source country to tax activities that do not emanate from the permanent establishment in some circumstances, which actually serves to

⁷² Id.

⁷³ See CENTRAL BOARD OF DIRECT TAXES, CIRCULAR NO. 5/2004, F.No.500/67/2003-FTD (Sept. 28, 2004), at § 8.

⁷⁴ Id. at § 6.

⁷⁵ Id. at § 7.

⁷⁶ See SPEECH BY DERMOT QUIGLEY, CHAIRMAN OF THE REVENUE COMMISSIONERS (IRELAND), INTERNATIONAL TAXATION ISSUES AND CURRENT AND FUTURE DEVELOPMENTS WITHIN REVENUE AUTHORITIES 12 (undated), available at Irish Revenue Tax and Customs, <http://www.revenue.ie/pdf/wtc.pdf> (visited Nov. 5, 2004).

⁷⁷ See Manuel F. Solano, *Mexican Tax Reform and Treaty Implications*, 18 TAX NOTES INT’L 533, 533, n.4 (1999).

inhibit revenue losses in the context of remote e-commerce sales.⁷⁸ Under the restricted force of attraction rule, the source country is permitted to tax the business profits derived from the sale by a non-resident firm of goods or merchandise of the same or similar kind as those normally sold through the permanent establishment. This clause is typically requested by developing countries to prevent avoidance of tax through the use of a home office in the foreign country to conduct business normally done at the permanent establishment.⁷⁹ The clause, however, will not apply if the foreign enterprise demonstrates that the sales were not made from the home office to avoid the tax on profits attributable to a permanent establishment.

As a result of this tax treaty rule, sales from a U.S.-based online company can be taxed by Mexico as long as similar sales are sold via an affiliate that maintains a traditional permanent establishment located somewhere in Mexico. For example, assume that Books Inc. is a large U.S.-based book retailer. Books Inc. owns retail outlets within Mexico (that constitute permanent establishments) and also maintains and operates exclusively from the United States a commercial web site that sells books. If a Mexican consumer orders online from Books Inc.'s web site then Mexico is entitled to tax the profits attributable to this sale because the company already maintains a permanent establishment within Mexico that sells the same or similar merchandise (unless Books Inc. demonstrates that its online sales do not have a tax avoidance purpose).

10. Netherland Antilles

The Netherland Antilles government passed a National Ordinance of Electronic Agreements along with special tax legislation for international Internet companies that base operations within the country.⁸⁰ Under the tax legislation, effective March 2001, Internet companies based in part in the Netherland Antilles will fall under a special tax regime with a corporate income tax rate of 2%.⁸¹

11. New Zealand

New Zealand has provided non-binding guidance to taxpayers with respect to Internet taxation issues, including cross-border income and GST

⁷⁸ See CONVENTION FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH REPECT TO TAXES ON INCOME, Sept. 18, 1992, U.S.-Mex., S. Treaty Doc. No. 103-7, art. 7(1), reprinted in 3 Tax Treaties (CCH) ¶ 5903. The OECD generally opposes the use of restricted force of attraction clauses in tax treaties. See Commentary to the OECD model tax treaty, *supra* note 6, at ¶ 7(8).

⁷⁹ For discussion, see Cockfield, *supra* note 1, at 205-215.

⁸⁰ See NATIONAL ORDINANCE ECONOMIC ZONE, NATIONAL GAZETTE NO. 18 (Feb. 12, 2001).

⁸¹ *Id.* at Art. 11(1). The rate sunsets on January 1, 2026. *Id.*

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matters.⁸² The government, however, does not appear to have passed any special e-commerce tax legislation although an informal administrative pronouncement offers examples of the potential income tax and goods and services tax (GST) implications of cross-border e-commerce transactions conducted by Australians in New Zealand.⁸³ The pronouncement additionally notes that: "Where relevant, current tax laws and interpretations will be applied to e-commerce transactions."

12. Portugal

Portugal has inserted an observation in the OECD model tax treaty Commentary that it may not follow the OECD's recent changes to create a server/PE category.⁸⁴

13. Singapore

Under Singapore's tax laws, software payments are classified as royalties, potentially subject to withholding taxes. In 2001, the tax authorities provided a ministerial order that maintains that payments for shrink-wrap software and certain other electronic transfers by non-resident consumers would be exempt from withholding taxes.⁸⁵ "Shrink-wrap" software, site licences, downloadable software, or software bundled with computer hardware will generally be exempt from withholding taxes.⁸⁶

Of interest, the exemption for payments for shrink-wrap software will only apply if the end user is only granted limited rights of use (e.g., no right to make copies for commercial purposes), which is the approach adopted by the income characterization changes to the Commentary to the OECD model tax treaty.⁸⁷ But payments for site licenses, downloadable software or software bundled with computer hardware are not subject to similar limitations and will not attract withholding, which is contrary to the approach adopted by the OECD.⁸⁸ The ministerial order would seem to impose non-neutral tax treatment between, for example, software sold in compact discs for commercial purposes (e.g., for copying and resale) which will be subject to withholding and the same software sold online to

⁸² See INLAND REVENUE (NEW ZEALAND), GUIDELINES TO TAXATION AND THE INTERNET (1998).

⁸³ See INLAND REVENUE (NEW ZEALAND), ABOUT YOUR SITUATION ... E-COMMERCE AND TAX, available at <http://www.ird.govt.nz/yoursituation-bus/australian/e-commerce-tax/>

⁸⁴ See OECD model tax treaty, *supra* note 4, at Commentary on art. 5, ¶ 45.6.

⁸⁵ MINISTERIAL ORDER, INCOME TAX (EXEMPTION OF ROYALTIES AND OTHER PAYMENTS FOR ECONOMIC AND TECHNOLOGICAL DEVELOPMENT) NOTIFICATION 2001, No. 297/2001, amended by S267/2001 (Feb. 21 2001, amended May 8, 2001).

⁸⁶ *Id.* at art. 2 to 4.

⁸⁷ *Id.* at art. 3.

⁸⁸ *Id.* at art. 4.

Singaporean resident for downloading which will not be subject to withholding.

In addition, Singaporean tax authorities have published a guide on the income tax treatment of e-commerce.⁸⁹ The guide discusses the income tax treatment of cross-border tangible and intangible goods. The guide also confirms that a server alone will not constitute a permanent establishment under Singapore's domestic tax law.⁹⁰

14. Spain

Spain's tax authorities maintain that, regardless of an actual physical presence, a permanent establishment exists wherever a company regularly conducts e-commerce transactions. These transactions are deemed to take place where the purchaser of the goods and services is resident. As a result, the Spanish government inserted a reservation in the recent server/PE changes to the Commentary to article 5 of the OECD model tax treaty, like Portugal, by asserting that the country may not follow the changes "until the OECD has come to a final conclusion."⁹¹ Moreover, the Spanish tax authorities take a broader view of the types of e-commerce transactions that could be subject to withholding, maintaining that downloads of shrink-wrapped software could attract withholding.

15. Switzerland

The Swiss tax authorities (federal tax administrators or FTA) have reportedly passed VAT guidelines on the taxation of telecom transactions, including comments on the tax treatment of electronic commerce.⁹²

16. United Kingdom

In 2000, the United Kingdom's Inland Revenue issued a press release indicated that servers will never, in and of themselves, be considered to be a permanent establishment of a foreign company.⁹³ Inland Revenue maintained this position even after taking into consideration the

⁸⁹ See INLAND REVENUE AUTHORITY OF SINGAPORE, INCOME TAX GUIDE ON E-COMMERCE (3rd ed., 2001).

⁹⁰ *Id.* at 10.

⁹¹ See OECD model tax treaty, *supra* note 6, at Commentary on Art. 5, ¶ 45.6.

⁹² See FTA Brochure 610.507-30 (1997); FTA Brochure 610.540-13 (2000), as reported in Xavier Oberson, *Switzerland*, in IFA Report, *supra* note 3, at 691.

⁹³ See INLAND REVENUE, PERMANENT ESTABLISHMENTS, at <http://www.inlandrevenue.gov.uk/e-commerce/ecom15.htm>.

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development of a new server/PE category within the Commentary to the OECD model tax treaty.⁹⁴

In 2000, Inland Revenue issued a technical note that proposed to use the OECD definition of royalties. The note also discussed proposals to create new rules for bundled payments where payment is provided for partly for intellectual property and partly for other items, which has implications for cross-border e-commerce transfers.⁹⁵

Finally, the Inland Revenue has ongoing consultation processes through the Electronic Commerce Consultation Forum (ECCF), which is comprised of members drawn from the tax authorities and industry participants. The ECCF is additionally broken into sub-groups that focus on specific e-commerce issues such as VAT, cross-border business profits, characterization, and tax administration and compliance.

17. United States

While Internet developments have led to a number of policy developments in the area of U.S. state and local sales and use taxes (briefly discussed in Part II.C.), very little action has taken place at the federal level with respect to international e-commerce developments. After the 1996 Treasury discussion paper on international taxation of e-commerce, the U.S. government entered into joint electronic commerce agreements with a number of other countries (including Australia, Chile, Columbia, the Netherlands, Ireland, Japan, Jordan and the United Kingdom) that included a tax provision which, like the one in the European Union-United States agreement, maintains "taxes on electronic commerce should be clear, consistent, neutral and non discriminatory."⁹⁶

As discussed above under the heading 'India', the U.S. tax authorities have entered into an undisclosed settlement agreement with Indian tax authorities whereby both parties accept that a U.S. taxpayer's server within India constitutes a permanent establishment. The interpretation appears to be consistent with the OECD's new server/PE rule.

Finally, as subsequently discussed in Part II.C., the United States has pursued reform efforts that deal with the tax treatment of software and intangible assets, which may ultimately assist with the determination of the appropriate tax treatment for cross-border e-commerce transactions.

⁹⁴ Id. The United Kingdom has additionally inserted these views within the Commentary to the OECD model tax treaty. See OECD model tax treaty, *supra* note 6, at Commentary on art. 5, ¶ 45.5.

⁹⁵ See INLAND REVENUE, REFORM OF THE TAXATION OF INTELLECTUAL PROPERTY (1999), as discussed in Gary Richards, UNITED KINGDOM, in IFA Report, *supra* note 3, at 711, 715-716.

⁹⁶ See JOINT E.U.-U.S. STATEMENT ON ELECTRONIC COMMERCE § 3(iv) (1997).

B. EUROPEAN UNION

Effective July 2003, the European Union's directive on electronic communications (the "E-commerce VAT Directive") requires all non-EU companies selling digital goods and services online to consumers within the EU to register with an EU tax authority and charge, collect and remit VAT.⁹⁷ Non-resident businesses can register under an interim "special scheme" arrangement with one EU member state, which will operate a form of clearinghouse to ensure that each EU member state receives its appropriate amount of VAT due to it.⁹⁸ After remittance, the member state will redistribute the VAT to the appropriate EU countries in which the digital goods and services were sold.

The E-commerce VAT Directive is designed in part to address problems associated with online business-to-consumer (B2C) sales, which are thought to present the greatest challenge to VAT schemes as consumer rarely comply with self-assessment obligations. There is less fear that business-to-business (B2B) sales over the Internet will create compliance problems because vendors engaged in these transactions have an incentive to assess, charge and collect VAT in order to receive input tax credits to offset the VAT payments.⁹⁹ The main impetus for the E-commerce VAT Directive appears to be the EU business lobby, which was concerned that, in absence of a rule that strived to force foreign suppliers to assess VAT, an uneven competitive playing field would persist because intra-EU supplies of goods and services would attract VAT (and corresponding higher prices) while supplies from non-EU countries could be sold to EU consumers on a VAT-free basis.

The new e-commerce VAT Directive has created concerns that it will impose costly collection obligations on non-EU firms.¹⁰⁰ An OECD TAG notes that different approaches to VATs and e-commerce may inhibit

⁹⁷ See Council Directive 2002/38/EC amending Directive 77/338/EECd as regards the value added tax arrangements applicable to radio and television broadcasting services and electronically supplied services, 2002 O.J. (L 128) 41 (May 7, 2002).

⁹⁸ Earlier proposals would permit non-resident firms to register and charge VAT in only one EU country and would only have strived to make larger firms comply with the collection obligations. See COMMISSION PROPOSAL FOR A COUNCIL DIRECTIVE AMENDING DIRECTIVE 77/388/EEC AS REGARDS THE VALUE ADDED TAX ARRANGEMENTS APPLICABLE TO CERTAIN SERVICES SUPPLIED BY ELECTRONIC MEANS, COM (2000) 349 (proposing to require non-EU companies to collect VAT on sales to EU consumers of digital products as long as sales into the EU exceed 100,000 Euros).

⁹⁹ For discussion, see Charles McClure, Jr., *The Value Added Tax on Electronic Commerce in the European Union*, 10 *INTERNATIONAL TAX AND PUBLIC FINANCE* 753 (2003).

¹⁰⁰ For discussion, see Stephen Bill & Arthur Kerrigan, *Practical Application of European Value Added Tax to E-commerce*, 38 *GA. L. REV.* 71 (2003); Gary Burnes, *Businesses and Governments Express Concern About European Commission's Proposed E-Commerce VAT Directive*, 20 *TAX NOTES INT'L*, June 20, 2000, at 2750.

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commercial activities and increase the risk of international double taxation.¹⁰¹ As previously discussed, in order to counter perceived problems with respect to emerging cross-border VAT and GST issues, the OECD's Committee on Fiscal Affairs has promoted a non-binding "Consumption Tax Guidance Series" for e-commerce and other issues.¹⁰²

Moreover, as mentioned, there are generally no general international treaties that govern cross-border consumption tax issues (unlike tax treaties, which are mainly directed at income taxes). In absence of such a treaty, it is unclear how the European Union plans to enforce its directive. Certain non-EU firms with online sales such as Amazon.com have voluntarily agreed to comply with the E-commerce VAT Directive while others such as AOL/Time Warner have announced that they will set up operations in European Union countries to assist with compliance.¹⁰³

An additional VAT issue surrounds compliance obligations and cross-border e-commerce sales. Under general VAT laws, countries may impose collection obligations on foreign companies if these companies maintain "permanent establishments" within their jurisdictions. Like the income tax treaty concept of permanent establishment, this is a defined term in VAT statutes and usually has a similar meaning where fixed places of businesses can constitute permanent establishments. The European Court of Justice has held that machinery alone cannot constitute a permanent establishment for VAT purposes so that the presence of a server alone within an EU country will not likely constitute a permanent establishment.¹⁰⁴ This position can be contrasted with other consumption tax laws such as the Canadian one where the presence of a server can constitute a permanent establishment for Goods and Services Tax purposes (and hence trigger foreign company collection and remittance obligations) even without the presence of a human being.¹⁰⁵

¹⁰¹ For a discussion of concerns arising out of the different tax treatment for international consumption taxes, see OECD IMPLEMENTATION REPORT, *supra* note 7, ¶14. See also Keith R. Evans, *Cross-Border E-Commerce and the GST/HST: Towards International Consensus or Divergence?*, 2 *CDN. J. OF LAW AND TECHNOLOGY* 1 (2003) (noting different approaches among the European Union, Canada and Australia).

¹⁰² See OECD IMPLEMENTATION REPORT, *supra* note 7, at 19.

¹⁰³ For discussion, see *Ebay Users Hit by Sales Tax*, BBC NEWS, June 6, 2003, available at <http://news.bbc.co.uk/1/hi/business/2968106.stm>.

¹⁰⁴ See Marcellin N. Mbwa-Mboma, *France, OECD Take Different Views of Unstaffed Servers as Permanent Establishments*, TAX NOTES INT'L, June 3, 2002, at 1107.

¹⁰⁵ See CCRA E-commerce GST Bulletin, *supra* note 48, at 27 (noting that Canadian GST legislation should be interpreted so that the definition of "permanent establishment" for GST purposes can include situations where a computer server alone is owned by a non-resident firm and is based within Canada).

C. POSSIBLE EXPLANATIONS FOR THE LACK OF REACTION

The survey of national responses to e-commerce tax challenges reveals that governments have chosen to approach these challenges with caution. A number of reasons could explain the lack of legislative and administrative action thus far.

First, governments may now be less concerned that e-commerce developments threaten their tax bases. Revenue losses associated with international e-commerce transactions are difficult to estimate as there are currently no empirical studies that attempt to measure these losses. In addition, there are few studies that demonstrate that e-commerce developments provide planning opportunities that would lead to base erosion in relatively high tax jurisdictions like the United States. One empirical study, however, does show that e-commerce developments may be facilitating international tax planning for U.S. multinationals although, again, revenue losses associated with this planning remain uncertain.¹⁰⁶ Tax authorities have noted the rise of certain 'grey market' business activity such as gambling and pornographic web sites located in offshore tax havens that may be leading to revenue losses, but they do not have firm estimates of these losses.¹⁰⁷ An OECD report issued in 2003 notes, "Contrary to early predictions, there does not seem to be actual evidence that the communications efficiencies of the internet have caused any significant decrease to the tax revenues of capital importing countries."¹⁰⁸

The lack of empirical evidence concerning revenue losses at the international level can be contrasted with the situation in the U.S. subnational context where several studies have shown that U.S. state and local governments are suffering revenue losses in the billions of dollars as a result of increased remote consumer sales attributable to mail order and Internet transactions involving tangible goods.¹⁰⁹ Moreover, there is at least

¹⁰⁶ See Carla Carnaghan and Kenneth J. Klassen, E-COMMERCE AND INTERNATIONAL TAX PLANNING (Working Paper, June 2004) (employing U.S. company data to document that companies with foreign subsidiaries use export sales to a greater degree when there are tax advantages to doing so, and that this relation is more pronounced for companies where e-commerce sales are more prevalent). *But see* Carla Carnaghan et al., *E-Commerce and Tax Planning: Canadian Experiences*, 3 CDN. ACC. PERSP. 8 (2004) (indicating that surveys of Canadian businesses show that firms rarely take into consideration tax planning issues prior to deployment of e-commerce strategies).

¹⁰⁷ For discussion, see OECD FORUM ON TAX ADMINISTRATION COMPLIANCE SUB-GROUP, COMPLIANCE RISK MANAGEMENT: PROGRESS WITH THE DEVELOPMENT OF INTERNET SEARCH TOOLS FOR TAX ADMINISTRATION (2004), § 6 (reviewing how tax authorities are employing technologies to assist with taxpayer audits).

¹⁰⁸ See OECD Business Profits TAG Report, *supra* note 34, at 74 (advocating that wholesale reform efforts are not needed to confront e-commerce tax challenges).

¹⁰⁹ For discussion, see Walter Hellerstein, *Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective*, 38 GA. L. REV. 1 (2003); Multistate Tax Commission, *Federalism at Risk*, 30 ST. TAX NOTES 551 (2003). For

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anecdotal evidence that aggressive tax planning such as entity isolation strategies has contributed to these revenue losses.¹¹⁰ This evidence has in part encouraged U.S. state tax authorities to form the Streamlined Sales Tax Project whereby state governments are contemplating the radical tax base harmonization of their sales and use tax systems to encourage voluntary compliance by firms with out-of-state sales.¹¹¹ Without similar evidence at the international level, tax authorities and legislative bodies may be understandably reluctant to focus their attention on an area that may not be contributing to significant revenue losses.

Second, the area where e-commerce presents the greatest tax challenges—cross-border business-to-consumer (B2C) sales—likely does not present significant problems at the present time. Cross-border business-to-business (B2B) e-commerce sales continue to dominate overall e-commerce and businesses, unlike consumers, have incentives to report incoming sales to, for example, justify the expensing of inputs for tax purposes or to receive credit for these inputs against other VAT liabilities.¹¹² Moreover, some observers maintain that source country base erosion will not take place because concerns surrounding the withdrawal of traditional physical presences (e.g., a retail outlet) and the replacement by

revenue loss estimates, see U.S. GENERAL ACCOUNTING OFFICE, SALES TAXES: ELECTRONIC COMMERCE GROWTH PRESENTS CHALLENGES; REVENUE LOSSES ARE UNCERTAIN (GAO/GGD/OCE-00-165) (2000); DONALD BRUCE & WILLIAM FOX, STATE AND LOCAL REVENUE LOSSES FROM E-COMMERCE: ESTIMATES AS OF JULY 2004 (Knoxville: University of Tennessee, Center for Business and Economic Research, 2004) (estimating losses between U.S.\$21.5 billion and U.S.\$33.7 billion by 2008).

¹¹⁰ See, e.g., Arthur J. Cockfield, *Walmart.com: A Case Study in Entity Isolation*, 25 ST. TAX NOTES 33, Aug. 26, 2002 (arguing that nexus attribution theories could be used by state tax authorities to hold e-tailers and their parent companies liable for uncollected remote sales taxes). In 2003, Walmart.com and certain other large online retailers agreed to begin collecting sales taxes on remote consumer transactions in exchange for insulation from liability for past remote collection practices, agreed to by thirty-eight state tax authorities. See Eric Chabrow, *States, Stores Make Online Sales Tax Deal*, INFORMATIONWEEK, Feb. 6, 2003, available at <http://www.informationweek.com/story/showArticle.jhtml?articleID=6512025>.

¹¹¹ As subsequently discussed, compliance by out-of-state vendors must be voluntary because U.S. states are constitutionally prohibited from mandating compliance as a result of concerns surrounding the interference with interstate commerce. For discussion on the Streamlined Sales Tax Project, see, for example, John A. Swain and Walter Hellerstein, *Recent Amendments to the Streamlined Sales and Use Tax Agreement: Third-Party Reimbursements and Bundled Transactions*, ST. TAX NOTES 659, Aug. 26, 2005, at 659 and Arthur J. Cockfield, *Jurisdiction to Tax: A Law and Technology Perspective*, 38 GA. L. REV. 85 (2003).

¹¹² In 2001, U.S. businesses generated roughly USD\$1.1 trillion in e-commerce sales and revenues. Over 93% of total sales came from B2B transactions (including more traditional Electronic Data Interchange transactions). Transactions between e-commerce businesses and consumers (so-called B2C sales) amounted to USD\$71 billion in 2001. See UNITED STATES DEPARTMENT OF COMMERCE, E-STATS (March 19, 2003), available at <http://www.census.gov/eos/www/paper/2001/1002estatstext.pdf>

virtual presences (like a retail website) have been overstated.¹¹³ The transition of many global e-commerce companies from pure “dot-coms” to so-called “clicks and mortars” (businesses that have both a virtual and traditional physical presence) has arguably inhibited revenue losses because these businesses will continue to maintain physical presences in foreign markets that may constitute permanent establishments and attract source country income taxation.

Moreover, the move by large e-tailers like Amazon.com and online auctions such as Ebay.com to create local foreign subsidiaries (like Amazon.co.uk and Ebay.co.uk in the United Kingdom) may have reduced concerns surrounding B2C revenue losses, at least with respect to sales of tangible goods. Online B2C transactions often remain confined within countries through the use of these local subsidiaries, belying to a certain extent earlier predictions of a borderless commercial world for regulatory purposes.¹¹⁴ Finally, in certain cases large Web-based multinational firms have voluntarily agreed to abide by foreign tax laws, which reduced the necessity for legislative steps to set out the scope and obligations of these firms. As discussed previously, for example, Amazon.com and AOL/Time Warner have agreed to strive to comply with the European Union’s VAT directive that strives to place VAT compliance obligations on foreign businesses for B2C transactions. As discussed, the OECD is also assisting with the development of new practices and technologies to encourage compliance with cross-border VAT rules for e-commerce.¹¹⁵

Third, certain countries have tax laws that clarify the tax treatment of software programs and intangible assets, which may provide a framework by analogy to resolve e-commerce tax issues.¹¹⁶ For instance, the U.S. Treasury Department first proposed draft regulations in 1996 on the classification of computer program transactions.¹¹⁷ These regulations

¹¹³ See Gary D. Sprague & Rachel Hersey, *Permanent Establishments and Internet-Enabled Enterprises: The Physical Presence and Contract Concluding Dependent Agent Tests*, 38 GA. L. REV. 299, 300 (2003) (arguing that business model changes have not taken place that would enable significant cross-border sales without the need for a local physical presence).

¹¹⁴ See David R. Johnson & David Post, *Law and Borders—The Rise of Law in Cyberspace*, 48 STAN. L. REV. 1367, 1379 (1996) (arguing that cyberspace should be treated as “a separate ‘space’ to which distinct laws apply.”). The commercial developments along with the apparent ability of existing international tax laws to deal with these developments appear to be more consistent with the view that cyberspace developments can be addressed through traditional regulatory tools. See, e.g., Jack L. Goldsmith, *Against Cyberanarchy*, 65 U. CHI. L. REV. 1199 (1998) (arguing that traditional legal tools of jurisdiction apply to Internet transactions).

¹¹⁵ See OECD IMPLEMENTATION REPORT, *supra* note 7; OECD, CENTRE FOR TAX POLICY AND ADMINISTRATION, FACILITATING COLLECTING OF CONSUMPTION TAXES ON BUSINESS-TO-CONSUMER CROSS-BORDER E-COMMERCE (2005).

¹¹⁶ See, e.g., IFA Report, *supra* note 3 (discussing efforts by country reporters to apply traditional tax laws to e-commerce developments).

¹¹⁷ See Prop. Treas. Reg. § 1.861-18, 61 Fed. Reg. 58, 153 (1996).

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clarified that, for purposes of determining whether royalty income is generated, taxpayers should determine what type of copyright has been transferred; the transaction will generally be treated as a sale of goods (and not a copyright license that would generate royalties) as long as the purchaser does not receive the right to reproduce the software for distribution to the public. Like the OECD income classification rules discussed previously, the U.S. regulations strive to treat functionally equivalent transactions the same way. U.S. taxpayers may be able to use these rules to determine the appropriate tax treatment for cross-border digital transfers of goods and services.

In addition, the United States has proposed new regulations to govern the tax treatment of non-arm's length transactions in cross-border services, including transactions involving intangible property.¹¹⁸ Proposed rules strive to inhibit disguised transfers of intangibles without adequate compensation where the transaction is characterized by the taxpayer as a transfer of services only. For bundled transactions that involve a services transaction and a transfer of an intangible, taxpayers must choose valuation methods that take into account each component of the transaction. Intellectual property laws of the relevant jurisdiction will determine legal ownership of the intangible or, if this approach is unworkable, ownership will be determined by looking to which controlled party controls the intangible. Rules also assist in valuing intangibles that have been enhanced or developed by another controlled taxpayer.

These tax rules could be applied to many e-commerce transactions that involve the cross-border transfer of digital goods and services. The rules seem sensible as they can be imposed in a neutral manner between e-commerce and traditional transactions and thus comport with the OECD's guidelines in this area that are espoused by the Ottawa Taxation Framework.¹¹⁹ In addition, this approach does not involve any significant departure from traditional international tax rules or principles and, again, appears to be consistent with the Ottawa Taxation Framework conditions.

Fourth, it may be too soon to gauge the national reaction to e-commerce tax challenges as governments and their tax authorities may be in the midst of preparing legislation or administrative guidance.¹²⁰ Also, my

¹¹⁸ See DEPT. OF TREASURY, TREATMENT OF SERVICES UNDER SECTION 482; ALLOCATION OF INCOME AND DEDUCTIONS FROM INTANGIBLES, 26 C.F.R. Parts 1 & 31, 68 Fed Reg. 53, 448. For discussion of emerging tax rules to govern the taxation of intangibles in the United Kingdom, Australia, and the United States, see Andrew Lymer et al., *Taxing the Intangible: Overview of Global Approaches and a Review of Recent Policy Changes in the UK*, 18 AUSTRALIAN TAXATION FORUM 431 (2003).

¹¹⁹ See OTTAWA TAXATION FRAMEWORK, *supra* note 8.

¹²⁰ See, e.g., RICHARD BIRD, TAXING ELECTRONIC COMMERCE: A REVOLUTION IN THE MAKING 18-19 (C.D. Howe Commentary, Sept. 2003) (concluding that "minor fixes" will suffice to meet e-commerce tax challenges in the short term although more comprehensive reform efforts may be necessary in the longer term).

survey within this Part may have inadvertently missed efforts by governments to address global e-commerce tax concerns, possibly understating the extent of this reaction.

The next Part explores an alternative explanation, noted elsewhere, whereby national tax authorities and their governments deferred to the OECD to resolve many of the pressing tax issues presented by international e-commerce.¹²¹

III. LESSONS FROM THE OECD'S E-COMMERCE TAX REFORM PROCESS AND OUTCOME

The Part strives to promote a better understanding of the reasons that underlie the general success of the OECD's e-commerce tax reform efforts along with lessons that can be learned from these efforts. The first section argues that the OECD's 'informal' e-commerce reform process, which included the promotion of guiding principles, consultation, deliberation, and the use of non-binding mechanisms, amounted to unprecedented global tax cooperation and was generally successful in confronting international e-commerce tax policy challenges. The second section argues that the OECD's success in the e-commerce arena demonstrates that calls for a formal World Tax Organization, which could bind national tax rules of participating nations, may be misplaced. To operate as a truly informal *world* tax authority, the last section discusses the need to formalize the OECD's outreach efforts to non-OECD member states to promote a more inclusive forum for consultation and deliberation.

A. HEIGHTENED INTERNATIONAL COOPERATION THROUGH INFORMAL INSTITUTIONS

The previous Parts reviewed how the OECD took a leadership role in the development of international e-commerce tax reform principles, which were accepted by the OECD member states.¹²² This section discusses how the OECD's use of 'soft institutions', enhanced voice, and

¹²¹ Duncan Bentley has similarly noted that the OECD's e-commerce tax reform effort has influenced the national policy response: "It is clear that it will now be difficult for any sovereign state to opt for an approach to international taxation of electronic commerce that does not reflect the consensus obtained through the work of the OECD." See Duncan Bentley, *International Constraints on National Tax Policy*, 30 TAX NOTES INT'L 1127, 1140 (2003) (describing OECD efforts with respect to, among other things, anti-corruption, information exchange, and harmful tax competition).

¹²² See also Chuck Gnaedinger, *TNI Interview: Joseph H. Guttentag*, 36 TAX NOTES INT'L 311, 316 (2004) (providing Guttentag's view that the OECD e-commerce tax reform "has made tremendous progress in creating a basic platform which has served to permit the imposition of appropriate taxes while preventing our tax systems from undercutting the growth of this remarkable industry.").

increased outreach to non-OECD member states assisted with reform efforts. The section also notes that the server/PE example offers a cautionary tale about the OECD process.

1. Soft Institutions

As discussed in Part I, the OECD's e-commerce tax reform process did not involve any institutions that can bind the tax policy of its member countries in any way. The Working Groups and other expert groups serve as fora to explore different policy alternatives, but cannot enact any changes without broad support and consensus by OECD members. The OECD model tax treaty or its Commentary are not binding, and members are permitted to insert reservations and observations that set out dissenting views.

To a certain extent, the OECD approach of encouraging discussion, study, and non-binding reform efforts resembles the phenomenon of 'soft institutions.' Soft institutions are said to be more informal processes employed to achieve consensus by providing a forum for actors to negotiate non-binding rules, such as principles, instead of binding conventions: "Soft institution building can provide more flexibility to actors, including the private sector, to implement the consensus."¹²³ The OECD approach is consistent with emerging views in international relations theory that "government networks" (e.g., relatively informal arrangements among government officials in the same agencies) may be best at addressing global challenges.¹²⁴ Informally coordinated and networked action by governments, it is thought, may lead to a new form of international law- and policy-making that addresses these challenges without imposing undue restrictions on national sovereignty.¹²⁵

Similarly, the use of non-binding institutions promotes the interests of the OECD members by reducing tax obstacles to international trade and investment (thus encouraging national economic growth) while protecting tax sovereignty to the greatest extent possible. As subsequently discussed in Part III.B., the preservation of tax sovereignty is likely a necessary prerequisite for the development of widely-accepted tax rules. The OECD process more closely resembles customary international law, which is

¹²³ See Suh-Yong Chung, *Is the Mediterranean Regional Cooperation Model Applicable to Northeast Asia?*, 11 GEO. INT'L ENV. L. R. 363, 395 (1999).

¹²⁴ See ANNE-MARIE SLAUGHTER, *A NEW WORLD ORDER* (Princeton and Oxford: Oxford University Press, 2004).

¹²⁵ *But see* Kenneth Anderson, *Book Review: Squaring the Circle? Reconciling Sovereignty and Global Governance through Global Government Networks*, 118 HARV. L. REV. 1255 (2005) (concluding that global networks may unduly erode sovereignty interests).

perhaps best understood as a set of normative expectations developed through observation of the actions of states.¹²⁶

As is the case in other areas of customary international law, peer pressure and the need to promote business certainty (again to promote national economic welfare) encourages the OECD member states to follow the consensus views once they have been adopted into the OECD model tax treaty. In contrast, conventional international law typically involves the use of treaties that, once entered into, create continuing obligations, unlike the OECD model tax treaty. Through the use of informal mechanisms, the OECD mediates and manages the expectations of its member states in an attempt to generate politically acceptable (and hopefully effective) international tax policy.¹²⁷

2. Enhanced Voice

With respect to the OECD's e-commerce tax reform efforts, Duncan Bentley notes, "It was one of the first occasions when new policy initiatives were developed at an international level before at least the OECD jurisdictions had first developed domestic policy positions. It was also the first time that public consultation both within and outside the OECD had taken place to that extent in developing new policies on international taxation."¹²⁸

The OECD e-commerce tax reform efforts arguably generated a series of 'firsts', discussed in Part I, that amounted to unprecedented international tax cooperation:

- (a) it was the first time that countries engaged in multilateral discussions that led to agreement on principles—the Ottawa Taxation Framework—that would guide the subsequent formulation of international tax rules;
- (b) it was the first time that the OECD joined with members of industry to agree to a framework—the Joint Declaration of Business and Government Representatives—to guide the development of new rules;¹²⁹

¹²⁶ For discussion, see Aaron Schwabach and Arthur J. Cockfield, *The Role of International Law and Institutions*, in *ENCYCLOPEDIA OF LIFE SUPPORT SYSTEMS* 611, 613 (UNESCO: Oxford, 2002).

¹²⁷ See, e.g., Robert Wolfe, *See You in Geneva? Legal (Mis)Representation of the Trading System*, 11(3) *J. INT'L RELATIONS* 339, 358 (2005) (arguing that, under an Fullerian understanding of international law, conventional international law is in fact similar to customary international law because the latter provides transparency, consensual knowledge and legitimation for the regime even though it does provide sanctions through formal dispute resolution processes).

¹²⁸ See Bentley, *supra* note 121, at 1139.

¹²⁹ The first agree-upon principle of this document reads "The implementation of a taxation framework for electronic commerce, and the administrative arrangements that support that framework, are priorities, and *governments and the business sector must co-operate in this*

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- (c) it was the first time that the OECD analyzed policy options in an extensive way through the publication of multiple discussion drafts of reports (that sometimes included both majority and minority viewpoints) from Technical Advisory Groups and Working Parties consisting of tax experts drawn from national tax authorities, industry and academics;
- (d) it was the first time that non-OECD countries were permitted to be part of ongoing deliberations along with the development of policy options through the appointment of representatives from non-OECD governments to Technical Advisory Groups;¹³⁰ and
- (e) it was the first time that OECD member states engaged in extensive discussions with respect to cross-border Value-Added Tax (VAT) issues, and attempted to promote consensus-driven reform efforts in this area.

The use of Working Parties and TAGs provided a forum for tax experts to deliberate in an extensive manner prior to the attainment of consensus. In particular, the decision to extend TAG membership to representatives from industry and non-OECD member states likely played a strong role in encouraging participants to 'buy in' to the recommended changes as they had a chance to voice their concerns from the outset. The survey in Part II supports this view as the OECD member states have not generally developed tax laws or administrative positions that are contrary to the OECD view (with, as subsequently discussed, the exception of the server/PE issue): it serves as evidence that the OECD countries made good on their promise, by signing onto the Ottawa Taxation Framework conditions, to abide by the consensus view. Interestingly, it was technology change, and not traditional policy concerns, that provoked this unprecedented global tax cooperation.¹³¹

The OECD e-commerce tax reform process encouraged cooperative efforts by providing significant opportunities for input without imposing any intrusive restrictions on the tax policy of the member countries.¹³² The

work in order to realise the full potential of the new technologies.”[my italics]. See also, Joint Declaration, *supra* note 10.

¹³⁰ See, e.g., OECD IMPLEMENTATION REPORT, *supra* note 7, at 12-13.

¹³¹ See Howard E. Abrams & Richard L. Doernberg, *How Electronic Commerce Works*, 14 TAX NOTES INT'L 1573, 1589 (1997) ("What may be a sound rule from a tax policy perspective may be totally unworkable in light of available technology Perhaps the most significant implication of the growth of electronic commerce for tax policy may be that technology rather than policy will determine the tax rules of the 21st century."). For discussion on the need to develop a coherent legal theory or analytical framework to promote a better understanding of the interplay between law and technology, see Arthur J. Cockfield, *Towards a Law and Technology Theory*, 30 MAN. L. J. 383 (2004).

¹³² For arguments in favor of this approach, see Jeffrey Owens, *Emerging Issues in Tax Reform: The Perspective of an International Bureaucrat*, 97 TNI 245-23 (1997) (advocating the use of multilateral processes that encourage tax cooperation, rather than tax harmonization reform efforts); Stanford G. Ross, *National versus International Approaches to Cross-Border Tax Issues*, 54 TAX NOTES 589 (1992) (advocating enhanced multilateral cooperation and coordination); Jack M. Mintz, *Is National Tax Policy Viable in the Face of*

combination of providing enhanced opportunities to voice concerns along with the use of soft institutions likely assisted with the development of effective reform that was acceptable to the OECD member states.¹³³ Moreover, the inherently conservative view in the Ottawa Taxation Framework and the Joint Declaration of Business and Government Representatives to use traditional international tax principles in the development of tax rules for e-commerce seems, in hindsight, the most effective reform path.

In contrast, the reform solutions proposed by certain tax observers, including this author, can now be portrayed as over-reaching.¹³⁴ In order to address possible source base erosion resulting from cross-border e-commerce sales, commentators proposed reform efforts including: (a) low, medium or high withholding tax rates for e-commerce payments; (b) qualitative economic presence tests (i.e., facts and circumstances tests) to enable source countries to tax e-commerce payments despite the absence of a traditional physical presence within the source country; (c) quantitative economic presence tests (e.g., permit source countries to tax above threshold sales such as \$1 million in sales); or (d) global formulary apportionment with destination sales as one of the factors to encourage source country taxation.¹³⁵

The lack of evidence surrounding source state base erosion resulting from e-commerce sales (discussed in Part II.C.), however, suggests that the OECD's more conservative reform path and insistence on applying traditional principles as well as the same tax rules to e-commerce and conventional commerce was likely the better approach. As previously noted, in the longer term an increase in international e-commerce—particularly in the sensitive tax area of cross-border B2C digital sales—may call for a re-evaluation of traditional rules and principles.

The OECD members have a lengthy history with respect to negotiating tax treaties based on the OECD model treaty, which in turn was based on earlier model treaties.¹³⁶ Moreover, the fact that the OECD member states cooperated effectively together on e-commerce reform may lead to enhanced loyalty that could encourage viable solutions in other areas

Global Competition?, 19 TAX NOTES INT'L 99 (1999) (discussing the need for greater coordination among national governments to limit the adverse effects of globalization).

¹³³ See also Charles E. McLure Jr., *Globalization, Tax Rules and National Sovereignty*, BULL. INT'L FISC. DOC. 328, 340 (2001) (noting that the OECD's e-commerce reform strategy, in contrast to its harmful taxation project, sought to negotiate areas of possible constraint on tax sovereignty).

¹³⁴ I argued that the international e-commerce income tax challenges could be addressed by bilaterally negotiating changes to tax treaties to promote the use of a low-rate withholding tax for e-commerce payments, an increased use of the restricted force of attraction rule to enhance source state taxation, and greater resort to the residual profit split methodology for transfer pricing purposes. See Cockfield, *supra* note 1, at 185-216.

¹³⁵ See, e.g., the sources in note 2.

¹³⁶ For discussion on the OECD's history, see note 5.

of policy concern. According to Hirschman, this Loyalty reduces the need for an equilibrium between Voice (the ability to express views on issues) and Exit (the ability to leave situations that impose overly restrictive conditions) as parties begin to trust each and accept a 'give and take' relationship where they are more willing to provide concessions in one area as they expect to receive concessions in other areas at some future date.¹³⁷

Because of the history of cooperation along with more recent efforts, it may be the case that the OECD member states have learned to trust the OECD process to the point where they are increasingly prepared to accept the OECD's leadership in resolving other areas of international tax policy concern, including binding multilateral mechanisms in limited areas such as transfer pricing arbitration. At a minimum, the trust encourages more modest efforts, such as enhanced multilateral information exchange, consistent transfer pricing documentation requirements and advanced pricing agreement (APA) procedures.¹³⁸

3. Server/PEs: A Cautionary Tale

While the OECD e-commerce tax reform efforts appear to have been generally successful, the development of the server/PE rule provides a cautionary tale on tax reform efforts undertaken by the OECD. In its discussion draft issued in December 1996, the Treasury Department reviewed the issue of server/PEs and concluded that servers would not likely constitute a permanent establishment under traditional tax principles: the report noted that international e-commerce would likely be best addressed by residence-based taxation.¹³⁹ Moreover, the IRS has narrowly construed the definition of permanent establishment in the past to exempt many business activities that are preparatory or auxiliary in character, such as the collection of information by a bank or the supervision of a construction site by a consulting firm.¹⁴⁰ In its first discussion of the issue,

¹³⁷ See ALBERT O. HIRSCHMAN, EXIT, VOICE AND LOYALTY - RESPONSES TO THE DECLINE IN FIRMS, ORGANIZATIONS AND STATES (1970). Hirschman's model has been used as an explanatory device to assist with understanding, among other things, European Union political and economic integration efforts. See Joseph H. H. Weiler, *The Transformation of Europe*, 100 YALE L. J. L. 2403 (1991).

¹³⁸ These efforts already occur on a multilateral basis for the members of the Pacific Association of Tax Administrators (PATA), including the United States, through its mutual agreement procedures (MAP) and (BAPA) bilateral advanced pricing agreements.

¹³⁹ See Treasury Report, *supra* note 1, at §§ 7.1.5 & 7.2.3.1.

¹⁴⁰ See IRS REVENUE RULING 72-418, 1972-2 C.B. 661 (exempting the U.S. office of a German bank from permanent establishment status because the office was mainly used to advertise and collect information on financial matters); IRS REVENUE RULING 77-45, 1977-1 C.B. 413 (exempting the U.S. office of a Canadian consulting engineering firm from permanent establishment status because the Canadian employees at the office were not authorized to make major decisions and their activities mainly involved planning and supervision).

the OECD similarly noted that servers are highly mobile.¹⁴¹ Finally, as noted above in the country review, tax authorities from England, Singapore, Ireland, and Hong Kong have issued administrative pronouncements that servers would never constitute permanent establishments under their domestic tax laws.

There are a number of policy rationales that argue against using servers as nexus for international income tax purposes.¹⁴² First, a server is simply a computer that has been networked to the Internet. There are millions of servers around the world that could potentially act as a permanent establishment: the new server/PE rule may be very difficult for tax authorities to monitor or enforce. Second, because the OECD test focuses on what the server *does*, the real test is actually placed on the software functions within the computer server. But software, like any information good, typically has high fixed costs of production but almost zero costs associated with copying and distribution on a network—software programs can be shifted to any server in the world and there may be no connection between the location of the software program and the jurisdiction where value is added or where the good or service is consumed (both of which serve as theoretical foundations for the imposition of international income taxes).

Third, in a related point, the server/PE rule provides opportunities for international tax planning that could lead to base erosion in high tax jurisdiction as servers or software functions within servers are transferred to low or nil income tax jurisdictions. Fourth, the use of a server/PE is arguably a significant departure from traditional international tax principles because traditional permanent establishments—construction sites, stores, factories—are fixed in a temporal and geographic sense and cannot be moved without the incursion of significant costs by a firm. Fifth, it is unclear how taxpayers or tax authorities will attribute profits to servers, if any, potentially leading to international double taxation when tax authorities cannot reach agreement on this issue.¹⁴³

Taking into account the apparent initial concerns about the server/PE rule expressed by the Treasury Department and the OECD as

¹⁴¹ See OECD TURKU REPORT, *supra* note 7, at ¶ 97.

¹⁴² In previous works, I have argued that servers should never constitute permanent establishments. See, e.g., Cockfield, *supra* note 1, at 186-191; Arthur J. Cockfield, *Transforming the Internet into a Taxable Forum: A Case Study in E-Commerce Taxation*, 85 MINN. L. REV. 1171, 1177-1200 (2001).

¹⁴³ In an environment of increased cross-border trade in intangible assets (including e-commerce goods and services), the appropriate amount of profit that should be attributed to a particular jurisdiction that created, transferred or sold the intangible asset is thought have become a more important issue. The OECD has produced several draft papers in this area to provoke discussion and consensus. See, e.g., OECD TECHNICAL ADVISORY GROUP ON MONITORING THE APPLICATION OF EXISTING TREATY NORMS FOR THE TAXATION OF BUSINESS PROFITS, ATTRIBUTION OF PROFIT TO A PERMANENT ESTABLISHMENT INVOLVED IN ELECTRONIC COMMERCE TRANSACTIONS (Discussion Paper 2001).

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well as the policy concerns noted previously, how did this rule eventually become enshrined within the OECD model tax treaty? As discussed within their government reports, certain OECD member states were concerned that, as net e-commerce importing nations, they would lose out on revenues associated with the income taxation of international e-commerce because foreign e-commerce businesses no longer needed to set up a traditional physical presence within their borders.¹⁴⁴ Taxing servers located within their jurisdictions seemed like one way to restore balance.¹⁴⁵ Other OECD countries, such as Spain and Portugal, were requesting even more aggressive changes to the model tax treaty, including an extension of the permanent establishment definition to include commercial web sites in some circumstances.¹⁴⁶

At the time of the discussion, the United States produced the majority of the world’s e-commerce¹⁴⁷ and other OECD member states were understandably concerned with the Treasury Department’s apparent support for residence-based rules for the taxation of e-commerce (under the view that source base erosion would take place to the benefit of e-commerce exporting nations). The support for a server/PE rule can be seen as a reaction against residence-based taxation under the apparent (but likely misguided) notion that taxing server profits would prevent or reduce base erosion attributable to sales from foreign companies that were physically

¹⁴⁴ See, e.g., Australian report, *supra* note 1, at ¶ 7.2.15 (“A web site located on a server, that is fixed in time and location, and through which business is conducted may constitute a [permanent establishment.]”); Herb Dhaliwal, ELECTRONIC COMMERCE AND CANADA’S TAX ADMINISTRATION, A RESPONSE BY THE MINISTER OF NATIONAL REVENUE TO HIS ADVISORY COMMITTEE’S REPORT ON ELECTRONIC COMMERCE 21(1998) (“Whether a file server fits the definition of a [permanent establishment] will depend on the facts and circumstances of the particular case. This issue will be dealt with on a case-by-case basis in a manner that is consistent with the Department’s current published interpretations and rulings.”).

¹⁴⁵ The fact that servers should be taken into account for permanent establishment purposes has been supported by at least a few commentators. See Luc Hinnekens, *Looking for an Appropriate Jurisdictional Framework for Source-State Taxation of International Electronic Commerce in the Twenty-First Century*, 26 INTERTAX 192 (1998) (proposing a “virtual permanent establishment” rule that would take into account qualitative criteria such as the presence of a server to determine whether the source country should be able to assert jurisdiction as well as quantitative criteria such as sales volumes); BRIAN J. ARNOLD & MICHAEL J. MCINTYRE, INTERNATIONAL TAX PRIMER 155-56 (2nd ed., 2002) (noting that the server/PE category would appear to be consistent with OECD precedents that recognize automated pumping equipment as a permanent establishment, even without human intervention).

¹⁴⁶ See also Michael J. McIntyre, *U.S. Taxation of Foreign Corporations in the Digital Age*, 55 BULL. INT’L FIS. DOC. 498 (2001) (arguing that the OECD should have permitted websites to constitute permanent establishments as long as the “virtual office” is used to perform the functions of a traditional office)

¹⁴⁷ See OECD, THE ECONOMIC AND SOCIAL IMPACTS OF ELECTRONIC COMMERCE: PRELIMINARY FINDINGS AND RESEARCH AGENDA 29 (1999) (estimating that the U.S. firms accounted for 80% of total global e-commerce).

located outside of the jurisdiction of consumption. As mentioned, the Ottawa Taxation Framework guidelines included the desire “to achieve a fair sharing of the tax base” and so the server/PE rule can be rationalized under the view that the rule would maintain the current sharing of tax revenues between residence and source countries. As discussed previously, this view can no longer be supported because (a) there is no evidence of significant source country base erosion; and (b) assuming that base erosion took place, it would necessitate significant profit attribution to the functioning of computer code, but the OECD seems to suggest in its e-commerce profit attribution report that attribution should be limited in most circumstances.¹⁴⁸

In order to move the process forward, the United States and other governments ultimately agreed to the server/PE rule despite initial opposition to the rule.¹⁴⁹ The U.S. may have preferred to work with its OECD partners to develop a consensus view on the server/PE topic, as it agreed to through the Ottawa Taxation Framework. Another possible explanation is the view by the Treasury Department that few to no profits would be attributable to servers hence the new rule would not dilute the ability of the United States to tax profits generated by e-commerce exports, returning the taxation of international e-commerce to the residence-based system discussed within Treasury’s 1996 discussion paper. As noted above, this view may be incorrect to the extent that the server/PE rule provides tax planning opportunities that permit firms to shift profits outside of relatively high corporate income tax jurisdictions like the United States.

A danger exists that bad policy will result from the kind of herd mentality that led to the adoption of the server/PE rule.¹⁵⁰ OECD member countries may have backed the rule, in part, under the view that it was needed to prevent the U.S., as the dominant producer of e-commerce goods and services, from deriving a windfall benefit from the application of the traditional permanent establishment rules to cross-border e-commerce transactions. The point here is that the OECD’s e-commerce reform processes and ultimate international tax policy positions were shaped by political concerns: political ‘horse-trading’ uninformed by a coherent policy perspective creates a risk that ‘bad’ tax policy will result.

In addition, the arguably ‘fuzziness’ of the Ottawa Taxation Framework guidelines, which included the desire for a “fair” sharing of revenues may have influenced the development of the server/PE rule under

¹⁴⁸ See note 143 *supra*.

¹⁴⁹ See COMMITTEE ON FISCAL AFFAIRS, CLARIFICATION ON THE APPLICATION OF THE PERMANENT ESTABLISHMENT DEFINITION IN E-COMMERCE: CHANGES TO THE COMMENTARY ON ARTICLE 5 ¶ 14 (2001) (noting that, in order to reach consensus, countries that initially opposed the view that no human intermediary was necessary for a finding of a permanent establishment ultimately signed onto to the changes).

¹⁵⁰ *But see* OECD Business Profits TAG Report, *supra* note 34, at ¶¶ 127-175 (providing different national views to justify the server/PE category).

the view that this rule would shore up source country taxation. As a result of the lack of agreement on international tax policy principles noted below, it may not be helpful to advocate fairness before the parties come to agreement on what constitutes a fair share of the international tax base. Having said that, the previous analysis shows that this Framework promoted in other cases the development of widely-accepted and arguably sound tax rules to govern international e-commerce.

B. INFORMAL VERSUS FORMAL WORLD TAX ORGANIZATIONS

This section builds on the analysis from the previous section by situating the OECD's e-commerce tax reform process within the ongoing debate on the need for a formal World Tax Organization that could impose binding tax rules on participating nations to limit adverse outcomes caused by, *inter alia*, international tax competition.

1. Lack of Agreement on Guiding Principles

Observers have noted that international tax policy analysis suffers from a certain degree of arbitrariness because analysts and tax authorities generally cannot come to agreement on the ways that accepted general principles such as the need for inter-nation fairness should guide actual reform efforts.¹⁵¹ The problem in part is that a particular nation's international tax interests may vary depending on its economic circumstances.¹⁵² For example, capital exporting nations tend to support

¹⁵¹ Dissatisfaction with traditional guiding principles such as the need for inter-nation equity or enhanced global efficiency is often expressed within the literature. See, e.g., Michael J. Graetz, *Taxing International Income: Inadequate Principles, Outdated Concepts and Unsatisfactory Policies*, 26 BROOKLYN J. INT'L L. 1357, 1362 (2001) (arguing that policy analysts employ outdated concepts and inappropriate principles that do not permit sound policy analysis); Stephen E. Shay, J. Clifton Fleming, Jr. & Robert J. Peroni, *The David R. Tillinghast Lecture "What's Source Got to Do With It?" Source Rules and U.S. International Taxation*, 56 TAX L. REV. 81, 83-84 (2002) (noting, "Because no clear economic or equitable principles guide the formulation of rules to divide income and expense by geographic origin, the construction of these rules has been a significantly arbitrary exercise"); Richard M. Bird & J. Scott Wilkie, *Source vs. residence-based Taxation in the European Union: The Wrong Question*, in TAXING CAPITAL INCOME IN THE EUROPEAN UNION: ISSUES AND OPTIONS FOR REFORM 78, 84 (Sijbren Cnossen ed., 2000) (noting, "The existing 'system' of international income taxation is posited on a set of facts that no longer holds, if indeed it ever did."). For a discussion on possible guiding principles, see, e.g., Michael J. McIntyre, *Guidelines for Taxing International Capital Flows: The Legal Perspective*, 46 NAT'L TAX J. 315 (1993); Alvin C. Warren, Jr., *Commentary: Alternatives for International Corporate Tax Reform*, 49 TAX L. REV. 599 (1994) (advocating greater resort to the non-discrimination principle).

¹⁵² For a discussion of the concept of inter-nation equity and economic allegiance theory, see Nancy H. Kaufman, *Fairness and the Taxation of International Income*, 29 LAW & POLICY INT'L BUS. 145 (1998).

residence-based taxation under the principle of capital export neutrality, which is achieved if a taxpayer's choice between investing at home or in a foreign country is not affected by taxes.¹⁵³ Capital importing nations tend to support source-based taxation under the principle of capital import neutrality, which maintains that companies operating abroad should be placed in the same tax position as their local competitors. Many developing nations and transitional economies prefer the rules within the United Nations model tax treaty, which strengthen source-based taxation.¹⁵⁴ Other nations may be both a capital exporting nation and a net e-commerce importing nation, which complicates matters and may lead to different preferred tax approaches for different industries.

This process can be distinguished from the different tax policy positions adopted by states or provinces within federal countries: if necessary, the highest court in the land can be resorted to provide one rule for all taxpayers to clarify how tax laws will interact among the different jurisdictions. For example, the U.S. Supreme Court has developed a bright-line physical presence test in the context of U.S. state and local sales and use taxation to ensure that inter-state commerce is not unduly inhibited by overly aggressive state laws.¹⁵⁵ Moreover, federal countries have legislative bodies that can pass legislation that comports with widely-accepted tax policy views (such as the passage by Congress of the *Tax Reform Act of 1986*, which reduced tax rates and broadened the income tax base, in manner that was consistent with many policy perspectives).

Similarly, within tightly integrated economic regions such as the European Union, the European Court of Justice plays an important (and increasing) role in developing a unified tax policy for the European Union countries. For example, in the 'Lankhorst-Hohorst' decision, the European Court of Justice ruled that thin capitalization rules cannot impose unequal treatment between resident and non-resident European Union companies, leading many European Union countries to re-design these rules.¹⁵⁶ The European Commission also plays an important role in shaping international

¹⁵³ For views that support the design of international tax laws on the basis of capital import export principles, see Robert J. Peroni, *Commentary: Deferral of U.S. Tax on International Income: End It, Don't Mend It – Why Should We Be Stuck in the Middle with Subpart F?* 79 TEX. L. REV. 1609 (2001); Robert J. Peroni, *Back to the Future: A Path to Progressive Reform of the U.S. International Income Tax Rules*, 51 U. MIAMI L. REV. 975, 981 (1997) (advocating simplified rules to strengthen residence-based taxation).

¹⁵⁴ See, e.g., UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES art. 5(7) (New York, United Nations, 1980) (extending source state taxation to the activities on independent agents in some circumstances).

¹⁵⁵ See *National Bellas Hess, Inc. v. Dep.t of Revenue*, 386 U.S. 753, 758 (1967); *Quill Corp. v. North Dakota*, 504 U.S. 298, 315 (1992).

¹⁵⁶ See EUROPEAN COMMISSION, "AN INTERNAL MARKET WITHOUT COMPANY TAX OBSTACLES: ACHIEVEMENTS, ONGOING INITIATIVES AND REMAINING CHALLENGES", COM (2003) 726, at 6-8.

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tax policy for the European Union countries. For example, beginning in 2001 the European Commission announced that it would begin to emphasize, as part of a longer term strategy, the 'consolidation' of corporate income tax bases, while permitting the member countries to impose their own tax rates.¹⁵⁷ Moreover, the Commission has achieved success in the past with, for example, value-added tax (VAT) harmonization and unified rules for the tax treatment of cross-border interest payments.¹⁵⁸

In contrast to the situation that exists for subfederal countries or for highly integrated regional economic unions, there is no international court or organization that has the authority to impose binding tax rules on national governments. Without such an organization, there is no body to encourage or mandate agreement on principles such as the need for international equity in the sharing of the cross-border income tax base. The lack of agreement on guiding principles would frustrate the ability of a global tax institution to impose rules that would attract widespread acceptance by national governments. This situation leads to a catch-22: the lack of agreement serves as a barrier to the formation of a world tax authority and the absence of a world tax authority frustrates the development of widely-accepted guiding principles for policy purposes.

¹⁵⁷ See EUROPEAN COMMISSION, "TOWARDS AN INTERNAL MARKET WITHOUT TAX OBSTACLES", COM (2001) 582. Unlike full-blown harmonization, proposed corporate tax consolidation schemes would co-exist with existing national tax regimes, thus preserving tax sovereignty to a greater extent. For example, the Commission is studying whether European Companies (European Union companies incorporated under the European Company Statute that takes effect on January 1, 2005) that have adopted common accounting standards can serve as the basis for developing a consolidated tax base. Other companies that employ country-specific accounting standards would be subject to the traditional tax rules under the different national tax systems. In 2003, the Commission announced that its efforts would concentrate on studying the viability of a 'Home State Taxation' system as well as the possibility of using harmonized accounting standards as the basis for a consolidated tax base for companies with European Union-wide activities. Under Home State Taxation, profits of a multinational firm would be computed according to the rules of one tax system only: the system of the home state of the parent company or head office of the firm. Each country would continue to tax its share of the firm's profits at its own corporate tax rate. See EUROPEAN COMMISSION, AN INTERNAL MARKET WITHOUT COMPANY TAX OBSTACLES: ACHIEVEMENTS, ONGOING INITIATIVES AND REMAINING CHALLENGES, COM (2003) 726, at 8-11.

¹⁵⁸ In 1993, the European Union countries harmonized their VAT tax bases and agreed to a minimum VAT rate of 15%. The minimum rate legislation was amended in 2001. See Council Directive 2001/4/EC of 19 January 2001 amending the sixth Directive (77/388/EEC) on the common system of value added tax, with regard to the length of time during which the minimum standard rate is to be applied (Official Journal of the European Union, 2001). In order to inhibit tax evasion on portfolio interest payments, the Commission passed a Directive whereby the member states agree to a transitional regime where each country must either exchange information on interest payments or withhold tax on these payments. See Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, arts. 11 & 12 (L 157/38 Official Journal of the European Union, 2003).

2. Theoretical Uncertainty Surrounding the Value of Formal Global Tax Organizations

Despite the inability to secure agreement on the application of international tax principles, there have been calls for the development of an international tax body other than the OECD.¹⁵⁹ An extensive literature has debated the merits of an (upper case) World Tax Organization, which would bind participating countries at the supranational level to inhibit perceived problems such as harmful international income tax competition.¹⁶⁰ This section provides an overview of some of the main points within this literature, while the next section explores how the informal and flexible nature of the OECD's tax reform process serves to better address international tax policy concerns.

Arguments in favor of a World Tax Organization include the view that: (1) it would restrict income tax competition that could lead to a 'race

¹⁵⁹ A UN report recommended the development of a world tax organization. UNITED NATIONS, RECOMMENDATIONS OF THE HIGH-LEVEL PANEL ON FINANCING FOR DEVELOPMENT (New York: United Nations, June 22, 2001). For discussion, see Frances M. Horner, *Do We Need an International Tax Organization?*, 93 TAX NOTES 709 (2001). See also VITO TANZI, TAXATION IN AN INTEGRATING WORLD 140 (1995) (suggesting that it might be time to establish a world tax institution); Reuven S. Avi-Yonah, *Globalization, Tax Competition and the Fiscal Crisis of the State* 113 Harv. L. Rev. 1573, 1670-1674 (2000) (advocating enhanced global cooperation and coordination through an extension of tax measures to the World Trade Organization); Victor Thuronyi, *In Defense of International Tax Cooperation and a Multilateral Tax Treaty*, 22 TAX NOTES INT'L 1291 (2001) (discussing the need for a global tax authority to administer a multilateral tax treaty based on the OECD model). An extensive literature review in this area is beyond the scope of this paper. For a recent treatment, see Adrian Sawyer, *Is an International Tax Organisation an Appropriate Forum for Administering Binding Rulings and APAs?* 2 E JOURNAL OF TAX RESEARCH 8, 12 (2004) (arguing that global tax institutions are needed to promote binding rules in certain areas such as transfer pricing disputes).

¹⁶⁰ For a sample of a few sources in this area, see, e.g., Peggy B. Musgrave & Richard A. Musgrave, *Fiscal Coordination and Competition in an International Setting*, in INFLUENCE OF TAX DIFFERENTIALS ON INTERNATIONAL COMPETITIVENESS 61 (*Proceedings of the VIIIth Munich Symposium on International Taxation*, 1990) (asserting that international tax competition will not secure an efficient allocation of resources among nations); Hans-Werner Sinn, *Tax Harmonization and Tax Competition in Europe*, 34 EUROPEAN ECONOMIC REVIEW 489 (1990) (arguing that international tax competition will lead to a greater focus of taxation on less mobile factors such as labour); Richard M. Bird & Jack M. Mintz, *Sharing the International Tax Base in a Changing World*, in PUBLIC FINANCE AND PUBLIC POLICY IN THE NEW CENTURY 405 (S. Cnossen & H. Sinn eds., Cambridge: MIT Press, 2003) (discussing barriers to international tax cooperation); John D. Wilson and David Wildasin, 88:6 *Capital Tax Competition: Bane or Boon*, JOURNAL OF PUBLIC ECONOMICS 1063 (2003) (reviewing the literature on tax competition and asserting that a better understanding of political processes is necessary to promote more informed modeling); ALEX EASSON, TAX INCENTIVES FOR FOREIGN DIRECT INVESTMENT 12-34 (2204) (discussing the policy implications of the use of tax incentives to attract foreign direct investment); and Robin Boadway, *Income Tax Reform for a Globalized World: the Case for a Dual Income Tax*, 16 J. ASIAN ECON. 910 (2005).

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to the bottom’ as nations compete for mobile capital by reducing their corporate income tax burdens, possibly leading to revenue shortfalls and the inability to fund needed government programs; (2) as countries reduce income tax burdens on capital, they tend to increase burdens on less mobile factors of production such as labor leading to regressive tax policy; (3) binding international tax rules might inhibit tax evasion or aggressive tax arbitrage strategies that deplete national revenues; (4) uniform income tax rules among nations could potentially lower compliance costs for multinational firms as they would have expend fewer resources to deal with different national tax laws (this is the motivation behind the EU Commission’s base consolidation proposals touched on previously); and (5) binding international agreements would inhibit countries from creating special tax incentives to attract mobile resources, which is thought to reduce international capital productivity as firms allocate resources to countries for tax reasons and not out of any real economic rationales.

Arguments against a formal World Tax Organization along with possible harmonization of tax bases and/or rates include the view that: (1) competition tames the so-called Leviathan tendencies of government to fund inefficient public services; (2) maintaining different income tax regimes promotes policy experimentation and innovation that could lead to future efficiency gains; (3) different income tax regimes can better address the distinct needs of different economies that, for instance, may prefer to subsidize certain business activities deemed crucial for national economic success; (4) centralized global institutions can be bureaucratic and could impose tax solutions that would create burdensome compliance costs for firms with cross-border activities; and (5) a World Tax Organization would unduly inhibit national sovereignty (this last item is taken up in the next section).

An ‘all or nothing’ approach identified above clearly oversimplifies the array of policy options provided to tax authorities. In fact, there exist more nuanced options that can be placed along a spectrum from the least tax sovereignty compromising to the most, including: (a) no cooperation whatsoever; (b) bilateral coordination via tax treaties; (c) multilateral informal cooperation and coordination (e.g., via the OECD model tax treaty); (d) multilateral coordination with limited binding rules such as binding arbitration for transfer pricing purposes; (e) more formal multilateral cooperation such as global formulary apportionment where participants would need to agree on a binding formula with specified factors to divvy up the international income tax pie; (f) multilateral agreement to harmonize national rates and/or bases; (g) formal World Tax Organization with authority to issue binding rules to participating nations after multilateral negotiations take place; and (h) a World Tax Organization with

legislative, executive and judicial branch for governance over international tax matters.¹⁶¹

The OECD's e-commerce tax reform efforts fall within the spectrum under paragraphs (b) and (c) by encouraging multilateral cooperation on tax solutions that are ultimately reflected in the OECD model tax treaty, which filters down into bilateral tax treaty negotiation and coordination. These reform processes take an intermediate position by permitting OECD nations to maintain a high degree of flexibility with their tax policies (hence preserving sovereignty) while agreeing to adopt coordination measures into their treaty network to ensure a consistent application of tax rules on cross-border transactions.

3. The OECD as informal 'world tax organization'

While there remains an ongoing debate surrounding the need for binding global tax institutions, observers generally note that movement in this direction remains unlikely for the foreseeable future.¹⁶² Most nations continue to view their tax systems as an important component in pursuing socio-economic policies and wish to maintain laws and policies tailored to their national interest without interference from a formal World Tax Organization or other overly intrusive binding measures: tax sovereignty concerns remain one of the prime drivers of international tax policy.¹⁶³ Viewed through the lens of international relations theory, the development

¹⁶¹ See, e.g., Paul R. McDaniel, *Formulary Taxation in the North American Free Trade Zone*, 49 TAX L. REV. 708 (1994) (discussing the need for comprehensive tax linkages among North American governments to reduce compliance costs and promote an efficient allocation of cross-border resources); Tim Edgar, *Corporate Income Tax Coordination as a Response to International Tax Competition and International Tax Arbitrage*, 51 CND. TAX J. 1097 (2003) (arguing that limited coordination rather than harmonization is the preferred alternative to inhibit harmful cross-border arbitrage activities).

¹⁶² See, e.g., Walter Hellerstein, *Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective*, 38 GA. L. REV. 1, 45 (2003) (noting that comprehensive international tax reform efforts "would require a degree of international tax cooperation that may charitably be described as implausible"); Richard M. Bird, *Shaping a New International Order*, BULL. INT'L FISC. DOC. 292, 297 (1988) (characterizing the desire for a world tax system as "utopian" and unrealistic); OECD, TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS para. 3.66 (Paris: OECD, looseleaf) (rejecting global formulary apportionment as a transfer pricing methodology because it "would require a level of international cooperation that is unrealistic to expect in the field of international taxation."); H. David Rosenbloom, *Sovereignty and the Regulation of International Business in the Tax Area*, 20 CAN.-U.S. L. J. 267 (1994) (discussing sovereignty constraints on international tax policy).

¹⁶³ For discussion on the ways that tax sovereignty concerns drive international policy positions, see Arthur J. Cockfield, *Tax Integration under NAFTA: Resolving the Conflict between Economic and Sovereignty Interests*, 34 STAN. J. INT'L L. 39 (1998) (arguing that incremental approaches that address sovereignty concerns promote sound policy).

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of international tax policy can be understood as an ongoing political process designed to accommodate the needs of important economic actors (e.g., multinational firms) by reducing tax barriers to cross-border trade and investment while, at the same time, meeting and respecting the political needs of nation states.¹⁶⁴ A better understanding of the political processes that shape international tax laws could lead to more informed policy analysis.¹⁶⁵

From this perspective, the OECD appears to be a good fit as it accommodates the interests of the most advanced industrial economies and their taxpayers without imposing any rules that would bind the tax policy of its member countries. The lack of authority to enact binding rules does not necessarily mean that the OECD is “toothless” as can be seen by returning to the vexing dilemma of international tax competition.

Since 1997, the OECD has taken the international lead in disentangling “fair” tax competition from “harmful” competition.¹⁶⁶ OECD member states have agreed to reduce their own “harmful preferential tax regimes” in the context of mobile financial and other services. For example, the OECD asserted that the use of foreign sales corporation provisions in the United States constituted a harmful tax practice.¹⁶⁷ In

¹⁶⁴ See, e.g., Robert A. Green, *Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes*, 23 YALE J. INT'L L. 79 (1998) (employing international relations theory to promote understanding of international tax cooperation mechanisms); Bird & Wilkie, *supra* note 151, at 96 (arguing that what matters most is not whether a proposed solution accords with a presumed normative principle, but whether the solution is likely to be accepted by major players in the international tax game).

¹⁶⁵ For discussion, see Julie Roin, *Taxation Without Coordination*, 31 J. LEGAL. STUD. 61 (2002) (discussing the political realities that deter tax harmonization efforts and concluding that these realities “are often ignored”); ARTHUR J. COCKFIELD, *NAFTA TAX LAW AND POLICY: RESOLVING THE CLASH BETWEEN SOVEREIGNTY AND ECONOMIC INTERESTS*, at 145-159 (Toronto: University of Toronto Press, 2005) (examining the trade-offs between political and economic concerns to discern an appropriate international policy approach for the NAFTA countries).

¹⁶⁶ OECD, *HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE* (1998). The ongoing OECD study aims to: identify the effects of tax competition; examine criteria for distinguishing between fair and harmful competition; and recommend ways in which governments acting individually or collectively could ameliorate negative tax competition effects. *Id.* at 8. The member states of the European Union have also agreed, through a non-binding political commitment, to eliminate tax measures that promote harmful tax competition. See Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy in OFFICIAL JOURNAL OF THE EUROPEAN COMMUNITIES, C2, January 6, 1998 (98/C 2/01) (discussing factors that determine whether taxation measures are “harmful”).

¹⁶⁷ See OECD, *TOWARDS GLOBAL TAX CO-OPERATION: PROGRESS IN IDENTIFYING AND ELIMINATING HARMFUL TAX PRACTICES* 14 (2000). These tax provisions subsidized foreign exports and were also found to be an illegal trade subsidy by a World Trade Organization panel. WTO, UNITED STATES—TAX TREATMENT FOR FOREIGN SALES CORPORATIONS, WT/DS108/AB/R (Feb. 2000).

addition, OECD members have agreed that they may retaliate against uncooperative tax havens who have not agreed to eliminate their harmful tax practices by December 31, 2005.¹⁶⁸

According to the OECD, by 2004 only two of the forty-seven harmful tax regimes maintained by OECD members remained.¹⁶⁹ Moreover, thirty-three tax havens had agreed to reform their tax laws to enhance information exchange and encourage transparency: only five countries remained on the list of uncooperative tax havens.¹⁷⁰ While its ultimate outcome remains uncertain, the OECD's harmful tax competition project can be portrayed as another significant step forward in international tax cooperation as it encourages multilateral coordination efforts to combat the use of tax havens to avoid or evade income taxes and limited tax base harmonization among OECD member states (by prohibiting the use of certain tax measures).

The potential success of the OECD's harmful tax competition project shows that global tax institutions may be able to address policy challenges without the need to resort to binding agreements or the traditional "sticks" of international law (such as threatened trade retaliation).¹⁷¹ Similarly, the success of the OECD e-commerce reform

¹⁶⁸ Taxpayers sometimes use tax havens to legally defer or illegally evade income tax liabilities, resulting in revenue losses to the high tax jurisdictions like the United States. These losses may be increasing. See, e.g., Martin A. Sullivan, *Economic Analysis: Latest IRS Data Show Jump in Tax Haven Profits*, TAX NOTES 151 (2004) (discussing a 64% increase in profits allocated to low tax jurisdictions by U.S.-based multinational firms from 1998 to 2000).

¹⁶⁹ See OECD 2004 Progress Report, *supra* note 167, at ¶ 12.

¹⁷⁰ *Id.* at para. 27.

¹⁷¹ *Id.* at para. 34 (concluding that "Substantial progress has been made in advancing the goals of the harmful tax practices project and many of the objectives originally set for this project have been accomplished"). But see Alex Easson, *Harmful Tax Competition: An Evaluation of the OECD Initiative*, 34 TAX NOTES INT'L 1037 (2004) (criticizing aspects of the project and noting areas where information exchange will not reduce abusive tax avoidance and evasion schemes); U.S. Foundation Lambastes OECD Global Forum on Taxation, 2005 WTD 221-9 (2005) (noting that OECD member states themselves often refuse to adopt the transparency and information exchange requirements they wish to impose on tax havens); Robert Goulder, *New Coalition Strikes Back at OECD Tax Haven Campaign*, 89 TAX NOTES 1352, 1352-53 (2000) (describing opposition to the OECD harmful tax competition project on the grounds that the project is too intrusive on the sovereignty of many developing countries and that it will unduly impede the movement of capital across borders). It is important to note that, as mentioned, the OECD harmful tax competition project contemplated retaliation against uncooperative tax havens, which is arguably more in line with traditional international law measures that seek to encourage compliance with legal rules through the use of "sticks." While this paper has taken the position that the OECD mainly preserves the ability of countries to pursue their own tax destinies, others maintain that OECD's international tax reform efforts in fact intrude to an unacceptable extent on tax sovereignty. See, e.g., Daniel Mitchell, *The Paris-based Organisation for Economic Cooperation and Development: Pushing Anti-U.S. Policies*

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process, where it arguably acted for the first time as a (lower case) world tax organization, serves as evidence that heightened multilateral cooperation and coordination through informal institutions can provide opportunities for the development of widely-accepted tax policy and rules.

C. THE ROAD AHEAD: THE NEED FOR MORE FORMAL OUTREACH

The fact that the OECD currently only needs to develop consensus for its thirty member states likely helps to find tax solutions. For the most part, these OECD members control the bulk of the world’s capital, and have similar interests as mature industrialized nations with service and technology-oriented economies. The ability to reach consensus on reform options is likely assisted by the fact that the OECD is constituted by only thirty countries so that reform does not become bogged down in a process where broader multilateral interests come into play. The OECD members include all of the most advanced economies of the world, and many have similar national interests so that they are, in the OECD’s own words, “like-minded,”¹⁷² which facilitates the attainment of consensus.

But the fact that the OECD generally remains a “rich countries’ club” is also a drawback for the development of effective international reform.¹⁷³ Countries such as India have viewed the OECD reform efforts with suspicion because of the understandable perspective that the organization is designed to protect the interests of its member countries. For example, the OECD model tax treaty eliminates withholding taxes on royalties, which supports the interests of net technology exporting countries.¹⁷⁴ By merely tinkering with the permanent establishment concept through the new server/PE rule, for instance, Indian tax authorities have argued that the OECD is protecting the interests of capital exporting nations at the expense of the interests of capital importing nations. Disagreements between OECD member countries and non-member countries are to be avoided as they reduce tax certainty and increase the risk of international

with American Tax Dollars, 6 PROSPERITAS 1 (Center for Freedom and Prosperity Foundation, 2006).

¹⁷² OECD, CHAIR OF THE HEADS OF DELEGATION OECD WORKING GROUPS, A STRATEGY FOR ENLARGEMENT AND OUTREACH 16-17 (2004) [“OECD Outreach Report”] (indicating that “like-mindedness” includes shared values concerning market-based economies and democratic principles).

¹⁷³ On the need to enlist non-OECD member input to promote effective international tax reform, see Bentley, *supra* note 121, at 1133-34. For discussion on the need to take better account of developing nations’ interests, see Reuven S. Avi-Yonah, *Globalization, Tax Competition and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573 (2000); Li, *supra* note 3, at 586 (arguing that inter-nation fairness should be paramount when different policy proposals are considered); Charles E. McClure, Jr., Will the OECD Initiative on Harmful Tax Competition Help Developing and Transition Countries? 59 *Bulletin for International Fiscal Documentation* 90 (2005).

¹⁷⁴ See OECD model tax treaty, *supra* note 6, at art. 12.

double taxation, which in turns inhibits international trade and investment (and harms the interests of OECD countries and their multinational firms).

One obvious way to create more inclusive reform efforts is to extend OECD membership to more countries. Mexico, for example, historically refused to enter into any tax treaties with developed nations but changed its policy and entered into its first treaty based largely on the OECD model with Canada in 1992 after Mexico was considered and later granted OECD membership in 1994 (the burgeoning Mexican tax treaty network was also influenced by Mexico's decision to enter NAFTA and the World Trade Organization).¹⁷⁵ It is unlikely, however, that the OECD will significantly increase membership in the near future, although the organization is considering membership extension to certain countries.¹⁷⁶ In any event, many countries may not wish to become an OECD member if they are forced to change tax policy (such as the extension of tax holidays to non-resident firms) or other aspects of domestic policy (such as privacy or criminal laws) in accordance with the OECD mandate to encourage democracy, the rule of law, and individual human rights.¹⁷⁷

In fact, in recent years the OECD has taken several significant steps to take into consideration the views from non-member countries. In 1997, the OECD began to add the positions of certain non-member countries to the OECD model tax treaty "in recognition of [the] growing influence of the Model Convention in non-member countries."¹⁷⁸ In 2002, the OECD, International Monetary Fund, and World Bank announced efforts to form the International Tax Dialogue to provide a forum for input from developing countries and other international organizations on tax measures to improve co-ordination of technical assistance, share good practices and pursue common objectives in improving the administration of national tax systems.¹⁷⁹

In addition, the OECD has sponsored multilateral tax centers in Austria, Hungary, Turkey, Mexico and Korea to hold meetings with representatives from non-OECD countries.¹⁸⁰ Moreover, the OECD

¹⁷⁵ See Income Tax Convention, Apr. 8, 1991, Canada-Mexico (amended by a Protocol on same date).

¹⁷⁶ For discussion, see OECD Outreach Report, *supra* note 172, at 6 (describing mandate to investigate OECD enlargement and outreach).

¹⁷⁷ On the other hand, an increasing number of developing nations might benefit from inclusion within the OECD if membership encourages more transparent statistics concerning economic indices by tapping into highly respected OECD statistical gathering resources. Greater transparency could encourage more inward foreign direct investment (FDI) into these developing nations as investors would be presented with more certain information concerning the economic status of the country where their FDI takes place.

¹⁷⁸ See OECD COMMITTEE ON FISCAL AFFAIRS, OECD MODEL TAX CONVENTION ON INCOME AND ON CAPITAL 10 (Condensed Version, 2003).

¹⁷⁹ For discussion, see Bentley, *supra* note 121, at 1133; Horner, *supra* note 160, at 712.

¹⁸⁰ See Charles Gnaedinger, *OECD Tax Centers Spark Dialogue for Non-OECD States' Benefit*, 2004 WTD 86-7 (2004).

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operates tax centers in Russia, China, Malaysia and India and assists with the development of regional programs in Latin America and Africa.¹⁸¹ The OECD also provides a Global Forum on tax matters whereby non-member countries are provided some opportunities for input and design of tax reform options.¹⁸² Finally, as discussed, the OECD developed outreach programs for its e-commerce tax reform efforts (such as membership in TAGs) to ensure that non-member states participated in the dialogue that led to changes within the OECD model tax treaty.

A more effective solution may be to combine and formalize the different outreach programs developed by the OECD.¹⁸³ The e-commerce example demonstrates that outreach heightens the chance for effective reform when non-member countries can participate in the deliberation and formulation of changes to international tax rules and principles. The formal structure could be designed in such a way to extend permanent membership to non-member countries to provide opportunities for them to voice their concerns and assist with the design of reform efforts. By creating a permanent structure, the OECD reform efforts could promote legitimacy with these non-members, further encouraging them to ‘buy-in’ to reform efforts.

Two-tiered membership could be extended to participating countries. The first tier would include all OECD member countries—consensus among these members would continue to be needed to enact major policy changes, such as amendments to the OECD model tax treaty. The second tier would include non-member countries who wished to be granted permanent membership within this tier. Countries from both tiers would be invited to deliberate policy changes through the Committee on Fiscal Affairs and its committees, but only tier one countries could ultimately make these changes (this approach is similar to the OECD’s e-commerce tax reform efforts).

Tier two status would be likely problematic for non-member countries but, given current political realities, it may be the best that they can hope for.¹⁸⁴ Permanent membership at least would provide non-

¹⁸¹ *Id.*

¹⁸² See OECD Outreach Report, *supra* note 172, at 31-36.

¹⁸³ See, e.g., OECD Outreach Report, *supra* note 172, at 35 (noting the development of more formal memberships in the context of the Global Forum on Competition).

¹⁸⁴ This proposal could be used to promote the reform advocated by Frances Horner who asserts that, for any international tax cooperation efforts to be successful with respect to taking into consideration the needs of developing countries, an agenda with the following five elements is required: (a) an open dialogue on all reform issues, including replacing fundamental principles of international tax such as the non-taxation of portfolio income; (b) dialogue on sharing revenues from profits, including analysis of global formulary apportionment; (c) taking into consideration how developed countries’ tax systems may inhibit development for developing countries; (d) increasing emphasis on training and providing other resources to support developing countries’ efforts to improve tax

member countries with more opportunities to access OECD resources and to provide input. It would also help to allay concerns that the OECD has been 'captured' by multinational firms based in OECD countries; the perceived influence of these firms may be reducing the legitimacy and effectiveness of OECD reform efforts.

The proposal would not change the *status quo* by any significant degree and hence might attract the necessary support from OECD members. The OECD's outreach program has already been formalized to a certain extent through the Board for Co-operation with Non-OECD Economies (a subsidiary body of the Committee on Fiscal Affairs) and the Advisory Group on Co-operation with Non-OECD Economies, which administers the outreach programs and advises the Board.¹⁸⁵ In addition, the Committee on Fiscal Affairs already permits certain non-OECD member countries to participate in committee work as Observers. In 2004, China and South Africa joined Russia and Argentina as Observers in the CFA: this seems to be a positive step in that it would be consistent with the view, noted earlier, that the OECD is effective at informally accommodating the changing global economic environment. The OECD could further legitimize its reform efforts and become a truly global tax organization by extending permanent membership to non-member countries to give them more opportunities to provide input into prospective reform efforts.

CONCLUSION

This Article reviewed national and OECD reactions to the challenges presented by the taxation of international e-commerce. The OECD took a lead role at promoting guiding principles to tackle these challenges then developed consensus-promoting processes to move the reform efforts forward. The success of these efforts likely pre-empted national legislative and administrative actions as governments, as revealed by the survey within this paper, were generally content to abide by the OECD views.

As evidenced by the e-commerce reform initiatives which involved unprecedented global tax cooperation, the OECD is increasingly acting as an informal (lower case) world tax organization in contrast to the sometimes touted need for a formal (upper case) World Tax Organization that could impose binding tax rules on participating nations. In a world where governments jealously protect their tax sovereignty, the OECD reform process, which emphasizes multilateral deliberation and consensus-building

administration; and (e) ensuring that developing countries can provide input into reform efforts. See Horner, *supra* note 160, at 714-715.

¹⁸⁵ See CENTRE FOR TAX POLICY AND ADMINISTRATION, HANDBOOK: DEVELOPING PARTNERSHIPS WITH NON-OECD ECONOMIES 4, 10 (2004) (describing three categories of partnerships, which extend cooperative efforts to non-OECD member states).

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through “soft institutions,” may be the best available option for the development of international tax policy that promotes international welfare while permitting nations to continue to pass tax laws in their perceived national self-interest. The OECD could further legitimize its reform efforts by creating a formal and simplified outreach program to provide a more inclusive forum for deliberation between OECD member and non-member states.