An *Antigua Gambling* Model for the International Tax Regime

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The international tax world is facing a defining moment. While there is little agreement on anything else within the field, there appears to be a wide and deep consensus that the modern international tax regime—the so-called flawed miracle emerging from World War II—is irrevocably broken. Rich countries, poor countries, multinational institutions, scholars, and politicians all seem to agree the time is now to revisit the international tax regime and rebuild it from the ground up. Leading the way is the Organization for Economic Cooperation and Development (OECD) through its Base Erosion and Profit Shifting (BEPS) project, which promises to adopt common international principles to prevent multinational taxpayers from using techniques that cause their income to fall through the cracks without any country able to meaningfully tax it.[1] But the BEPS project, as well as all similar efforts, faces the formidable task of building a consensus without the infrastructure of a new institutional framework for international taxation.

Of course, the task of developing an entirely new institutional framework for international tax is a major and daunting one. Rather than address the enormity of this entire project, this Essay will focus on one aspect that has received less attention as of late: even if a consensus around new rules can be universally agreed to, what happens when countries break the rules?

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1. *See generally* ORG. ECON. COOP. DEV., ADDRESSING BASE EROSION & PROFIT SHIFTING (2013), *available at* www.loyensloeff.com/nl-NL/Documents/OECD.pdf [hereinafter OECD BEPS REPORT].

This issue has proven sticky, even under the current international tax regime. Countries that are signatories to tax treaties often disagree on how to apply or interpret them. Traditionally, such treaties provided that the "competent authorities" of the signatory countries would meet and work out such differences.[2] If the differences were accidental or purely technical, this would make sense. But what if the disagreement represents fundamental policy differences? Should the countries submit the disagreement to arbitration? Should the parties withdraw from the treaty? Should the taxpayers be involved or only the governments?

These issues will only be exacerbated in any new multilateral framework emerging from BEPS or similar projects.[3] To date, however, little attention has been paid to these issues within the emerging debates over a new institutional framework for international taxation. This Essay will address these issues, using a recent dispute in the World Trade Organization (WTO) between the United States and the tiny country of Antigua and Barbuda over internet gambling as a model for framing the discussion.

To this end, Part I of this Essay will briefly describe the *Antigua Gambling* dispute and the resolution adopted by the Dispute Settlement Body of the WTO. Part II will then briefly describe the state of the modern debate over BEPS and similar projects. Part III will use *Antigua Gambling* as a thought experiment of how to build dispute resolution mechanisms for international tax, proposing several potential alternative models that could be adopted.

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2. *See* US Model Income Tax Convention of Nov. 15, 2006 art. 25, *available at* http://www.treasury.gov/press-center/press-releases/Documents/hp16801.pdf.

3. *See* Marie Sapirie, *News Analysis: A Preview of Country-by-Country Reporting*, 141 TAX NOTES 263 (Oct. 21, 2013) ("The OECD suggests that improvements to the mutual agreement procedure (MAP) will complement the BEPS project. However, the MAP may not be quite the panacea for the uncertainty resulting from the introduction of new rules . . . . The introduction of a mandatory and binding arbitration provision in the existing MAP provisions in tax treaties could help in situations when a treaty is available. . . . [M]andatory and binding arbitration alone would not eliminate the uncertainty from the new rules . . . .").

I. THE *ANTIGUA GAMBLING* DISPUTE BETWEEN THE UNITED STATES AND ANTIGUA AND BARBUDA

In July of 2013, the government of Antigua and Barbuda announced the formation of a committee to direct "the government's plan to build the framework necessary to suspend selected US intellectual property rights . . . ."[4] In other words, Antigua and Barbuda declared its intent to begin selling copyrighted songs, movies, and other material directly to U.S. consumers without paying royalties.[5] What made this different from any college student ripping their favorite songs off of BitTorrent or Pirate Bay was that these sales were to be completely legal. How could that be?

Antigua and Barbuda is the smallest member country of the WTO and for years hosted popular online gambling sites directed primarily at U.S. gamblers. In 2006, the United States enacted the Unlawful Internet Gambling Enforcement Act (UIGEA),[6] making it illegal to offer online gambling in the United States. In response, Antigua and Barbuda brought a claim in the WTO that the United States was impermissibly restraining international trade in services in violation of the General Agreement on Trade in Services (GATS). After several rounds of hearings and appeals, Antigua and Barbuda won the case. The typical remedy for a violation of GATS is permission for the aggrieved country to retaliate by enacting restraints or tariffs on services from the other country.

Unfortunately, this remedy would not be very effective between the United States and Antigua and Barbuda. Why? For the simple reason that there is virtually no trade in services between the United States and Antigua and Barbuda. So even if Antigua and Barbuda could impose retaliatory tariffs of 1000 percent on services provided by the United States in Antigua and Barbuda, it would prove near meaningless. In response, the WTO permitted Antigua and Barbuda

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4. *See* Press Release, Government of Antigua and Barbuda, Antiguan Government Announces Formation of WTO Remedies (July 17, 2013), http://www.ab.gov.ag/article_details.php?id=4294&category=38.

5. *See* Tim Worstall, *Antigua's Coming Legal Copyright Theft Site*, FORBES, Jan. 25, 2013, *available at* http://www.forbes.com/sites/timworstall/2013/01/25/antiguas-coming-legal-copyright-theft-site/.

6. 31 U.S.C. §§ 5361–5367 (2006).

to retaliate not under GATS but under the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). This is referred to as "cross-retaliation," as the aggrieved member state is permitted to retaliate under one agreement for a violation of a different agreement under the purview of the WTO.[7] In other words, Antigua and Barbuda could, perfectly legally, sell U.S. copyrighted material in the United States.

In response, the United States was provided the opportunity to repeal the ban and comply with the WTO ruling. The United States declined, citing the ability under the WTO for member states to enact legislation for public morality. Instead, it appealed the decision to the Appellate Body of the WTO.

The Appellate Body agreed in part with the United States that it did have a legitimate interest under GATS in furthering public morals. The problem was that the United States permitted inter-state gambling on horse racing through so-called "off-track betting" locations.[8] Thus, at a minimum, the United States was discriminating against offshore gambling websites with respect to horse racing. Accordingly, the Appellate Body held that the public morals exception did not justify discrimination against offshore gambling with respect to horse racing.[9]

The United States requested reasonable time to comply with this decision, but eventually Antigua sought permission to retaliate against the United States for failing to comply. At this remedy stage, the Dispute Settlement Body took into account the holding of the Appellate Body by limiting the right of Antigua to retaliate only to those lost profits attributable to horse racing, and not to all online gambling, such as poker and other card games.[10] Thus, although

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7. *See infra* note 29.

8. 31 U.S.C. § 5362(10)(D) ("The term 'unlawful Internet gambling' shall not include any activity that is allowed under the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 et seq.).").

9. *See* Appellate Body Report, *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R (Apr. 7, 2005), *available at* http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds285_e.htm [hereinafter Appellate Body Report]. *See generally* Mitchell E. Kilby, *The Mouse That Roared: Implications of the WTO Ruling in US-Gambling*, 44 TEX. INT'L L.J. 233 (2008).

10. *See* Decision by the Arbitrator, *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, *Recourse to Arbitration by the United States under*

Antigua requested the ability to cross-retaliate in an amount up to $3 billion per year, the WTO limited the Antigua retaliation to approximately $21 million per year.[11]

Even at this relatively small annual amount, *Antigua Gambling* represented the first time the WTO ruled in favor of a specific form of cross-retaliation. Prior to *Antigua Gambling*, the mere threat of cross-retaliation had proven sufficient to result in a negotiated compromise between the countries.[12] But in *Antigua Gambling*, the United States decided that the offending law was sufficiently important to its public policy as to be worth incurring the cost from cross-retaliation. Despite continued attempts at bilateral negotiations to avoid the implementation of the cross-retaliation, it appears as if Antigua and Barbuda will pursue its options to begin suspending obligations to protect U.S. intellectual property rights under TRIPS.[13]

II. THE OECD BEPS PROJECT AND DISPUTE RESOLUTION

What does *Antigua Gambling* have to do with international tax? One of the primary difficulties facing the international tax regime is the lack of reciprocity between large, developed countries and

Article 22.6 of the DSU, WT/DS285/ARB (Dec. 21 2007).

11. *See id.*

12. *See* Douglas Lerley, *Defining the Factors that Influence Developing Country Compliance with and Participation in the WTO Dispute Settlement System: Another Look at the Dispute over Bananas*, 33 L. & POL'Y INT'L BUS. 615 (2002). Although the WTO did approve of cross-retaliation by Ecuador against the European Union in the *EC-Bananas III* dispute, ultimately the dispute in that case was between the United States and the EU. *Id.* at 633–35. Thus, *Antigua Gambling* represents the first time a developing country on its own was granted permissible cross-retaliation against a developed country in the WTO. *See* Georgia Hamann, Note, *Replacing Slingshots with Swords: Implications of the Antigua-Gambling 22.6 Panel Report for Developing Countries and the World Trading System*, 42 VAND. J. TRANSNAT'L L. 993 (2009).

13. *See* Press Release, Government of Antigua and Barbuda, Latest Meeting with the USTR Disappointing (Nov. 20, 2013), *available at* http://www.ab.gov.ag/article_details.php?id=4553&category=38 ("[T]here is no escaping the fact that this was a disappointing meeting, and that the USTR proposals fell far short of what is required to settle this matter."); Press Release, Government of Antigua and Barbuda, Antigua and Barbuda's WTO Remedies Implementation Committee (Oct. 23, 2013), *available at* http://www.ab.gov.ag/article_details.php?id=4503&category=38 ("Prime Minister Hon. Baldwin Spencer . . . observed that 'in the face of the ongoing failure of the United States to negotiate with Antigua and Barbuda a reasonable settlement of this dispute, the implementation of trade remedies awarded by the WTO is an important international responsibility . . . .'").

smaller, less-developed countries. In other words, why would countries between which there is little trade want to agree on a tax treaty lowering tax barriers to trade? But without a tax treaty, at least currently, there is no way for the United States to coordinate with another country to prevent multinational corporations from exploiting gaps in the international tax regime. So wealthier countries such as the United States want smaller countries to cooperate on tax enforcement matters, even if they do not want to enter into a tax treaty to do so.[14] Understandably, however, many smaller countries have resisted cooperation on tax enforcement, especially if doing so would undermine what little economic or tax base they have in the first place.

As evidenced by the BEPS project, the primary challenge to the functioning of the existing international tax regime is the abuse of transfer pricing. Transfer pricing is the primary means by which taxpayers and governments divide tax base between multiple countries in which a multinational taxpayer does business.[15]

As a simple example, assume a company manufactures widgets in Country A and sells those widgets in Country B. It costs $200 to manufacture a widget in Country A, and it can be sold for $700 in Country B, for a total of $500 worldwide profit per widget. Which country is entitled to tax that $500?

Of course, both Country A and Country B claim the right to tax the profit. Country A is where the widget was designed and manufactured, and Country B is where the widget was sold. The $500 profit could not exist without both countries being involved. But what if both countries claim the power to tax the income? Assume each country imposes a tax of 20 percent on the total $500 profit, so that there is $100 tax owed to each country for a total of $200 tax. Now the company faces a choice. If it sells the widget in Country B, it results in $300 after-tax profit. If it sells the widget in Country A, however, it need only pay tax to Country A. So long as it can sell the

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14. *See* Adam H. Rosenzweig, *Thinking Outside the (Tax) Treaty*, 2012 WIS. L. REV. 717 [hereinafter Rosenzweig, *Thinking Outside*]. This has been evidenced by the rise of so-called "Tax Information Exchange Agreements" between such countries.

15. *See* Reuven S. Avi-Yonah, *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation*, 15 VA. TAX REV. 89 (1995).

widget for one dollar more than $375, it will make more after-tax profit selling in Country A, because a 20 percent tax on $375 is $75, resulting in $300 after-tax profit. But Country B clearly values the widget more than Country A, since it is willing to pay $500 per widget.

This is a simplified example of the so-called "double tax" problem.[16] Double tax is considered undesirable because it distorts behavior and thus leads to deadweight loss. In the example, the deadweight loss comes from selling the widget to a Country A consumer that values it less than a Country B consumer. For this reason, most countries have unilaterally adopted some form of double-tax relief regimes.[17]

There are two primary methods countries have adopted: (1) territorial exemption and (2) foreign tax credit.[18] Under territorial exemption, as applied to the example, Country A simply would not tax income arising from sales in Country B. This clearly solves the double tax problem, since now only Country B would tax the income. Under the foreign tax credit, Country A would simply subtract any tax paid by the company to Country B from whatever amount of tax the taxpayer would owe to Country A. In the example, Country A would charge $100 in tax but subtract the $100 paid to Country B for a total of zero tax owed to Country A.

There are complications in both territorial exemption and credit methods, but the basic idea is relatively simple and effective, and can be implemented unilaterally by any country wanting to relieve double taxation of cross-border trade. The problem, of course, is that the country granting relief is effectively sacrificing tax revenue as a result. For example, under a territorial exemption regime, Country A collects no tax revenue for sales made in Country B, and under a tax credit regime, Country A is reducing its tax revenue by the amount of taxes paid to Country B. Thus, there is a clear tradeoff between

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16. *See* Michael J. Graetz & Michael M. O'Hear, *The "Original Intent" of US International Taxation*, 46 DUKE L.J. 1021 (1997).

17. *See id.*

18. *See, e.g.*, Paul R. McDaniel, *Territorial vs. Worldwide International Tax Systems: Which is Better for the US*, 8 FLA. TAX REV. 283 (2006).

worldwide efficiency in trade, on the one hand, and tax revenue, on the other.

One solution would be for the countries to agree on how to divide the tax base between Country A and Country B, by treaty for example.[19] For example, assume that both countries agreed that $100 of the profit was attributable to manufacturing and $400 was attributable to sales. In that case, Country A would tax the $100 of profit and Country B would tax the $400 of profit. The total $500 would be taxed only once, thus solving the double tax problem.

The dominant mechanism used to divide worldwide income of multinational taxpayers under the current international tax regime is transfer pricing.[20] Under transfer pricing, a hypothetical intermediate step is added to an inter-state transaction. In the example, transfer pricing would provide that the company be deemed to have sold the widget from Country A to a retail store in Country B for the wholesale price of the widget, with the retail store in Country B selling to the ultimate consumer for the final sales price. For example, assume the retail price was $300. The sale from Country A to Country B would generate $100 of profit, which Country A would tax. The retail store in Country B would have a profit of $400 from selling the widget it bought for $300 for $700. In other words, by setting an intermediate price for the goods, transfer pricing effectively divides the profit between Country A and Country B.

The difficulty, of course, is choosing the proper "price" for the hypothetical intermediate transaction. The primary method adopted by most jurisdictions, including the United States, is typically referred to as the comparable uncontrolled price method (sometimes called the comparable sales method).[21] Under this method, tax authorities look to the price at which the company sells widgets to third-party retail stores around the world and assumes this is what it would have charged a retail store in Country B, had it engaged in the hypothetical intermediate transaction.

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19. *See* Rosenzweig, *Thinking Outside*, *supra* note 14.

20. *See* Avi-Yonah, *supra* note 15.

21. *See* ROBERT FEINSCHREIBER, TRANSFER PRICING METHODS: AN APPLICATIONS GUIDE ch. 5 (2004).

The comparable sales method works quite well for fungible, tangible goods. For example, if a company sells one barrel of oil for $100 at arms-length to a refinery, it is likely that all barrels of oil would sell for $100 to refineries. The comparable-sales method begins to fall apart, however, as the ability to identify comparables decreases; in particular, the comparable sales method is difficult to apply in the context of vertically integrated companies that sell primarily intellectual property-driven products.[22] For example, what is the value of licensing the name Google from the United States to Germany when Google would never license that name to a third party under any circumstances?

Instead, countries rely on taxpayers to report an initial transfer price for their goods and services. This, in turn, creates incentives for taxpayers to pick transfer prices that result in the most favorable tax result, rather than one that reflects the "true" arms-length price. Taken together, a significant concern has arisen over time that taxpayers are manipulating transfer pricing solely to minimize their worldwide tax liabilities.[23]

Taken to an extreme, taxpayers could even report *different* transfer prices to different countries. This results in the problem of double non-taxation, or some of the income effectively being subject to tax in no country at all. Returning to the example, assume the taxpayer reports a transfer price of $300 to Country A but $600 to Country B. In such case, Country A would impose a tax on $100 of profit, and Country B would impose a tax on $100 of profit. The remaining $300 of real economic profit "disappears," in that no one country is able to impose tax on that profit even it wanted to.

One obvious solution to the resulting double-non taxation is for Country A and Country B to sign a treaty permitting their tax authorities to compare notes and force the taxpayer to use only one transfer price for both countries.[24] Both Country A and Country B would have an incentive to do so, since they would both capture additional tax base. But what if a third country, Country C, was involved? Absent taxes, Country C would not be involved in the sale

22. *See, e.g.*, Avi-Yonah, *supra* note 15.
23. *See* OECD BEPS REPORT, *supra* note 1.
24. *See* Rosenzweig, *Thinking Outside*, *supra* note 14.

of the widget between Country A and Country B. But now the taxpayer has an incentive to funnel the sale of the widget through Country C, because doing so would permit the taxpayer to report different transfer prices to Country A and Country B. Further, since this is presumably valuable, the taxpayer would be willing to pay a fee to Country C to do so.

Assume the taxpayer establishes a corporate subsidiary in Country C and sells the widget to Country C for $300. As between Country A and Country C, the taxpayer only earns $100 of profit. The Country C company now sells the widget to Country B for $600. As between Country B and Country C, there is also only $100 of profit. The remaining $300 of profit is now located in Country C. Why would the taxpayer want the profit to be located in Country C? Primarily because Country C has no income tax on the profits but instead charges a fee for the privilege of incorporating there. Unlike the previous case, there now is a country—Country C—with an incentive to assist the taxpayer in shifting profits out of Country A and Country B. Even worse, what if the taxpayer was able to report different transfer prices to Country C, as well (for example, if Country C has an unsophisticated revenue service)? In that case, the remaining $300 of profit could actually end up "stateless," with no country meaningfully able to tax it.[25]

The problem is that now, neither Country A nor Country B can unilaterally or even working together capture the $300 tax base without risking double taxation. This is because neither Country A nor Country B can know whether the $300 is subject to tax or is in fact being taxed without asking Country C (or the taxpayer, which will be discussed below). Country C, however, has no incentive to share information with Country A or B, because doing so would cause it to lose the taxpayer's franchise fees. Now, unlike in the bilateral situation, the countries involved do not have an incentive to cooperate to prevent taxpayers from escaping tax through transfer pricing.[26] Put differently, double taxation can always solve double non-taxation—the only question is, which is worse?

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25. *See* Edward D. Kleinbard, *Stateless Income*, 11 FLA. TAX REV. 699 (2011).
26. *See* Rosenzweig, *Thinking Outside*, *supra* note 14, at 743–44.

All that is necessary for this phenomenon to hold is for there to be at least one country in the world that has a high need for revenue and that would otherwise not be able to attract investment other than through abetting tax avoidance.[27] So long as there is at least one such country, then all of the countries that have difficulty attracting investment or generating a stable domestic revenue base will also have an incentive to engage in tax competition so as not to be left out.

That leaves a world in which most wealthy countries with stable domestic tax bases and/or the ability to attract foreign investment have an incentive to work together to prevent transfer pricing abuse, while small, poorer countries have an incentive to assist taxpayers in avoiding wealthy country taxes.

There are three potential ways to tackle such problems. First, wealthy countries could "crack down" on their own taxpayers by imposing large fines on companies that refuse to cooperate. Second, wealthy countries could "crack down" on the small, poorer countries serving as tax havens for wealthy taxpayers. Third, wealthy countries could create a multinational institution to force taxpayers and countries to cooperate with each other to prevent the use of tax havens.

While all three potentially have the theoretical ability to work, in the real world, all three have been tried to combat transfer pricing abuse to little effect. While such efforts have proven more successful in the money laundering and tax evasion context, attempts to punish taxpayers or states that are perceived as engaging in improper transfer pricing activity have proven less than successful in eradicating competitive behavior. One argument raised to explain this is that, as punishment increases, the need for revenue in poor countries increases as well, only furthering the need to engage in even more harmful types of tax competition.[28]

Regardless, there is a clear disconnect between the incentives of relatively wealthier countries that have an incentive to cooperate and want to do so through organizations such as the OECD, and relatively poorer ones that have an incentive to compete over taxes. Ultimately,

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27. *See* Adam H. Rosenzweig, *Why Are There Tax Havens?*, 52 WM. & MARY L. REV. 923, 951 (2010).

28. *See id.* at 967.

it is this disconnect—and the resulting double non-taxation—that has led to the crumbling of the modern international tax regime and the call for a new institutional framework for international tax.

III. AN *ANTIGUA GAMBLING* MODEL FOR INTERNATIONAL TAX

What lessons can be drawn from these two stories? In the tax context, it appears disparate incentives between some developed and developing countries have led to a breakdown in the international order. In the trade context, we observe a dispute between arguably the wealthiest and poorest member nations being resolved pursuant to the terms of the WTO treaties and within the institutional framework of the WTO. Why has the WTO framework been so successful when the international tax framework seems not to have been? Could the lessons from the WTO be incorporated into the BEPS project to solve this problem?

The primary reason this disconnect arises is that the WTO institutional framework takes into account the disparate incentives of the developed and developing member nations in a manner that the international tax regime does not. Instead, the international tax regime continues to try to adopt a harmonized worldwide regime, which could be thought of as a one-size-fits-all approach. But if certain developing and developed countries cannot even agree on the normative starting point for the international tax regime, how can they agree on policing transfer pricing? Even worse, as noted above, only one country needs to defect from the regime for the entire system to unravel. Thus, the international tax system seems at an impasse. The primary thesis of this Essay is that, in building a new institutional framework, the international tax regime can learn from the recent experiences of the WTO in overcoming this impasse by balancing the interests of both developed and developing nations.

So what would an international tax regime look like that would incorporate the lessons of *Antigua Gambling*? The clearest answer would be to build a dispute settlement mechanism into the BEPS project that permits a form of cross-retaliation such as that used in the WTO. In other words, the current BEPS project focuses on building a set of consistent international norms on transfer pricing and dividing the tax base of multinational corporations among countries. Without

some mechanism to incorporate smaller countries that might have disparate incentives, however, this may not prove effective. The WTO cross-retaliation model could provide one such mechanism.

Turning to the WTO cross-retaliation mechanism in particular, in relevant part, Article 22 of the dispute settlement understanding of the WTO provides:

> 2. If the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance . . . such Member shall . . . enter into negotiations with any party having invoked the dispute settlement procedures, with a view to developing mutually acceptable compensation. If no satisfactory compensation has been agreed within 20 days after the date of expiry of the reasonable period of time, any party having invoked the dispute settlement procedures may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements.
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> 3. In considering what concessions or other obligations to suspend, the complaining party shall apply the following principles and procedures:
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> (a) the general principle is that the complaining party should first seek to suspend concessions or other obligations with respect to the same sector(s) as that in which the panel or Appellate Body has found a violation or other nullification or impairment;
>
> (b) if that party considers that it is not practicable or effective to suspend concessions or other obligations with respect to the same sector(s), it may seek to suspend concessions or other obligations in other sectors under the same agreement;
>
> (c) if that party considers that it is not practicable or effective to suspend concessions or other obligations with respect to other sectors under the same agreement, and that the circumstances are serious enough, it may seek to suspend concessions or other obligations under another covered agreement;

> (d) in applying the above principles, that party shall take into account:
>
> (i) the trade in the sector or under the agreement under which the panel or Appellate Body has found a violation or other nullification or impairment, and the importance of such trade to that party;
>
> (ii) the broader economic elements related to the nullification or impairment and the broader economic consequences of the suspension of concessions or other obligations;[29]

There are two crucial aspects to cross-retaliation in the WTO context that would need to be amended to fit within the international tax context. First, the WTO is a dispute resolution body. Thus, there would need to be established some permanent dispute resolution body for international tax. While this may be difficult in practice, it is not difficult in theory and has been covered in other places, so this Essay will assume that away. Second, the retaliation in the WTO is intended to increase sales or profits for private actors in the complaining party country at the expense of competitors in the offending country, potentially leading to political pressure to repeal the offending law.[30] In the tax context, however, the remedy would have to result in revenue for the government of the complaining country.

It is for these two reasons that the WTO mechanism has typically been deemed insufficient for international tax.[31] First, and primarily, as between countries that have not entered into tax treaties, there are no common norms to be violated. Thus, unlike in the WTO, there cannot be dispute resolution as to an underlying norm that does not

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29. Amelia Porges, *General Agreement on Tariffs and Trade: Multilateral Trade Negotiations Final Act Embodying the Results of the Uruguay Round of Trade Negotiations*, 33 I.L.M. 1125, 1239–40 (1994).

30. *See, e.g.*, Mark L. Movsesian, *Enforcement of WTO Rulings: An Interest Group Analysis*, 32 HOFSTRA L. REV. 1, 10 (2003).

31. *See* Rosenzweig, *Thinking Outside*, *supra* note 14, at 758–65.

exist, making the WTO model inapplicable to most international tax disputes.[32]

In the specific context of BEPS, however, it might be possible to establish commonly accepted worldwide norms. In such a case, the primary hurdle to applying a WTO model to international tax—the lack of common norms—would be overcome. A WTO-type regime would remain difficult to translate into international tax, however, because as between asymmetric countries with little or no trade, there is no direct retaliation possible in the tax context. This is where an *Antigua Gambling* type model comes into play.

For example, assume a world in which clear BEPS norms were established and agreed upon. What would happen if the United States adopted a rule unilaterally imposing a U.S. net income tax on income that should properly be allocated to the Cayman Islands under BEPS, such as income earned by Cayman entities with no U.S. business presence but with at least one U.S. shareholder?[33] In retaliation, the Cayman Islands could impose a similar income tax on U.S. entities with no Cayman Islands presence but owned by at least one Cayman shareholder. Of course, the universe of such entities would presumably be quite small or even nonexistent.

Similarly, assume the United States enacts an anti-tax haven law in direct contradiction to BEPS that imposes a net U.S. income tax on all non-U.S. subsidiaries of U.S. companies located in jurisdictions with no corporate income tax. As a result, all U.S. taxpayers with Cayman subsidiaries would liquidate their Cayman entities and reform them in another, permissible jurisdiction (say, Ireland). The Cayman Islands would lose significant revenue as a result of the fees that would have been charged to these entities. In response, the Cayman Islands could impose an income tax on all Cayman entities that have a U.S. subsidiary, but this would not be very effective for two reasons. First, there are likely few such companies. Second, to the extent there are such companies, they could easily move out of the Cayman Islands in response to such a tax. Thus, not only would retaliation not replace the lost revenue to the Cayman Islands, it could

32. *See id.* at 762.

33. While it may seem strange for a country to sign on to international norms and then intentionally violate them, that is precisely what occurred in *Antigua Gambling*.

actually hurt the Cayman economy by losing Cayman business to other jurisdictions.

So it seems apparent that direct retaliation would not be particularly useful in the international tax context, even if a country such as the United States clearly violated agreed-upon norms embodied in BEPS. This presents a challenge to translating an *Antigua Gambling* model to international tax. The remainder of this section will consider some potential alternatives.

A. Gross Withholding Tax and Tradeable Credits

Assume three countries, A, B, and C, are all signatories to BEPS. Countries A and C are large countries and Country B is the small country. Country A adopts a rule treating companies legally formed in Country B as Country A domestic companies if there is a reason to believe the company is engaged in tax avoidance. Country A is ruled to be in violation of BEPS in adopting this rule, but it refuses to change the rule because it believes the rule is necessary to prevent abusive tax structuring.

In response, Country B is permitted to cross-retaliate by imposing a gross withholding tax on all payments made by Country B companies subject to the Country A rule. Country B is able to collect the gross withholding tax because these companies are legally formed and actually located in Country B. Thus, as is typical with source-based taxation, there is not a collection problem. As a result, Country B is able to replace some of its lost revenue.

There is a double tax problem, however. Companies subject to the new Country A law will have to pay Country A net income tax and Country B gross withholding tax. Presumably such companies would not want to be located in Country B if they would have to pay Country A income tax and Country B withholding tax. The solution would be for Country A to grant a credit to the company for the withholding taxes paid to Country B. In this manner, the credit would act as a form of indirect revenue transfer, increasing revenue for Country B and lowering revenue for Country A.[34]

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34. *See generally* Michael Keen & David Wildasin, *Pareto Efficient International Taxation*, 94 AM. ECON. REV. 259 (2004).

Notice what the combination of the gross withholding tax and the credit accomplishes. First, it permits Country A to enact a tax rule it thinks is important to its national interest, even if it is in violation of BEPS. This is substantially similar to what the United States did in *Antigua Gambling*. Second, Country A is permitted to raise revenue under this new tax rule. Third, the credit permits some of that revenue to be transferred from Country A to Country B, to offset any potential lost revenue from Country A enacting the new rule. Assuming that Country A—as the larger country—is able to impose a greater tax liability with less distortions than Country B, which is a standard assumption, this could also be efficiency enhancing. This, in turn, could mean that there actually could be more total revenue for both Country A and Country B.

There could well be some technical problems that arise, but none of these should prove fatal to the proposal. For example, since the company, while legally formed and operated in Country B, is treated as a Country A company, all of its income may be considered "domestic source," meaning the credit could not be used by the company. One way to resolve this problem would be to require Country A to permit the credit for Country B taxes as part of the dispute settlement system. However, if Country A refuses to comply with the dispute settlement system in the first place, it may not want to do so with respect to the credits either.

This leads us to the harder issue—why would Country A comply with this at all? After all, Country A unilaterally violated BEPS in the first place by enacting the original law. There are two potential responses. First, historically, countries have tended to comply with WTO rulings even in the absence of a realistic threat of retaliation. For example, the United States complied with a WTO ruling requiring it to repeal a law mandating turtle protection devices on shrimping boats, even though the aggrieved countries, including Malaysia, could not realistically retaliate.[35] So perhaps in the interest of maintaining international consensus, Country A would be willing

35. *See* Howard F. Chang, *Toward a Greener GATT: Environmental Trade Measures and the Shrimp-Turtle Case*, 74 S. CAL. L. REV. 31 (2000).

to comply with the order and issue tax credits for Country B withholding taxes.

Second, the credit could be made transferable to any BEPS member country. In this manner, even if Country A would not accept the tax credit, perhaps the company could sell its tax credit to a taxpayer in Country D. Even better, knowing this is possible could make it more likely that Country A would accept the credit in the first place, since not doing so would only hurt its own taxpayers.

B. Extraterritorial Excise Tax and Extended Taxing Authority

A second option would be to provide a complaining country with taxing authority over taxpayers within the territory of the offending country.[36] Returning to the example, in response to Country A imposing its taxing authority over certain Country B corporations in violation of BEPS, Country B could impose a one-quarter percent excise tax on the income of all Country A corporations. From a revenue standpoint, the benefits of this approach are clear: Country B would be able to tax the larger Country A worldwide base and thus offset the revenue lost from Country A's law.

There are two difficult issues under this proposal, however. First, it would presumably be difficult for Country B to collect such a tax. Country A could be required to assist Country B in collecting such a tax, but if the countries could agree on tax collection, it is unlikely they would be in the dispute in the first place. An alternative would be for the other BEPS member countries to agree to assist Country B in collecting the excise tax. Thus, if a Country A corporation had no operations in Country B but did have operations in Country C, Country C could collect and remit the excise tax to Country B. Since Country C is not part of the dispute, presumably it would not oppose such assistance on the premise of maintaining the BEPS consensus. To the extent there were additional costs to Country C in doing so, such costs could be taken into account in setting the rate of the excise tax *ex ante* or could be added to the excise tax *ex post*.

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36. *But cf.* Eric T. Laity, *The Competence of Nations and International Tax Law*, 19 DUKE J. COMP. & INT'L L. 187, 252–53 (2009).

Second, there remains the possibility of double taxation. Unlike with the gross withholding tax, however, this is less problematic. Assuming it could be collected, the tax would be a double tax on Country A corporations with no operations in Country B. Presumably Country A corporations would not like this and would lobby Country A to fix it. Country A could have two potential responses. First, Country A could repeal the offending law. This would remove the offensive provision and thus the right to cross-retaliate, meaning Country B would be required to repeal the excise tax. In return, Country B would regain the original tax base it lost due to Country A adopting the offending law in the first place. Alternatively, Country A could choose to keep the offending law and provide a credit to Country A taxpayers. As with the withholding tax, this would have the effect of transferring revenue from Country A to Country B, to offset the lost revenue due to the offending law.

There are several benefits of the worldwide excise tax over the gross withholding tax. First, the revenue can be precisely calibrated, rather than turning on the happenstance of the timing of source payments. In other words, under a withholding tax, the complaining country would need to wait for payments of interest, dividends, or royalties actually to be made before the tax could be collected. Under the worldwide excise tax, this problem would not exist. Second, from a political economy standpoint, the tax is being felt by more Country A companies and thus could more likely lead to increased lobbying to repeal the offending law.[37] Under the withholding tax scheme, only those companies with connections to Country B would be affected. Third, the worldwide excise tax is more reciprocal in that the offending law extends Country A taxing jurisdiction into Country B; so it seems appropriate for the remedy to be to permit Country B to extend its taxing authority into Country A.

The tradeoff is the difficulty of collection. How that cost/benefit tradeoff is measured depends on how likely it might be for BEPS

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37. *But cf.* Jide Nzelibe, *The Case Against Reforming the WTO Enforcement Mechanism*, 2008 U. ILL. L. REV. 319, 323 (2008) ("[T]he challenge is not how to eliminate altogether the influence of interest groups in the WTO enforcement scheme, but rather how to develop a strategy that effectively harnesses interest-group dynamics in the service of reducing trade barriers.").

countries to cooperate with a complaining country to collect the tax. If such countries would cooperate, the worldwide excise tax may well be superior to the gross withholding tax. If not, the converse would be true.

C. Incorporate BEPS into the WTO

The final and perhaps most radical solution would be to incorporate BEPS into the WTO institutional framework.[38] This would prove difficult for the reasons stated above, primarily because the WTO addresses rules that are intended to increase private trade and not government revenue. That does not mean it would be impossible to incorporate tax disputes into the WTO, however.

In fact, the WTO dispute settlement regime has already dealt with an international tax issue in the United States extraterritorial income (ETI) regime cases. In that set of cases, the United States adopted an income tax rule that effectively subsidized U.S. companies that exported goods to other countries.[39] The WTO ruled that such a provision violated the General Agreement on Tariffs and Trade (GATT), notwithstanding that it was an income tax rule and not a tariff, because it subsidized U.S. exports at the expense of the exports of other countries. The WTO then authorized the EU to impose up to $4 billion per year in retaliatory tariffs on imports from the United States.[40] Unlike in *Antigua Gambling*, however, the United States eventually complied and repealed the offending rules (although it took several losing cases in front of the WTO for the United States to do so).[41]

As a technical matter, applying cross-retaliation in the context of the WTO would be the simplest of the three alternatives. Since Article 22 already exists, if BEPS were part of the WTO set of agreements, the WTO would be able to permit a complaining country

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38. *But cf.* Laity, *supra* note 36, at 253–54.

39. *See generally* Paul R. McDaniel, *The David R. Tillinghast Lecture Trade Agreements and Income Taxation: Interactions, Conflicts, and Resolutions*, 57 TAX L. REV. 275 (2004).

40. *See generally* Rosendo Lopez-Mata, *Income Taxation, International Competitiveness and the World Trade Organization's Rules on Subsidies: Lessons to the U.S. and to the World from the FSC Dispute*, 54 TAX LAW. 577 (2001).

41. *See* McDaniel, *supra* note 39.

to cross-retaliate under any of the other WTO agreements for a violation of BEPS, such as permitting Country B to cross-retaliate under TRIPS for a violation of BEPS. This may always be the case in international tax because the first requirement of Article 22.3—that the complaining country first seek to retaliate under the tax agreement—will always be insufficient as between large and small countries. In fact, this may make cross-retaliation the norm with respect to violations of BEPS, as opposed to violations of other agreements in which it has been applied sparingly.

The real difficulty in applying cross-retaliation in the context of the WTO is the public revenue aspect of international tax. Under the example, Country B's complaint would be that the law adopted by Country A deprived Country B of revenue in violation of BEPS. Permitting residents of Country B to sell copyrighted songs in Country A without violating TRIPS does not replace this revenue, at least not directly. Rather, it leads to increased profits for residents of Country B. Alternatively, the WTO could permit tariffs on trade as retaliation, as it did in the ETI case, which would raise revenue. In the ETI case, however, the point of the tariff was to offset the impermissible trade subsidy, with the goal of encouraging the United States to repeal the offending provision. In fact, the amount of the tariff was calculated based on the lost trade to private actors in the EU, based on an assumed share of worldwide trade and not on any last revenue to EU member states.[42] Thus, traditional retaliation methodologies utilized by the WTO would not respond to this revenue concern of international tax.

This can be resolved, however, by applying an assumed tax rate to the assumed private gains from such sales. In fact, this is very similar to what the WTO did in the *Antigua Gambling* case itself. In that case, once it was clear that the United States was in violation and would not conform, the only issue up for debate was how much permissible retaliation was appropriate. Under the methodology of Article 22, the WTO created a counter-factual in which the United States did conform and then calculated how much profit Antigua would have earned. The main dispute between the United States and

42. *See id.*

Antigua was not over this methodology but rather over whether the counter-factual should be permitting unlimited offshore gambling websites or only offshore gambling websites for horse racing. Although the WTO agreed with the United States that only horse racing was the appropriate counter-factual, it permitted Antiguan sales of U.S. copyrighted material up to the amount of lost profits if offshore online horse racing gambling were permitted—$21 million per year.

In the tax context, the same counter-factual approach could be adopted, but with an assumed tax rate applied. Assume Country B establishes that it lost $100 million of tax revenue due to the law adopted by Country A, and that the Country B tax rate is 10 percent. The next step is simply to divide the $100 million by 10 percent—that is, $1 billion—to establish how much in profits Country B taxpayers can make by selling Country A copyrighted material.

Not only does this solve the problem mathematically, it may actually make cross-retaliation more effective than in other contexts. In the *Antigua Gambling* context, the United States was able to protect U.S.-based remote gambling on horse racing by sacrificing $21 million per year in sales of copyrighted material. If the benefits of such protection were greater than $21 million to the horse racing gambling industry, this would be a net positive for the United States. But in the tax context, Country A would be collecting additional revenue from U.S. taxpayers by adopting the offending law at the expense of costing other U.S. business $1 billion in sales annually. Assuming the owners of copyrighted songs and books in Country A would not be too interested in paying $1 billion a year in a *de facto* tax solely to permit Country A to impose a separate tax under the offending law, this would lead to pressure to repeal the offending law—precisely the intended goal of cross-retaliation under Article 22.[43]

However, unlike in the typical WTO context, repeal of the offending law need not necessarily be the ultimate goal of tax cross-retaliation. The reason is that taxes are just money, and BEPS is an understanding on how to divide that money among states. Any lost

43. *See* Nzelibe, *supra* note 37.

tax revenue arising from a violation of BEPS can therefore be completely replaced by substitute tax revenue generated by the cross-retaliation. So long as the complaining country ends up with at least the same amount of revenue before and after the adoption of the offending provision, there would no longer necessarily be a violation of an international tax norm under BEPS. Unlike in the trade context, where the goal is to return to the more economically efficient open trading regime, in the tax context, the remedy may itself be the new regime. In this manner, cross-retaliation could actually help stabilize the emergence of a new international consensus rather than destabilize it.

Incorporating BEPS into the WTO would also increase the cost of failure to comply. If BEPS were a stand-alone regime, the only consequence of disregarding BEPS would be the collapse of BEPS. But if BEPS were part of the WTO, disregarding BEPS could potentially lead to the unraveling of GATT, GATS, and/or TRIPS. To the extent these agreements are important to a particular country, BEPS could "piggy-back" on them as a way of solidifying BEPS as an international norm. Cross-retaliation would only increase this benefit, since it would inexorably tie together these regimes.

IV. CONCLUSION

As the countries of the world continue to confront the challenges facing tax law in the next century, new models for an institutional framework for international tax become increasingly crucial to any success. While significant progress has been made in furthering underlying norms to serve as the basis for a modern international tax regime, less focus has been paid to building the institutions and structures necessary to implement these norms. To this end, this Essay proposes looking to the recent experience of the WTO in the *Antigua Gambling* case as a model for the new international tax regime. By balancing the needs of both larger, wealthier countries and smaller, poorer ones, the *Antigua Gambling* model could help overcome one of the largest obstacles confronting the modern international tax regime. Perhaps an *Antigua Gambling* model could serve as the basis for the beginning of a new institutional framework for international tax.