REVOLUTION OR EVOLUTION
SOVEREIGNTY, THE FINANCIAL CRISIS AND THE GOVERNANCE OF INTERNATIONAL TAXATION

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I. INTRODUCTION

Debates concerning the political, economic and social impacts of globalisation have continued unabated for over two decades. One aspect of globalisation most experts agree on is that growing economic interdependence demands increased international cooperation. In their seminal work on the impact of economic integration Keohane and Nye argued that a condition of *complex interdependence* characterised world affairs.[1] States retain formal sovereignty and remain key actors in systems of economic regulation, yet with the rapid internationalisation of markets, systems of production and corporations, the political authority of states is being challenged and is arguably in decline. In the absence of actual political authority beyond the state, effective governance in this increasingly interdependent, or 'globalised', world demands institutions and practices capable of enhancing cooperation and providing relative order within international economic relations.

It is contended that the need for effective global governance based on cooperation and shared decision-making is nowhere more apparent than in international taxation issues. The growing use of offshore jurisdictions to avoid or evade tax or other regulatory obligations in recent years is staggering, with the Bank of International Settlements (BIS) estimating that between 60 to 80 per cent of all international financial transactions are routed through offshore centres.[2] However, even within the European Union (EU), states have been particularly reluctant to cede their sovereign authority in relation to managing domestic tax affairs.[3] Yet in an era of transnational production and global capital markets national tax systems are highly interdependent – changing tax policies and practices in one country may have profound impacts on the tax systems of their neighbours. The extent of this interdependence has led commentators such as Radaelli to conclude that 'international taxation is a governance problem in search of institutionalization'.[4] Therefore, what is required is an international commitment to efficient and robust arrangements for the taxation and distribution of revenue from international business transactions.

Despite an acute need for more authoritative international tax governance,[5] this paper argues that the goal of establishing robust and sustainable international tax cooperation

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1 Robert Keohane and Joseph Nye, *Power and Interdependence: World Politics in Transition* (Little, Brown, 1977).

2 Richard Palan, *The Offshore World: Sovereign Markets, Virtual Places, and Nomad Millionaires* (Cornell University Press, 2003); Nicholas Shaxson, *Treasure Islands: Tax Havens and the Men Who Stole the World* (Palgrave Macmillan, 2011).

3 Benjamin Cohen, *Organizing the World's Money: The Political Economy of International Monetary Relations* (Basic Books, 1977): Claudio M Radaelli and Ulrike S Kraemer, 'Governance Areas in EU Direct Tax Policy' (2008) 46 *Journal of Common Market Studies* 315, 319.

4 Claudio M Radaelli, *The Politics of Corporate Taxation in the European Union: Knowledge and International Policy Agendas* (Routledge, 1997) 176.

5 See, eg, Dale Pinto and Adrian Sawyer, 'Towards Sustaining the Future of Taxation: Is a World Tax Organisation Necessary and Feasible in Today's Globalised World?' (2009) 24 *Australian Tax Forum* 179.

may be as elusive as ever despite the vaunted progress made since the The Group of Twenty (G20) endorsed the Organisation for Economic Co-operation and Development's (OECD) tax transparency agenda in April 2009. The paper begins with a sketch of the origins and the evolution of the international tax regime before assessing the structure of the governance problems central to international taxation. The second section of the paper argues that the contemporary theoretical literature concerning the multiple dimensions of state sovereignty provides a useful analytical framework for assessing the significance and likely effectiveness of recent developments aimed at enhancing international tax cooperation. The paper concludes with a sovereignty-centred analysis of these recent initiatives and argues that, while they represent incremental reform, the ongoing reluctance of key states in the international tax regime to cede their *de jure* sovereignty is likely to compromise the prospects of achieving effective international tax governance.

II. THE STRUCTURE OF THE INTERNATIONAL TAX REGIME

In an international regime built on the principle of preserving sovereignty, as is the case with taxation, the fundamental governance problem concerns the question which state has the right to tax the profits or income derived from international business.[6] Indeed many commentators correctly point out that the very notion of 'international taxation' as a concept is misleading when we are actually studying the interaction of domestic tax systems with international business transactions.[7] In technical terms the challenge is to develop a fair and efficient way to allocate the international tax base between sovereign states. The widely held economic ideal is that of tax neutrality whereby international investment decisions are not influenced by tax considerations. Because this theoretical ideal of international tax neutrality is elusive, the most practical approach is to tax international transactions according to either the *source* or *residency* principle. Under the residency principle, individuals and firms within a particular jurisdiction (residents for taxation purposes) are taxed by their home government on their worldwide income regardless of where it is earned. With the alternative source principle, firms and individuals are taxed on their income within the jurisdiction in which it was actually earned. Each approach offers a sound theoretical basis on which to establish an international tax regime, but in reality there is a real prospect of distributional conflicts between states over the control of the international tax base.[8]

Take the hypothetical (although common) example of a developing economy whose growing export sector is reliant on foreign investment. Such a country would benefit greatly from a source-based regime as it could tax profits from onshore production. In contrast our hypothetical country would suffer under a residence-based system because profits would be repatriated to investing countries before being taxed. These tensions have given rise to a complex web of Double Tax Agreements (DTAs), which attempt to '[d]isentangle national jurisdiction to tax by allocating the international tax base to the residence and source countries involved.'[9] This uncertainty regarding the allocation of the tax base combined with most states' desire to maximise revenue enhances the risk of double taxation. This occurs when two (or perhaps more) overlapping jurisdictions each attempt to tax an international transaction. While the risk of double taxation is real, a mitigating factor over the course of the 20th century has been the ability of international investors and Multi-national Corporations (MNCs) to successfully lobby governments to establish DTAs that limit double taxation. Indeed, with the advent of increased capital mobility, financial deregulation, and transnational production associated with economic

6 Michael J Graetz and Michael M O'Hearh, 'The 'Original Intent' of U.S. International Taxation' (1997) 46 *Duke Law Journal* 1021.
7 Brian J Arnold and Michael J McIntyre, *International Tax Primer* (Kluwer Law International, 2002) 2-3.
8 Graetz and O'Hearh, above n 6, 1021; Sol Picciotto, *International Business Taxation: A Study in the Internationalization of Business Regulation* (1992) 67-8.
9 Thomas Rixen, *The Political Economy of International Tax Governance* (Palgrave Macmillan, 2008) 63.

globalisation in recent decades, competitive pressures to attract investment have enhanced the structural power of investors relative to that of national governments, leading to tax competition and the related problem of double non-taxation.

In practice most DTAs use a combination of the source and residency approaches. As a general principle, active business or corporate income is taxed at the source while investment income is taxed in the country of residence, with the latter having become more important as international capital markets have expanded in recent years. When the tax rate in the source country is lower than in the residency jurisdiction (as is often the case with foreign investment from the developed world) countries such as the United States use a residency-based approach to taxing offshore corporate income, but apply a system of tax credits to ensure that investors can deduct tax paid offshore against their domestic liability. Another variation is that governments often impose a withholding tax on the passive earnings of foreign investors thus deviating from the residence approach.[10] In practise this means that the tax base is shared between the two countries concerned.

The taxation of offshore capital income depends on the effective exchange of information between tax authorities which in turn relies on high level international administrative cooperation because, as Rixen notes, otherwise 'tax authorities have to rely on the reports of taxpayers themselves, who have an economic incentive to under-report their true income.'[11] In the absence of such administrative cooperation and effective information exchange there is a significant risk of double non-taxation, through avoidance, legal tax planning and illegal international tax evasion. The latter usually involves resident investors failing to declare their offshore investment income to tax authorities.

International tax treaties have been relatively successful in terms of managing tax conflicts between developed economies and increasingly robust anti-avoidance measures have had an impact on the most blatant cases of illegal international tax evasion.[12] However, international tax regulation is far from comprehensive and is notoriously difficult to enforce, especially when there are strong economic incentives to grant tax concessions to attract investment.[13] This is clearly demonstrated in the case of Offshore Financial Centers (OFCs), which seek to attract investment and the establishment of financial services firms through a combination of low or negligible levels of taxation, scant regulation and lack of transparency.

OFCs, or tax havens, are regularly derided by politicians and the popular press alike, but such centers are often difficult to accurately define. Proponents of tax harmonization argue that any country that offers very low tax rates, especially on foreign investment, can be classified as a tax haven although such definitions are inevitably contested and some jurisdictions may exhibit tax haven characteristics while the tax system (and country itself) is not considered a tax haven. However, business and most governments do not subscribe to this relatively radical view and argue that sovereign governments should be free to choose the taxing and spending mix that is most appropriate to their particular needs.[14] Moreover, most liberal economists argue that a degree of tax competition between countries is healthy and keeps government accountable.[15] As a result, many of the definitions of tax havens and attempts to regulate them are not so concerned about the types and levels of taxation they impose but instead focus on their transparency, or the ability of tax authorities in other countries to gather information about transactions in tax haven jurisdictions. While tax havens are almost as old as taxation itself, modern tax havens first came to prominence in the 1920s as the ultra rich increasingly sought ways to

10 Sol Picciotto, Regulating Global Corporate Capitalism (Cambridge University Press, 2011) 224.

11 Ibid 61.

12 Michael Graetz, *Foundations of International Income Tax* (Foundation Press, 2003) chapters 5, 9.

13 Sol Picciotto, *Regulating Global Corporate Capitalism* (Cambridge University Press, 2011).

14 Michael C Webb, 'Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition' (2004) 11 *Review of International Political Economy* 787.

15 Charles Tiebout, 'A Pure Theory of Local Expenditures' (1956) 64 *The Journal of Political Economy* 416.

avoid rising taxes in Britain, Europe and North America. One of the first (and still most significant) tax havens was Switzerland, although it was soon followed by smaller European states and dependencies such as Liechtenstein and the Channel Islands, and subsequently by Caribbean jurisdictions such as Bahamas and Cayman Islands.[16] More controversially established financial centres such as the United States and the City of London have been accused of using lax regulation and opacity to attract foreign capital.[17]

The international tax regime as described above has been designed to protect the sovereign right of nation states to make tax law. A consequence of this regime, with its network of bilateral DTAs, is that there is a need for high-level administrative cooperation in order to ensure that firms and individuals with international sources of income are not subject to either conventional double taxation or double non-taxation. Given this context, it is not surprising that informal administrative co-operation dates back the first DTAs with the League of Nations developing a draft *Treaty on Mutual Administrative Assistance on Matters of Taxation* in 1928.[18]

However, from the outset, early DTAs were more concerned with the prevention of double taxation rather than strengthening cooperation around administrative issues and enforcement.[19] This trend, which continued through the 20th century, can be explained by three factors which are still of relevance to contemporary debates about the most effective strategies for enhancing cooperation in relation to international tax issues. Firstly, at this historical juncture, national revenue authorities were not overly concerned about the extent and fiscal impact of international tax evasion. Indeed it was not until the problem became more acute in the 1970s and 1980s that states engaged in more concerted efforts to improve cooperation around administrative issues.[20] Secondly, international business and financial actors naturally held a greater interest in avoiding double taxation while consistently opposing attempts to create formal bilateral and multilateral structures designed to enhance administrative cooperation. As early as 1927, the International Chamber of Commerce dismissed the League of Nations *Draft Treaty on Mutual Administrative Assistance in Tax Matters* as 'an extension beyond national frontiers of an organised system of fiscal inquiry' and 'an organised plan of attack on the taxpayer.'[21] Needless to say such countervailing pressures from business groups have been a constant feature of the debate ever since the OECD's Business and Industry Advisory Council made numerous representations against the OECD-Council of Europe multilateral *Convention on Mutual Administrative Assistance in Tax Matters*.[22]

The most significant impediments to the creation of formal structures to enhance international tax cooperation relate to the perceived threat they pose to state sovereignty and established principles of international public law. Generally, national governments have been unwilling to commit to uniform standards for tax and financial data or to allow foreign governments to actively pursue offshore tax investigations, which either contradict domestic law or where they have no significant tax interest. This political reluctance to cede tax sovereignty in the interests of formal administrative cooperation is also reinforced by general principles of international public law that limit states' abilities to gather evidence and enforce their tax laws offshore. Moreover, until very recently attempts to unilaterally enforce tax laws have been stymied because most states (and particularly

16 Richard Eccleston, 'Globalization, the GFC and the Politics of Taxation' in Giorel Curran and Elizabeth van Acker (eds), *Business and the Politics of Globalisation: After the Global Financial Crisis* (Pearson, 2008) 68.

17 Marshall Langer, 'The Case for Limiting Revenue Sharing Tax Agreements' (2005) 40 *Tax Notes International* 641; Jason Sharman, 'Offshore and the New Political Economy' (2010) 17 *Review of International Political Economy* 1, 4.

18 Picciotto, *International Business Taxation*, above n 8, 25.

19 Arnold and McIntyre, above n 7, 81-83.

20 Vito Tanzi, *Taxation in an Integrating World* (The Brookings Institution Press, 1995) 85.

21 Picciotto, *International Business Taxation*, above n 8, 251.

22 OECD, *OECD's Current Tax Agenda: April 2011* (OECD, 2011) 30 <http://www.oecd.org/dataoecd/38/17/1909369.pdf>.

Switzerland) limit extradition and other measures aimed at improving law-enforcement to criminal matters and do not include taxation administration.[23]

III. THE COLLABORATION PROBLEM OF INTERNATIONAL TAXATION

International relations scholars make a useful distinction between *coordination* and *collaboration* problems in global governance. Coordination problems are relatively benign in that all states stand to benefit from reaching an agreement and as such tend to be self-enforcing. Setting uniform standards for data transmission and aviation transport are examples of coordination problems. In contrast collaboration problems are defined as a governance regime where agreement delivers net benefits to the international community at large, but individual states may gain advantages from defection. Under such circumstances compliance becomes a more significant concern[24] and the ability to enforce the agreement on potential defectors, either through sanctions, reputational costs or some other political or economic means becomes critical. As mentioned in the introduction, the international tax regime can be classified as being a collaboration problem in that international cooperation will enhance the capacity of states to tax mobile capital, yet individual states face incentives to compete for capital by providing tax and regulatory concessions leading to the potential for tax competition.[25] Despite the growing need for more institutionalised tax governance, states have historically resisted the creation of such a regime because of the potential threat it would pose to their fiscal sovereignty.[26] The next part of the paper is devoted to exploring the dimensions of tax sovereignty in detail and assessing whether the Global Financial Crisis (GFC) and subsequent initiatives aimed at limiting international tax evasion represent fundamental reform of the international tax regime.

IV. SOVEREIGNTY AND THE GOVERNANCE OF INTERNATIONAL TAXATION

Cooperation and effective governance in world affairs are constrained by the fact that formal political authority resides at the level of the nation state and as a result the international system is to varying degrees anarchical. In some regions (such as the EU) and some policy arenas (such as trade and the WTO) states have ceded elements of their sovereignty to supranational institutions. However, as outlined above, this has not been the case in the international tax arena.[27] Indeed the DTA regime, which has evolved over the past 80 years, has been designed to improve coordination without limiting the fiscal sovereignty of states. Yet despite this intention, the DTA regime has come under sustained pressure because of the artificial separation of legal and economic aspects of commerce and the associated rise of OFCs which has facilitated the creation of an elaborate offshore system which provides fertile ground for international tax evasion.[28]

Ironically, a system that was devised to preserve the fiscal sovereignty of states and their right to tax and spend in accordance to domestic political imperatives has been seriously compromised. This apparent contradiction highlights that while analyses of international tax governance often evoke sovereignty as a central concept, as Ring states,

23 Marie Yates et al, ‘The Death of Information Exchange Agreements? Part Three’ (2011) 22 *Journal of International Taxation* 48, 50.

24 Lisa Martin and Beth Simmons, ‘Theories and Empirical Studies of International Institutions’ (1998) 52 *International Organization* 729.

25 Sven Steinmo, ‘The End of Redistribution? International Pressures and Domestic Tax Policy Choices’ (1994) 37(6) *Challenge* 1; Mark Hallerberg and Scott Basinger, ‘Internationalization and Changes in Tax Policy in OECD Countries: The Importance of Domestic Veto Players’ (1998) 31 *Comparative Political Studies* 321.

26 Diane Ring, ‘What’s at Stake in the Sovereignty Debate’ (2008) 49 *Virginia Journal of International Law* 155, 168-70.

27 Pinto and Sawyer, above n 5.

28 Palan, above n 2; Sharman, ‘Offshore’, above n 17; Shaxson, above n 2.

remarkably 'little attention has been directed at what precisely is meant by sovereignty and what place it has in international tax policy.'[29] Not only is it necessary to define and operationalise the different dimensions of sovereignty in order to fully understand the challenges of international tax governance, but assessing the extent to which the international tax regime sustains different dimensions of sovereignty provides an important test of the likely effectiveness and durability of international tax cooperation.

Traditionally, sovereignty has defined the condition whereby a state or other legal authority has effective legal and political control over its territory and people.[30] This definition suggests that making international commitments may limit a state's capacity to make and administer its own tax laws, effectively eroding its formal sovereignty. It is true that historically national governments have shown considerable determination to maintain their fiscal independence, but both the theoretical literature on contemporary sovereignty and empirical studies of international taxation suggest that maintaining formal legal sovereignty in the fiscal arena may be an unrealistic and even counterproductive objective. International relations scholars, such as Stephen Krasner, argue that it is increasingly necessary to distinguish between the formal legal nature of sovereignty (as described above) and effective political sovereignty.[31] The argument is that in an era of globalisation and 'complex interdependence', in which the conduct of one state inevitably has consequences for others, this leads to a condition in which most states are in practice semi-sovereign.[32] At the level of legal authority states may enjoy a high degree of sovereignty, but in practice the political and economic capacity of national government is highly constrained by the broader international system in which they are situated. As Diane Ring has recently argued, sovereignty may still exist, but it has been fundamentally transformed.[33]

In the context of international taxation Thomas Rixen provides some useful insights into the two dimensions of sovereignty described above with his distinction between *de jure* sovereignty, or the right to formal legal freedom, and the more important *de facto sovereignty,* or the ability to achieve policy objectives in practice. In these terms we can explain how the reluctance of states to engage in legislative or administrative cooperation (threatening their *de jure* sovereignty) has left them vulnerable to international tax competition, avoidance and evasion which ironically has compromised their fiscal independence and capacity (*de facto sovereignty*).[34] Given that scholars such as Rixen argue that *de jure sovereignty* will have to be compromised for states to preserve their fiscal independence, the next part of the paper is devoted to a brief assessment of whether post-financial crisis developments within international tax cooperation are consistent with such a transformation and whether they are likely to result in a more robust and durable international tax regime.

V. DE JURE SOVEREIGNTY AND THE FAILED OECD HARMFUL TAX COMPETITION INITIATIVE

By the late 1990s the growth in OFCs and the associated threat they pose to advanced, high tax economies prompted unprecedented regulatory action against so-called 'tax havens'.[35] After a period of lengthy and difficult negotiations the OECD eventually published its

29 Ring, above n 26, 158.
30 Stephen Krasner, 'Sovereignty, Regimes, and Human Rights' in Volker Rittberger (ed), *Regime Theory and International Relations* (Oxford University Press, 1993) 139, 139-142; John McLaren, 'The OECD's 'harmful tax competition' project: Is it international law?' (2009) 24(3) *Australian Tax Forum* 449-51.
31 Ibid.
32 Stephen Krasner, 'Pervasive Not Perverse: Semi-Sovereigns as the Global Norm' (1977) 30 *Cornell International Law Journal* 651, 652.
33 Ring, above n 26, 158.
34 Rixen, above n 9, 27.
35 OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD,1998).

report on Harmful Tax Competition in 1998, which set out 'a rough core of agreed principles concerning the nature of the problem and the appropriate remedial actions to be taken.'[36] More specifically the report sought to reduce the use of harmful tax practices such as providing incentives to attract new foreign investment that were not available to domestic firms. More ambitious was a commitment to reduce the activities of tax havens, or any state which 'offers itself, or is perceived to offer itself, as a place used by non-residents to escape tax in their country of residence.'[37] This attempt to regulate tax havens was ambitious because it directly challenged the sovereign interests of the states identified as tax havens and because none of the states concerned was a member of the OECD.

In a detailed study of the OECD's attempt to regulate international tax havens, Jason Sharman notes that despite the intent of the world's richest nations 'by 2002 the small-state tax havens had prevailed, and the campaign to regulate international tax competition had failed.'[38] While the OECD has a good track record in terms of fostering expert consensus on economic policy issues and regulatory practice, the attempt to regulate tax havens has been quite different. Whereas traditionally the OECD has been successful at devising regulatory regimes that are implemented by member states for their mutual benefit, the tax haven initiative involved threatening and coercing small and generally poor non-member states. This was a radical departure from the inclusive and cooperative approach which the OECD had traditionally adopted.[39] Unwilling to relinquish their sovereignty and comparative taxation advantage, the vast majority of jurisdictions identified as tax havens by the OECD fought back and defended their reputation. In the political battle that ensued, the OECD was vulnerable to claims that it was trying to eliminate the very competition it generally promotes simply because it was in the interests of its wealthy, high tax member states.[40]

These biting criticisms combined with intensive business lobbying of the US government ultimately forced the OECD to engage in a tactical retreat by watering down their Harmful Tax Competition (HTC) agenda to a point where it was clear that the campaign to regulate international tax competition had failed at that time.[41] As far as sovereignty is concerned, the failed HTC initiative is consistent with a broader history of international tax governance in that states are willing to cooperate in relation to international tax matters if agreements offer the prospect of mutual benefit without threatening their *de jure* sovereignty, such as the DTA regime. On the other hand, states strongly oppose international agreements, which have the potential to threaten either their economic competitiveness or their fiscal sovereignty. The final section of this paper assesses whether renewed attempts to promote tax transparency arising from the G20 at the height of the GFC represent a 'revolutionary' development in international tax governance and whether there is evidence of states compromising their *de jure* sovereignty in the interests of creating a regime that could support more robust and durable international tax cooperation.

36 Jason Sharman, *Havens in a Storm: the Struggle for Global Tax Regulation* (Cornell University Press, 2006).

37 OECD, *Harmful Tax Competition*, above n 25.

38 Sharman, *Havens*, above n 31; Robert Kurdle,'Tax Policy in the OECD: Soft Governance Gets Harder' in Kerstin Martens and Anja Jakobi (eds), *Mechanisms of OECD Governance* (Oxford University Press, 2010) 86; Ronen Palan, Richard Murphy and Christian Chavagneux, *Tax Havens: How Globalization Really Works* (Cornell University Press, 2010) 212-25.

39 Sharman, *Havens*, above n 36; Richard Woodward, *The Organisation for Economic Cooperation and Development* (Routledge, 2009).

40 Webb, above n 14, 800; Sharman, *Havens*, above n 31, 119.

41 Ring, above n 26, 185-191.

VI. THE GLOBAL FINANCIAL CRISIS, SOVEREIGNTY AND THE RENEWED GLOBAL FORUM

There are very few constants in business and politics, a point clearly highlighted by the recent financial crisis. In terms of international tax regulation, the GFC has prompted unprecedented political support for what were ailing attempts to regulate tax havens.[42] For example, between 2002 and November 2008 only 39 OECD Tax Information Exchange Agreements (TIEAs) designed to end tax haven secrecy had been signed. In contrast 640 agreements have been signed in the last three years alone.[43] This success has led OECD Secretary-General Angel Gurría to state 'what we are witnessing is nothing short of a revolution. By addressing the challenges posed by the dark side of the tax world, the campaign for global tax transparency is in full flow.'[44] While some critics argue that there are real limitations to the OECD TIEAs,[45] most commentators argue that they are part of a broader movement to limit international tax evasion.[46] Perhaps the most significant development was the commitment made by G20 leaders in April 2009 'to take action against non-cooperative jurisdictions, including tax havens'.[47] How then can we explain this unprecedented commitment to regulate tax havens on the part of the world's most significant economies and do these statements represent a real commitment to sacrifice *de jure* sovereignty in the interests of improved international tax cooperation?

The first reason is largely symbolic. When G20 leaders first met in Washington D.C. at the height of the GFC in November 2008 they were under significant political pressure to reach agreement on a common response to the crisis and to further endorse and expand the OECD's existing work on tax havens was an obvious issue on which all leaders could agree. Secondly, tax havens may not have been the central cause of the GFC, but they were clearly a symptom of the underregulated and overly secretive international financial system which did contribute to the crisis. Moreover, if the G20 is successful in ending bank secrecy and making international finance more transparent then the potential for international tax evasion will be limited as a consequence. Finally, the GFC and its aftermath had an unprecedented impact on the budget position of all advanced economies. While Australian government debt is forecast to peak at a modest 7.2 per cent of GDP,[48] the situation is much more serious in the United States where federal debt is expected to reach US$ 13.1 trillion or 90 per cent of GDP by 2014 after recording a federal deficit of US$1.4 trillion in 2009 alone.[49] Given the vast magnitude of the public debt burden facing many of the world's leading economies it is not surprising that many governments have a renewed interest in limiting international tax avoidance and evasion.

The extent to which the G20's commitment to ending international tax evasion yields real dividends ultimately depends on the longer term political resolve of world leaders,

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42 Richard Eccleston, Peter Carroll and Aynsley Kellow, 'Handmaiden to the G20?: The OECD's Evolving Role in Global Governance' (Paper presented at the Australian Political Science Association Conference 2010, University of Melbourne, 27 September 2010).

43 OECD, *The Global Forum on Transparency and Exchange of Information for Tax Purposes: Information Brief* (2011) <http://www.oecd.org/dataoecd/32/45/43757434.pdf>.

44 Angel Gurria quoted in OECD, *Global Forum Consolidates Tax Evasion Revolution in Advance of Pittsburgh* (2009) <http://www.oecd.org/document/32/0,3343,en_2649_37427_43601579_1_1_1_1,00.html>.

45 Yates et al, above n 23.

46 See Tax Justice Network <http://www.taxjustice.net/cms/front_content.php?idcatart=2>; Reuven Avi-Yonah, 'The OECD Harmful Tax Competition Report: A Tenth Anniversary Retrospective' (2008) 89 (Public Law and Legal Research Working Paper Series No 115, University of Michigan, August 2008) 5; McLaren, above n 30.

47 G20, *London Communiqué: The Global Plan for Recovery and Reform* (2 April 2009) <http://ww.g20.org/Documents/final-communique.pdf>.

48 Commonwealth Government Treasury, *Budget Paper No. 1* (2011) 7-6 <http://cache.treasury.gov.au/budget/2011-12/content/download/bp1_bst7.pdf>.

49 Congress of the United States Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2009 to 2019* (2009) 16 <http://www.cbo.gov/ftpdocs/99xx/doc9957/01-07-Outlook.pdf>.

however progress to date has generally exceeded (albeit modest) expectations. The key institutional development arising from the financial crisis was the OECD's success in securing a G20 mandate in support of its international taxation agenda. More specifically, and in part because developing and reaching agreement on detailed proposals on financial reform was more elusive,[50] the G20 formally endorsed the OECD's tax transparency agenda at the second leaders meeting in London, April 2009, committing the G20:

> To take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of tax information.[51]

This declaration and commitment to potentially impose sanctions, such as an increased withholding of taxes against uncooperative jurisdictions, represented a watershed moment in terms of the international commitment to tax transparency. The G20's April 2009 request of the OECD to 'develop an effective peer-review mechanism to assess compliance' assumed a tangible form in September 2009 with the creation of a revised and enhanced Global Forum on Transparency and Information Exchange for Taxation Purposes (GF). Note - the original Global Forum was established in 2000.[52]

Reflecting the growing political commitment to international tax transparency, this revised GF incorporates a number of important structural and procedural changes relative to the early 2000s. The revised Global Forum has deliberately been established at arms length to the OECD to promote involvement of the non-OECD members in the Forum's management and activities. This institutional separation was formally established by the OECD Council's 2009 decision to sponsor and provide secretarial support to the Global Forum but to grant it formal autonomy from the organisation's governance structures.[53] In practical terms, this is designed to formally give OECD members and non-members equal footing in the Forum's Steering Group (who establishes the work program) and in the Peer Review Group (who conduct assessments) as well as on the Forum's Secretariat. Given non-OECD members lack of participation in the failed HTC initiative, improving the inclusiveness and legitimacy of the Forum is central to its ongoing success.[54] Theoretically this is significant because true democratic participation should help ensure that the GF cannot be used as an instrument of powerful states.

While critics argue that the Forum's agenda, work program, and aspects of the assessments it conducts, continue to be dominated by the interests of powerful member states, these critics acknowledge that this is inevitable in any international Forum and that the current regime represents a significant improvement on past practice.[55] There is also a consensus among Forum participants interviewed for this research that a critical test as to whether the revised Forum processes are inclusive and equitable, will be the extent of discrimination in the reviews and assessments of OECD member states relative to non-members. In terms of participation, the fact that non-member states Bermuda and China have been elected to positions as vice-chairs of the Forum Steering Committee, while India

50 Interview with official associated with the Global Forum Process (September 2009). This research has been informed by interviews with a range of officials associated with the Global Forum Process which were granted under the condition of anonymity.

51 G20, above n 47.

52 Ibid; Tony Porter and Veronica Rubio-Vega, 'Global Forum on Transparency and Exchange of Information for Tax Purposes,' in Thomas Hale and David Held (eds), *Encyclopedia of Transnational Governance Innovation* (2011); Adrian Sawyer, 'Peer Review of Tax Information Exchange Agreements: Is it More than Just About the Numbers?' (2011) 25 *Australian Tax Forum* 213.

53 OECD, *The Global Forum*, above n 43.

54 Porter and Rubio-Vega, above n 52, 63.

55 Interview with official associated with the Global Forum Process (June 2011).

and Jersey have been elected as vice-chairs of the Forum Peer Review Group represents real progress.[56]

In terms of process, the most significant changes include the introduction of a more robust, two-staged peer-review process designed to establish the extent that GF members (which numbered 101 in April 2011) complied with the emerging international standard for information exchange. The tax transparency standard promoted by the original GF, established in 2000, was widely criticised because it assessed compliance based on whether the jurisdiction under review had entered into 12 information exchange agreements irrespective of whether they had appropriate legal and regulatory framework to support information exchange, or whether the jurisdiction concerned effectively exchanged information in practice. [57] In contrast the revised post-2009 peer process assesses the legal and regulatory framework and a jurisdiction's capacity to exchange information in 'Phase 1' followed by a field-based 'Phase 2' assessment which involves assessing the extent to which tax information is exchanged in practice.[58]

In addition to these procedural changes to the peer-review process the Global Forum has also elaborated and refined the criteria against which a country under review would be assessed. The Global Forum previously recognised a country as having 'substantially implemented' the international standard on having signed a threshold of 12 TIEAs, which was widely criticised on the grounds that an Offshore Financial Centre (OFC) could meet the standard without compromising its offshore business by entering into agreements with obscure states of little economic significance.[59] In contrast, the revised criteria represents an incremental shift away from the arbitrary 12 agreement threshold towards a requirement that members 'network of information exchange agreements should cover all relevant partners.'[60] This is suggestive of a more nuanced review regime, which attempts to establish the quality and relevance of exchange agreements rather than just an arbitrary quantum.

It may be too early to make a definitive assessment of how this new standard will be assessed in practice; as of July 2011 34 Peer Review assessments had been published including 12 combined phase 1 and 2 reports.[61] Based on this preliminary evidence the new regime does represent an incremental improvement relative to the Forum process that existed prior to 2009. More specifically the revised GF has promoted tax transparency in the following ways:

- The G20's mandate for the Global Forum's work combined with the threat of sanctions for non-compliance has resulted in the dramatic expansion of the information exchange network with 600 TIEAs having been signed since 2008; and
- All OECD member states and recognised financial centres have committed to the forum process; and
- Many jurisdictions have made or are making legislative and administrative changes to support information exchange including improving corporate governance and accounting standards.

Despite this progress in terms of enhancing the legal infrastructure for exchanging tax information we will not be able to evaluate the impact of these developments on international tax evasion until 'Phase 2' assessments have been conducted on jurisdictions

56 OECD, *The Global Forum*, above n 43.
57 Yates et al, above n 23; Sawyer, above n 52.
58 OECD, *Implementing Tax Transparency Standards: An Assessor's Handbook.* (OECD, 2nd ed, 2011) 45-60.
59 Picciotto, *Regulating Global Corporate Capitalism*, above n13, 249-50.
60 OECD, *Launch of Peer Review Process: Terms of Reference to Monitor and Review Progress Towards Transparency And Exchange of Information for Tax Purposes* (2010) 8 <http://www.oecd.org/dataoecd/37/42/44824681.pdf>.
61 OECD, *The Global Forum*, above n 43; Sawyer, above n 52.

identified as tax havens in the OECD's initial HTC progress report.[62] Once this process has been completed the critical test will be whether the published assessments are rigorous and whether the international community, led by the Global Forum, can develop effective strategies to ensure jurisdictions address any deficiencies identified in the 'Phase 2' review. However, there are some early signs of evidence of changed behaviour in terms of the supply of aggressive offshore schemes as well as the success of various voluntary disclosure schemes administered by tax authorities in wealthy industrial economies.[63] For example, the Australian government recently reported significant declines in capital flows to OFCs such as Liechtenstein (80 per cent), Vanuatu (50 per cent) and Switzerland (22 per cent); jurisdictions that have historically been used in aggressive tax planning schemes.[64] Another dimension of changed behaviour brought about by improved information exchange and associated measures, is that small developing states are no longer willing to establish OFCs as part of a development strategy. For example, the government of Mauritius has recently abandoned its ambition of establishing an OFC in light of the recent OECD and G20 initiatives.[65]

Such progress is clearly significant, especially given the recent history and politics surrounding international tax affairs. However the evidence suggests that recent developments fall short of a revolution in international tax governance. In terms of our focus on tax sovereignty, the developments described above clearly represent a deepening of administrative cooperation but this has only been possible because the international commitment to the OECD's standard for tax information exchange does not threaten *de jure* sovereignty of states. For all the talk of international tax cooperation there is little evidence that states will enter into agreements that will limit their ability to attract capital or compel deeper administrative cooperation. For example, there remains deep-seated resistance to proposals for the automatic exchange of information beyond a handful of European states.[66] Similarly radical proposals to allocate international taxes on a country by country basis are also opposed on this basis (as well as massive transitional issues involved).[67]

A more subtle concern with the revised GF process is that while it is much more equitable than the pre-GFC regime, the process, like with most intergovernmental institutions, is captive to the interests of its powerful members. To this extent the smaller jurisdictions remain concerned that they will have to make concessions that will not be imposed on larger jurisdictions impeding their ability to attract capital. For example, both press coverage and off-the-record interviews with participants in the GF process suggest that core countries such the United States can exert considerable influence over their assessment.[68] Similarly China's ability to insist that Macau did not receive a negative assessment has been well documented.[69] This evidence suggests that powerful states are unwilling to cede their *de facto sovereignty* to the revised GF and that the regime risks becoming an instrument through which powerful states can support their unilateral anti-avoidance provisions. This will inevitably become increasingly difficult to sustain, especially if jurisdictions such as the United States do not reciprocate by providing tax and

62 OECD, *Towards Global Tax Cooperation: Progress in Identifying and Eliminating Harmful Tax Competition.* (2000).

63 OECD, *Offshore Voluntary Disclosure: Comparative Analysis, Guidance and Policy Advice* (2010) <http://www.oecd.org/dataoecd/60/31/46244704.pdf>.

64 Kate Walsh, 'Inquiry Windfall for ATO', *Australian Financial Review* (Melbourne), 13 July 2011, 8.

65 Interview with official associated with the Global Forum Process (June 2011).

66 David Spencer, 'FATCA and Automatic Exchange of Tax Information' (2010) 21 *Journal of International Taxation* 62.

67 Kurdle, above n 38, 84; Kimberly A Clausing and Reuven S Avi-Yonah, 'Reforming Corporate Taxation in a Global Economy' (The Hamilton Project Discussion Paper No 2007/2008, The Brookings Institution, Washington DC).

68 IFC Review, Global Forum Releases Nine Peer Review Reports (30 June 2011) <http://ifcreview.com/viewnews.aspx?articleId=3022>.

69 Shaxson, above n 2, 106.

financial information for non-resident investors. Ironically such unilateralism has the potential to undermine the trust on which successful international tax cooperation depends.

This paper acknowledges that the creation of the revised Global Forum represents a significant institutional development which has the potential to support tax information exchange. However, despite the financial crisis and the rhetoric around ending tax haven abuse, to date there is little evidence of states demonstrating a willingness to compromise their *de jure sovereignty* in order to put the governance of international taxation on a more sustained footing. Given this lack of progress I share Rixen's concerns that 'it is unlikely that increased administrative cooperation and information exchange will suffice to cope effectively with the problem of avoidance and evasion, as long as countries are independent in their international tax affairs.'[70]

70 Rixen, above n 9, 201.