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WHY STUDY TAX HISTORY?

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Why Study Tax History?

P. Harris and D. de Cogan eds., *Studies in the History of Tax Law, Volume 9*, (Hart, 2019)

Reuven S. Avi-Yonah* 

Since the beginning of this century, John Tiley organized an annual tax history conference at Cambridge, a tradition that was continued after his death under the leadership of Peter Harris. These are the papers from the ninth Cambridge Tax Law History Conference, held in July 2018. In the usual manner, the papers have been selected from an oversupply of proposals for their interest and relevance, and scrutinized and edited to the highest standard for inclusion in this prestigious series. The result is an outstanding book, with many high quality contributions to historical tax research.

The papers fall within five basic themes. Four papers focus on tax theory: Bentham; social contract and tax governance; Schumpeter's 'thunder of history'; and the resurgence of the benefits theory. Three involve the history of UK specific interpretational issues: management expenses; anti-avoidance jurisprudence; and identification of professionals. A further three concern specific forms of UK tax on road travel, land and capital gains. One paper considers the formation of HMRC and another explains aspects of nineteenth-century taxation by reference to Jane Austen characters. Four consider aspects of international taxation: development of EU corporate tax policy; history of Dutch tax planning; the important 1942 Canada–US tax treaty; and the 1928 League of Nations model tax treaties on tax evasion. Also included are papers on the effects of WWI on the New Zealand income tax and development of anti-tax avoidance rules in China.

The papers are of obvious importance to tax historians. But the majority of readers of this journal are not tax historians, but rather tax academics and practitioners. Why should they be interested in tax history?

One obvious answer is that it is frequently impossible to understand the present state of tax law without knowing what led to it. Casebooks often make the mistake of omitting cases that have been overturned by later enactments. The result is that students are unable to comprehend the current law because they do not understand what the lawmakers were trying to achieve. For a classic exposition on this theme, read C.I. Kingson *The Foreign Tax Credit and its Critics*, 9 Am. J. Tax Pol'y 1 (1991), which explains in detail what were the loopholes that led to the enactment of each of the "baskets" in IRC section 904. This article should be required reading for anyone who is concerned with tax complexity, especially since after TCJA we are back to five baskets (there used to be only two from 2004 to 2017).

But there is another, deeper reason why we should care about tax history: Solutions in tax tend to repeat themselves in cyclical fashion, and therefore studying the past can suggest remedies for current ills. For example, one of the common proposals to fix the problem of cross-crediting under the GILTI regime is applying the foreign tax credit limitation on a country by country basis. That was the foreign tax credit regime that prevailed before 1986, and thus studying the history of the pre-1986 credit can help us understand the problems of enacting this fix.

Another example is the limitation on benefits (LOB) provision that is found in almost all US tax treaties. The current model US tax treaty from 2016 treaty states that treaty benefits are denied to a company unless—

ii) with respect to benefits under this Convention other than under Article 10 (Dividends), less than 50 percent of the company's gross income, and less than 50 percent of the tested group's gross income, is paid or accrued, directly or indirectly, in the form of payments that are deductible for purposes of the taxes covered by this Convention in the company's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property), either to persons that are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph (a), (b), (c) or (e) of this paragraph or to persons that meet this requirement but that benefit from a special tax regime in their Contracting State of residence with respect to the deductible payment. (emphasis added).¹

"Special tax regime" is a newly defined term:

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¹ US Model (2016), article 22(2)(b)(ii).

l) the term “special tax regime” with respect to an item of income or profit means any legislation, regulation or administrative practice that provides a **preferential effective rate of taxation** to such income or profit, **including through reductions in the tax rate or the tax base**. With regard to interest, the term special tax regime includes notional deductions that are allowed with respect to equity. However, the term shall not include any legislation, regulation or administrative practice:

- i) the application of which does not disproportionately benefit interest, royalties or other income, or any combination thereof;
- ii) that, with regard to royalties, satisfies a substantial activity requirement;
- iii) that implements the principles of Article 7 (Business Profits) or Article 9 (Associated Enterprises);
- iv) that applies principally to persons that exclusively promote religious, charitable, scientific, artistic, cultural or educational activities;
- v) that applies principally to persons substantially all of the activity of which is to provide or administer pension or retirement benefits;
- vi) that facilitates investment in entities that are marketed primarily to retail investors, are widely-held, that hold real property (immovable property), a diversified portfolio of securities, or any combination thereof, and that are subject to investor-protection regulation in the Contracting State in which the investment entity is established; or
- vii) that the Contracting States have agreed shall not constitute a special tax regime because it does not result in a low effective rate of taxation (emphasis added).²

This means that the withholding tax reductions of the treaty will not apply to a company 50% or more of its income (or of the income of its consolidated group) is paid in deductible payments either to residents of third countries or to a company in the treaty partner country that is subject to a low effective tax rate because of a “special tax regime.”

One might think that this is a completely novel provision, because it implements the “single tax principle” (i.e., international taxation should aim to prevent both double taxation and double non-taxation), which itself derives from the G20/OECD BEPS-project of 2013-2015. As the new preamble to the OECD model now states:

*(State A) and (State B)...Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital **without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance...**(emphasis added)³*

According to this interpretation, the nature of the LOB changed after BEPS. Before 2016, the LOB was designed to prevent the US from having a “treaty with the world”, i.e., enabling taxpayers from non-treaty countries to invest into the US through a designated treaty. This was the role of the US-Netherlands Antilles treaty before it was terminated in 1984. After BEPS, the LOB is designed to implement the single tax principle.

However, it turns out that there is nothing new under the sun, if one looks back far enough. The first US model tax treaty dates to 1981, and it included the following language in the LOB provision:

*3. Any relief from tax provided by a Contracting State to a resident of the other Contracting State under the Convention shall be inapplicable to the extent that, under the law in force in that other State, the income to which the relief relates bears significantly lower tax than similar income arising within that other State derived by residents of that other State.*⁴

This language is conceptually the same as the “special tax regime” language in the current model LOB. It disappeared from the 1996 and 2006 versions of the US model but is now back in the 2016 model.

Moreover, the roots of the 1981 LOB language can be traced even further back. The first U.S. treaty that indicated that double non-taxation of U.S. source income was inappropriate was the treaty with Luxembourg (1962), which precluded the application of reduced U.S. withholding rates to certain Luxembourgian holding corporations that were not subject to tax on a residence basis. Similar language appears in the 1963 protocol to the Antilles Treaty, in the 1970 U.S. treaty with Finland and the 1975 U.S. treaty with Iceland. The U.K. treaty of 1975 imposed limitations

² US Model (2016), article 3(1)(l).

³ OECD Model Tax Convention (2017), preamble.

⁴ United States Dept. of Treasury Model Income Tax Treaty, (1981) article 22, ,

on the benefits of corporate residents if the tax imposed by the residence country was “substantially less” than the general corporate tax and twenty-five percent. Ultimately, the origin of the 2016 special tax regime provision can be traced back to the work of Stanley Surrey in the 1950s and 1960s.⁵

Another example is the contemporary notion that deductions for interest or royalties should not be allowed unless there is a corresponding inclusion on the payee side that results in a minimum level of tax paid. This is reflected in the US BEAT (although it unfortunately does not take into account whether a minimum tax level is imposed) and in the OECD’s GLOBE proposal (Pillar II of BEPS 2.0).

Once again, a look at the history shows that this idea is in fact very old in international tax terms. It is in fact included in the very first League of Nations model of 1927, which is discussed in the Harris et al. volume. And the rationale given for it in the commentary sounds very modern as well:

*From the very outset, the Committee realized the necessity of dealing with the questions of tax evasion and double taxation in co-ordination with each other. It is highly desirable that States should come to an agreement with a view of ensuring that a taxpayer shall not be taxed on the same income by a number of different countries, and it seems equally desirable that such international co-operation should prevent certain incomes from escaping taxation altogether. The most elementary and undisputed principles of fiscal justice, therefore, required that the experts should devise a scheme whereby all incomes would be taxed once and once only.’ (emphasis added).*⁶

As Gianluca Mazzoni has shown, this early enunciation of the single tax principle reflects primarily the views of Charles Clavier of Belgium, a now forgotten but originally very important member of the group of technical experts that drafted the original model.⁷

We should, of course, not assume that these instances necessarily show that the earlier examples influenced the latter. The converse is more likely to be the case: Faced with similar issues, tax policy makers reached similar conclusions without knowing about earlier similar solutions. But surely it makes more sense to study the tax history rather than re-inventing the wheel. The Harris et al. volume and the entire series that it is part of are major contributions to this endeavor. Otherwise, we are indeed doomed to repeat the history we have forgotten.

⁵ See R.S. Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of US Treaty Policy*, 59 NYLS L Rev 305 (2015).

⁶ League of Nations, *Commentary on Model Tax Treaty* (1927).

⁷ Gianluca Mazzoni, *Present at the Creation: Archival Research and Evidence on the Origins of the Single Tax Principle*, 47 Intertax 10, 813-831 (2019).