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Lecture in Human Rights: Tax Policy, Global Economics, Labor and Justice in Light of COVID-19

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LECTURE IN HUMAN RIGHTS: TAX, POLICY, GLOBAL ECONOMICS, LABOR, AND JUSTICE IN LIGHT OF COVID-19

Reuven S. Avi-Yonah[*]

ABSTRACT

International Tax Law has extensive ramifications on the wealth gap between wealthy developed nations and poor developing nations. This divide in prosperity has been made clear again in the global response to the COVID-19 pandemic. Developing nations are currently ill-equipped to adapt to, and regulate, an equitable system of taxation on a domestic level. A further challenge is the difficulty of ensuring that foreign investors, especially multinational corporations, are able to comply with tax regulations. Developed nations such as the United States and members of the European Union must continue to work with developing nations to reduce tax evasion and increase revenues in a manner that is equitable for developing nations. The recent enactments of the Global Intangible Low-Tax Income ("GILTI") and the Base Erosion Anti-Abuse Tax ("BEAT") aim to ensure that multinational corporations comply with U.S. tax rates. GILTI and BEAT provide developing countries a framework for raising tax revenues from multinational companies. These tax innovations may help developing nations raise tax revenues, but they also restrict the ability of these nations to create their own tax schemes. If developing nations can coordinate a tax scheme that allows them to raise revenue from multinational corporations, they will ensure a more equitable distribution of resources and contribute to closing the global wealth gap.

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INTRODUCTION

The ongoing coronavirus pandemic has highlighted one of the most significant global problems of our time: the wealth-gap between the wealthy developed countries in the Global North and the poor developing countries in the Global South.[1] The lack of resources in the poor nations has led to a disparity in living conditions compared to citizens of wealthier countries. The citizens in poor Southern nations have lower literacy rates, higher mortality rates, and lower wages, among other critical resource gaps. The global COVID-19 pandemic has exacerbated these problems and has placed more burdens on poor nations and their citizens. To adequately address these issues, wealthy countries must work with poor countries to develop a system of equitable wealth distribution and elevate the standard of living for all citizens.

Part I of this article provides background information on systems of taxation in an international human rights context. It explores the challenges poor nations face in levying taxes, especially on multinational corporations and the wealthy. Part II details the manner in which international tax competition has steadily led to a decline in resources for poor countries while the race to the bottom has benefited the wealthy nations due to investors escaping tax regimes overseas. Lastly, Part III looks at some of the recent developments, specifically in U.S. tax law via the 2017 Tax Cuts and Jobs Act which may provide possible solutions to the global wealth gap by closing international tax loopholes through the enactments of the Global Intangible Low-Tax Income (GILTI) and the Base Erosion Anti-Abuse Tax (BEAT).

I. INTERNATIONAL TAX LANDSCAPE IN THE CONTEXT OF HUMAN RIGHTS

For many years, tax law has played a central role in basic human rights issues in the modern world. Due to recent increases in the large gap between the relatively wealthy global North and the relatively poor global South, tax law is more important than ever. In response to this gap, the United Nations set sustainable development goals to address issues of poverty[2] in the developing world. The sustainable development goals center around aspects of poverty such as: literacy[3],

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[1] Jean-Philippe Therein, *Beyond the North-South Divide: The Two Tales of World Poverty*, 20 Third World Quarterly 4, 723 (1999).

[2] U.N. Dep't of Int'l Econ. & Soc. Affairs, Transforming Our World: the 2030 Agenda for Sustainable Development, U.N. Doc A/Res/70/1 (September 27, 2015).

[3] *Id*. at 17.

hunger[4], access to basic resources needed to live a decent life[5], the ability to vote, education[6], and gender equality.[7] There is a clear consensus that significant change must take place to realize each of these rights for individuals across the globe.

Within the context of the current global pandemic and the potential of a global recession, the inequities of human rights are becoming worse. Global issues such as climate change and widespread migration pressures intersect with, and exacerbate, these problems.[8] All of these issues, however, are in the background. For decades, the most fundamental problem has been that wealthy countries are not financially or politically willing to share resources with poor countries at the volume required to address substantial resource gaps as sharing resources would involve impossible rates of taxation.[9] Most official government aid is miniscule in countries that are most in need of substantial aid. The general public of the United States perceives the amount of foreign aid to be much greater than it actually is.[10] Although foreign aid is a very small percentage of the United States federal government's budget, it is under tremendous scrutiny. Wealthy nations need to share resources more equitably with poorer nations for these poorer nations to thrive.[11]

Some economists believe the United States government needs to address the country's internal wealth inequality before it can work towards global change. Even considering the inequality gap in the United States, to achieve global equality, economists have calculated that the degree of sharing needed would involve impossible rates of taxation that no wealthy country's government would ever be willing to bear to distribute to the poorer countries.[12]

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[4] *Id*. at 15.
[5] *Id*.
[6] *Id*. at 17.
[7] *Id*. at 18.
[8] Int'l Org. for Migration, Migration and Climate Change, IOM Research Series No. 31 (Nov. 2008).
[9] Wojciech Kopczuk, et al, *The Limitations of Decentralized World Redistribution: An Optimal Taxation Approach*, 49 EUR. ECON. REV. 4, 1051 (2005).
[10] Hak-Seon Lee, *Inequality and U.S. Public Opinion on Foreign Aid***,** 182 WORLD AFFAIRS 273 (2019).
[11] As the Jewish source explains, "the poor of your city [must] come first." Deuteronomy 15:11; Ferid Belhaj, *Why Wealthy Countries Must Step Up Their Contribution to Fight Global Poverty*, (Dec. 5, 2019), https://www.worldbank.org/en/news/opinion/2019/12/05/why-wealthy-countries-must-step-up-their-contribution-to-fight-global-poverty (last visited Feb. 18, 2021).
[12] Slemrod, Joel B. and Kopczuk, Wojciech and Yitzhaki, Shlomo, *Why World Redistribution Fails* (Sept. 2002). NBER Working Paper No. w9186, Available at SSRN: https://ssrn.com/abstract=330325.

A. Issues Stemming from Concentration of Wealth in Rich Nations

The fundamental problem of global wealth inequality suggests that a more effective way of approaching the issue of unequal wealth concentration in rich nations is to try to help developing countries help themselves. That raises the taxation question of, how do developing countries raise revenue? In the United States, some of the main sources of revenue for the federal government in the last century have been the individual income tax and the corporate income tax.[13] However, other wealthy countries generally rely more heavily on consumption taxes.[14] None of these revenue sources work perfectly outside of wealthy countries, especially not in developing countries.

Despite their downsides, consumption taxes are generally the biggest source of formal revenue for developing countries, even though a large part of their economies are informal. The informal sector is economic activity that is not reported to the state, and that is not regulated or protected by the State. Because this informal part of the economy is outside the formal system, it has been difficult to raise significant revenues from consumption taxes.[15] To aid this issue the International Monetary Fund ("IMF")[16] has promoted the Value Added Tax ("VAT") as an efficient source of revenues in many developing countries. For many years, the IMF has pressured developing countries to adopt this most popular and widespread consumption tax.[17] Nevertheless, many poor countries have instead

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[13] Office of Mgmt. & Budget, Exec. Office of the President, Historical Tables: Receipts by Source 1934-2025; *see also* Tax Policy Center, What are the sources of revenue for the Federal Government?, https://www.taxpolicycenter.org/briefing-book/what-are-sources-revenue-federal-government (last visited Feb. 19, 2021) (In 2019 individual income tax amounted to 50% if federal U.S. revenue and the corporate tax 7%).

[14] Consumption taxes like the U.S. state sales tax or the value added tax are imposed on consumption, not income. The value added tax (VAT) is the biggest revenue raiser in most countries of the world. See Avi-Yonah, *The Inexorable Rise of the VAT: Is the U.S. Next?,* 150 TAX NOTES 127 (Jan. 4, 2016).

[15] IMF, *Corporate Taxation in the Global Economy, Report of the IMF Staff to the Executive Board* (Jan. 22, 2019).

[16] The International Monetary Fund is an international financial organization composed of 190 countries. The IMF states that the organization's purpose is "to ensure the stability of the international monetary system—the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other." IMF, About the IMF, https://www.imf.org/en/About#:~:text=The%20International%20Monetary%20Fund%20(IMF,reduce%20poverty%20around%20the%20world (last visited Feb. 15, 2021).

[17] *See* Nuria Molina and Javier Pereira, *Critical Conditions: The IMF Maintains its Grip on Low-Income Countries*, Eur. Network on Debt and Dev. (Eurodad), Apr. 2008, at 4 (criticizing the IMF's imposition of privatization and liberalization conditions on poor nations in exchange for resources).

imposed an import VAT, rather than consumption taxes, because they can control the imports of goods and therefore control more internal revenue.[18] However, data shows these countries are also having a hard time collecting significant resources from VAT taxes.[19]

Other taxation methods, such as personal income taxes, also have many problems. First, developing nations do not have enough resources to properly collect personal income tax.[20] Unless an individual is employed by a large formal employer, which is part of the formal economy and the income tax is withheld from their wages, a collection problem will emerge. The lack of resources for developing nations is especially problematic when it comes to taxing the elite because some hide their money overseas. Even though hiding money overseas is illegal in almost every country in the world, it still happens frequently. Previously, these developing countries did not tax account holders on foreign source income but realized that this became an invitation for the wealthy to hide their money overseas and evade tax payments.[21]

Finally, the most promising source of revenue for developing nations is the corporate tax. Typically, in more developed nations, the corporate tax rate is less than 10% of total revenues, whereas the individual income tax rate amounts to over 30% along with the VAT adding another 30%.[22] In developing countries, the average corporate tax rate used to be 25% of revenues but that has come under

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[18] Eric Toder, Jim Nunns, and Joseph Rosenberg, *Implications of Different Bases for a VAT*, TAX POLICY CENTER (Feb. 14, 2012), https://www.taxpolicycenter.org/publications/implications-different-bases-vat#:~:text=A%20value%20added%20tax%20(VAT,of%20selected%20goods%20and%20services.

[19] Lilianne Ploumen, *Why developing countries need to toughen up on taxes*, THE GUARDIAN, (Jul. 7, 2015, 4:47 AM) https://www.theguardian.com/global-development/2015/jul/07/why-developing-countries-need-to-toughen-up-taxes-sdgs (last visited Feb. 20, 2021) ("Developing countries need support to broaden their tax base and build tax collection capacity. Two years ago, the Netherlands started giving technical assistance to developing countries, and we now plan to double our current contribution. Today, we are active in 10 countries and we are starting an initiative to generate extra resources for building tax collection capacity."), *See* Kaisa Alavuotunk et al., *The Effects of the Value-Added Tax on Revenue and Inequality*, J. OF DEV. STUD., 490, 504 (2019) (study indicating that "VAT adoption has not led to increased government revenues").

[20] Eric M. Zolt and Bird, Richard Miller, Redistribution Via Taxation: The Limited Role of the Personal Income Tax in Developing Countries, UCLA L. REV., Vol. 52, 2005, UCLA School of Law, Law-Econ Research Paper No. 05-22, Available at SSRN: https://ssrn.com/abstract=804704.

[21] *Id.*

[22] Office of Mgmt. & Budget, Exec. Office of the President, Historical Tables: Receipts by Source 1934-2025.

pressure within the last few decades. The main problem is not illegal tax evasion, but rather legal tax avoidance. Since the 1980s, the pressures of globalization have led to intense tax competition among developing countries to attract investment by multinationals.[23] Most portfolio investors focus on risk and do not invest in developing countries. However, there are other investors, namely multinationals, that invest in these countries anyway, via direct investment.

To attract multinational corporations to their borders, developing countries have tended to offer various tax breaks.[24] The process begins with a multinational investor compiling a list of developing countries that they are interested in, and then investors narrow down these countries using non-tax considerations such as geographical location, political stability, education and infrastructure.[25] Once the list has been narrowed, the multinational investor will systematically pitch an investment opportunity to different developing countries in exchange for significant tax breaks.[26] Many developing countries agree to the presented terms, because they know that the investor will continue to move down the list, to other countries, if they do not accept. Additionally, developing nations agree to these large tax breaks because of the benefits the multinational corporations bring, such as job growth and boosts to the economy.

One example of this process is from the 1990s involving Intel, the large American multinational corporation. Intel went to Israel and told the government they were willing to invest there but that they had an alternative option to invest in Ireland.[27] Intel essentially wanted to know what Israel would offer them and choose the better option for themselves. In the end, Intel received the entire Israeli

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[23] Charles Oman, *Policy Competition for Foreign Direct Investment: A Study of Competition among Governments to Attract FDI*, DEV. OF CENTRE OF THE ORG. FOR ECON. CO-OPERATION AND DEV. (2000), www.oecd.org/mena/competitiveness/35275189.pdf.

[24] *Id.* at 18 ("as the competition heats up, governments come under increasing pressure to engage in costly "bidding wars" that leads them continually to increase the level of public subsidies offered to investors — fiscal and financial "incentives" — until that level far surpasses any that could possibly be justifiable from society's perspective")

[25] *See* Reuven S. Avi-Yonah, Hanging Together: A Multilateral Approach to Taxing Multinationals in Thomas Pogge and Krishen Mehta (eds.), Global Tax Fairness, 113 (2016); James R. Hines, Jr., & Eric M. Rice, *Fiscal Paradise: Foreign Tax Havens and American Business*, Q. J. ECON. 109, 149 (1994); Rosanne Altshuler and T. Scott Newlon, The Effects of U.S. Tax Policy on the Income Repatriation Patterns of U.S. Multinational Corporations, in Giovannini et al. (eds.), Studies in International Taxation (1993).

[26] *See* Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1588, 1646 (2000).

[27] *See* Robert Lenzner, *Investing, Not Giving*, FORBES, Dec. 18, 1995, at 106.

Government development budget for that year, a billion dollars, which was used to build a factory. Intel later went back to Ireland, where they also received a tax break, in exchange for building a factory.[28] The same has happened in Costa Rica, Brazil, Mexico and other developing nations.[29] This type of auction is typical and fundamentally means that because the corporate tax has come under significant pressure and reduction, there has been a significant reduction in revenues as well.

B. International Tax Regime: U.S. Follows Tax Residential System While Other Nations Utilize Different Methods

Before getting to the heart of international tax system issues, it is important to explain the United States tax system and to provide context to the systems of other nations. Most countries in the world have an international tax regime, where the rules are different, but the concepts are similar to those of the United States' system. The way many international tax systems are designed, are to first encompass the world of potential taxpayers and then to divide the taxpayers between residents and non-residents.[30] From the United States perspective, any U.S. citizen is also a tax resident.[31] However, not all countries follow the rule that tax residents must be present in the country to maintain residential status.[32]

Each nation's perspective on taxation of non-residents and residents differs. First, it is important to consider taxation of non-residents. For example, how does the United States tax non-residents either investing or conducting business in the United States? Generally, the United States' system looks for another non-personal nexus because non-residents do not have a personal nexus (i.e., they are not residents or citizens) to the taxing jurisdiction.[33] Although some non-U.S. source

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[28] *See Frankly Intel*, IRISH TIMES (Jan. 31, 1997), https://www.irishtimes.com/business/frankly-intel-1.27689 (noting Ireland's low corporate tax rate as advantageous reason for Intel's investment in Ireland); Shelley Emling, Ireland Works to Stay in the Outsourcing Game, N.Y. TIMES (June 5, 2009), https://www.nytimes.com/2004/06/05/your-money/ireland-works-to-stay-in-the-outsourcing-game.html (noting Ireland's reduction of their corporate tax rate from 16 percent to 12.5 percent in 2003).

[29] *See* Avi-Yonah, *supra* note 26.

[30] It is important to note that the tax term 'resident' is not the same as the immigration court definition.

[31] 26 U.S.C. § 7701(a)(30)(A).

[32] *See* Kyle Pomerleau, *How Countries Define Their Income Tax Borders*, TAX FOUND. (June 1, 2015), https://taxfoundation.org/how-countries-define-their-income-tax-borders-0/.

[33] *See, e.g.*, Reuven S. Avi-Yonah et al., *U.S. International Taxation* 31 (3d ed. 2011) ("The source rules are provisions of the Code (and tax treaties) that designate rules for assigning income to a

income is taxed in the United States when it is connected to a trade or business, the general idea is that the nexus must be found. Historically, there has also been conflict regarding whether corporations belong to the resident or nonresident category. Different countries use various control tests to determine this question. For example, within the United States, if the corporation was incorporated in the U.S., it is considered a tax resident. In the United Kingdom, on the other hand, a corporation is a tax resident if it is managed and controlled from the U.K., and other former British colonies follow this approach, as do most E.U. member states.

Further, there is a distinction between business income and non-business income. First, business income refers to the normal income tax scheme where net income is taxed annually.[34] Business income assessments examine business deductions as well as income. Once these two figures are netted, they can be applied to income tax at the normal rates.[35] Second, non-business income oppositely refers to investment income that is not actively related to the conduct of business.[36] Dividends, interest, royalties and capital gains are usually considered non-business income.

An issue with non-business income in the United States is that it can encourage remote investors. A remote investor is a foreign taxpayer who has never been to the United States. In these situations, there can be no expectation that the remote investor will file tax returns because a net-based tax (allowing deductions) on foreign investors, which requires auditing those deductions, is very difficult to enforce. In addition, it is difficult to allow remote investors to claim deductions because there is no possibility of auditing them when tax returns are not filed.

One way to overcome this taxation deficit is to impose taxation on a gross basis. This means no deductions will be allowed for incomes that are sourced in the U.S., but if the income falls within one of the types of taxable income, a 30% tax is imposed on a gross basis. This tax is collected by withholding. Then, treaties could apply to reduce the rate below 30%, sometimes to zero, for treaty country residents. Treaties could also apply to business income and limit the tax rate of the source country. For example, U.S. treaties typically reduce the withholding tax on U.S.

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particular jurisdiction.").

[34] Internal Revenue Serv., Topic No. 407 Business Income (last updated Mar. 5, 2021), https://www.irs.gov/taxtopics/tc407.

[35] Internal Revenue Serv., Topic No. 559 Net Investment Income Tax (last updated Mar. 12, 2021) https://www.irs.gov/taxtopics/tc559.

[36] Internal Revenue Serv., Topic No. 407 Business Income (last updated Mar. 5, 2021), https://www.irs.gov/taxtopics/tc407.

source dividends from 30% to 15% and U.S. source interest from 30% to 0%.

Last, it is important to look at residents' taxation. On a worldwide basis, the United States has jurisdiction to tax residents on income regardless of the derived source.[37] However, in 2017, the U.S. partially switched to an exemption system, under which dividends from foreign subsidiaries are exempt from U.S. tax.[38] This exemption system is complicated compared to either full taxation or full exemption, because it exempts only a part of the profits of foreign subsidiaries of U.S. corporations from taxation.[39]

II. CHANGING ISSUES WITH THE EXISTING INTERNATIONAL TAX REGIMES

When observing international tax regimes through a humanitarian lens, it is necessary to identify the prevalent issues in the current tax landscape. These major issues are partly responsible for the inequities between developing and developed nations. Part A will discuss the recent methods of tax evasion, the legislative and diplomatic response to this issue, and the remaining flaws to be solved. Part B will discuss the issue of double international taxation and the United States' current attempts to mitigate the issue.

A. Tax Evasion

Economists such as Gabriel Zucman from UC Berkeley have estimated that over 20 trillion tax dollars a year are evaded.[40] Therefore, it is no surprise that the most important aspect of this discussion is developments within the past decade that have highlighted the potential of significantly improving the revenue raising

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[37] *See* 26 U.S.C.S. § 61 (2020).

[38] *See* Kyle Pomerleau, *A Hybrid Approach: The Treatment of Foreign Profits under the Tax Cuts and Jobs Act*, TAX FOUND., Fiscal Fact No. 586 (May 3, 2018), https://taxfoundation.org/treatment-foreign-profits-tax-cuts-jobs-act/.

[39] *Id*.

[40] He computed this using statistics from the Bank of International Settlements in Basel that show disparities between what countries' official books show and what their actual investments are. His assumption is that illegal investment tax evasion is done exclusively by the elite, which is a plausible assumption. There was more information released that supported this assumption through the Panama Papers hacking. Both the Panama Papers and Paradise Paper hackings, or leaks, have revealed the scope of the elitist involvement in tax evasions within many developing countries. Annette Alstadsæter, Niels Johannesen & Gabriel Zucman, *Who Owns the Wealth in Tax Havens? Macro Evidence and Implications for Global Inequality*, 162 L.J. OF PUB. ECON., 89-100 (2018).

capacity of these taxes. Because of developing countries' relative lack of leverage over their wealthy residents, they do not have enough power to curb tax evasion. This lack of leverage is most visible in the context of multinational corporations, and it perpetuates the limited capacity developing nations possess to collect income tax from the wealthy.[41] Instead, advancements have been developed within the wealthy countries, such as the creation of instruments and techniques, that promise to significantly reduce the scope of this type of tax evasion and to increase revenue.[42]

First, tax evasion is a fundamental problem that has traditionally been difficult for both developing and developed countries to control. Although the IRS is the most sophisticated tax agency in the world, the ability to enforce individual income taxes in situations where there is neither withholding nor information reporting is quite limited (below 70% compliance).[43]

Neither withholding nor information reporting applies easily when the income is from foreign sources. Regarding withholding, since 1984, the United States implemented the portfolio interest exemption which unilaterally abolished withholding on interest payments to foreigners.[44] This was done to attract more investment and attract it in a way that would not require information reporting.[45] Within the international context, there is no treaty that is required to avoid withholding. Although treaties generally require the collection of information,

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[41] *See* Hugh Ault & Brian Arnold, *Protecting the Tax Base of Developing Countries: An Overview*, 2 UNITED NATIONS DEP'T OF ECON. AND SOC. AFF., (May 2013) ("While the work of the OECD is important, and made substantial efforts to take the viewpoints of developing countries into account in formulating its analysis, it was clear from the beginning that some kind of independent examination of the problems of tax avoidance and the resulting profit shifting and base erosion from the perspective of developing countries was required. This is true for a number of reasons. In the first place, most developing countries are primarily (though not exclusively) concerned with the reduction in source-based taxation, rather than the shifting of the domestic income of locally-owned companies to low or no tax jurisdictions. Secondly, the corporate tax on inward investment typically plays a larger role in total revenue in developing countries than in countries with more developed tax systems. In addition, the potential responses to base erosion and profit shifting are limited to some extent by the administrative capacity of developing country tax administrations.").

[42] *See generally* Technology Tools to Tackle Tax Evasion and Tax Fraud, ORG. FOR ECON. CO-OPERATION AND DEV., (2017), https://www.oecd.org/tax/crime/technology-tools-to-tackle-tax-evasion-and-tax-fraud.pdf.

[43] *Understanding the Tax Gap and Taxpayer Noncompliance*, Hearing Before the H. Comm. on Ways and Means, 116th Cong. 2019 Leg., 1st Sess. 2 (testimony of Hon. J. Russell George, Treasury Inspector Gen. for Tax Admin.).

[44] *See generally* Marilyn Doskey Franson, *Repeal of the Thirty Percent Withholding Tax on Portfolio Interest Paid to Foreign Investors*, 6 NW. J. INT'L L.& BUS., 930 (1984-1985).

[45] *Id.*

American banks do not have the obligation to collect any information about foreign interest payments.

Thus, members of the elite in some developing countries specifically invest within the United States to avoid detection.[46] The only requirement for a foreign investor to invest and avoid detection is to establish a shell corporation.[47] Once a shell corporation is established, the foreign investor can invest his or her money into the United States through the corporation. Another benefit of a shell corporation is that it allows foreign investors to create corporate bonds, which are exempt from withholding on interest. Further, no information about the beneficial owner (i.e., the actual investor) of the shell corporation can be given.[48] Therefore, account holders accumulate money offshore undetected.

This system has led to significant problems since its inception. Within a year of the adoption of the portfolio interest exemption, over 300 billion dollars was moved from Latin American countries to banks in Miami, Florida.[49] This movement of money was essentially the same as the entire amount of official aid (i.e., governmental assistance) that was given to all these countries combined. The political elites immediately pocketed the official aid once it was given and put it back into the banks, creating a cyclical process.[50]

Further, large sums of money were moved through shell corporations in the Cayman Islands and other tax havens where the taxes are unenforceable.[51] Ten years ago, however, meaningful change occurred due to problems within wealthy

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[46] Gaspard Sebag, *UBS Ordered to Pay Record $5.1 Billion in French Tax Fraud Trial*, BLOOMBERG (Feb. 20, 2019), https://www.bloomberg.com/news/articles/2019-02-20/ubs-ordered-to-pay-more-than-4-2-billion-in-french-tax-trial.

[47] A shell Corporation in a tax haven can be done easily while abroad, without ever having to visit the investing country. *See* Michael Winter, *Google Dodged $ 2 Billion in Taxes Using a Shell Company in Bermuda*, USA TODAY (Dec. 11, 2012), https://www.usatoday.com/story/tech/2012/12/10/google-bermuda-shell-company-2-billion-tax-dodge/1759833/; *See also* Michele Fletcher, *The Transfer Pricing Labyrinth*, GLOBAL FIN. INTEGRITY (June 26, 2014), https://gfintegrity.org/transfer-pricing-labyrinth/.

[48] Interest payments made to foreign corporations are exempted under the "portfolio interest exemption" without any U.S. tax withholding. 26 U.S.C.S. § 871(h) (2020).

[49] *See* Charles E. McLure, Jr., *U.S. Tax Laws and Capital Flight from Latin America*, 20 INTER-AMERICAN L. REV., 321 (1989); Chander Kant, *Foreign Direct Investment and Capital Flight* 1 (Princeton Studies in Int'l Fin. No. 80, 1996).

[50] Jorgen Juel Andersen, Niels Johannesen & Bob Rijkers, *Elite Capture of Foreign Aid: Evidence from Offshore Bank Accounts* 1-5 (World Bank Grp., Working Paper No. 9150, 2020).

[51] Chris Horton, *The UBS/IRS Settlement Agreement and Cayman Island Hedge Funds*, 41 UNIV. OF MIAMI INTER-AMER. L. REV. 357, 362 (2010).

countries like the U.S. and members of the European Union.[52] These countries did not retain withholding policies that allowed for investor information to be collected, and it became difficult to determine whether foreign investors were actually foreigners. Governments rightfully were concerned that citizens were engaging in round-trip transactions.[53] The U.S. Senate held hearings involving Union Bank of Switzerland ("UBS") to investigate the matter.[54] The Senate determined that Americans were taking advantage of the same provisions and pretending to be foreigners for the purpose of avoiding taxes.[55] UBS's system would send bankers to places where the wealthy congregate within the U.S., and these bankers would persuade wealthy Americans to give them their money through electronic transfers. The money usually was transferred from accounts that were already offshore, but sometimes, the money would be smuggled offshore through methods such as hiding diamonds inside of toothpaste.[56] Once all the money was offshore, UBS would create American shell corporations in the Cayman Islands.[57] Next, these 'foreign' shell corporations would invest via UBS and Zurich back into the United States.[58]

Eventually, a whistleblower discovered this system and reported it in exchange for a reward of 100 million dollars.[59] At the UBS Senate hearing, UBS maintained that their actions were entirely legal because their conduct adhered to the written law.[60] According to UBS's interpretation of the law, the owner of the money only was required to give UBS a W-8 BEN form attesting to be a foreigner once they created the foreign shell corporation.[61] UBS felt that it was perfectly legal for it to collect the funds and transmit them to the Cayman entity, even though some agents

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[52] Tax Haven Banks and U.S. Tax Compliance - Obtaining the Names of U.S. Clients with Swiss Accounts: Hearing Before the Permanent Subcomm., on Investigations, 111th Cong. 1 (2009).
[53] Reuven S. Avi-Yonah, *What Goes Around Comes Around: Why the US is Responsible for Capital Flight (and What it Can Do about It)*, (Jan. 23, 2013). U of Michigan Public Law Research Paper No. 307, Available at SSRN: https://ssrn.com/abstract=2208553.
[54] *Id*.
[55] Tax Haven Banks and U. S. Tax Compliance - Obtaining the Names of U.S. Clients with Swiss Accounts: Hearing Before the Permanent Subcomm., on Investigations, 111th Cong. 1 (2009).
[56] *Id*.
[57] *See* Offshore Tax-Avoidance and IRS Compliance Efforts, Internal Revenue Serv. (July 8, 2020), https://www.irs.gov/newsroom/offshore-tax-avoidance-and-irs-compliance-efforts.
[58] Sebag, *supra* note 46.
[59] Eamon Javers, *Why Did the US Pay This Former Swiss Banker $104M?*, CNBC (Apr. 30, 2015), https://www.cnbc.com/2015/04/30/why-did-the-us-pay-this-former-swiss-banker-104m.html.
[60] Tax Haven Banks and U. S. Tax Compliance - Obtaining the Names of U.S. Clients with Swiss Accounts: Hearing Before the Permanent Subcomm, on Investigations, 111th Cong. 1 (2009).
[61] *Id*.

of UBS actually knew that the owner of this corporation was an American.[62]

To address this crisis, Congress enacted the Foreign Account Tax Compliance Act ("FATCA") of 2010 to supervise and regulate accounts that are suspected to be American owned.[63] FATCA applies to foreign financial institutions and requires that if an institution knows or has reason to know that it has an American-owned account, it must report that information to the IRS.[64] If the institution fails to do so, it can be subject to penalties such as withholding tax on the institution's own income from U.S. sources, which, for many, is a hefty penalty.[65] If FATCA had been approved before the UBS scheme, UBS, which receives a large income from U.S. branches all over the country, would have been in financial disaster for being non-compliant.

Unfortunately, FATCA has not been as effective as planned. The way FATCA is written has been mostly unenforceable because foreign financial institutions face domestic criminal offences for disclosing information about their depositors to the IRS.[66] However, under the Obama administration, the Treasury Department successfully negotiated intergovernmental agreements with more than 100 countries to permit these foreign institutions to provide information to their own government. Then, the foreign government under the Intergovernmental Agreement shares the information with the IRS.[67] These negotiations have promoted numerous international multilateral agreements for the automatic exchange of tax information under the so-called "common reporting standards."[68] While this change was positive for American policies, many international countries were displeased with FATCA because they felt it was an overstep of Americans telling their banks what to do and what information to give.[69] The added penalties

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[62] *Id*.
[63] FATCA was the brainchild of Charlie Rangel, the head of the Ways and Means Committee at the time. 26 U.S.C. §§ 1471–1474, § 6038D.
[64] Sullivan & Cromwell LLP, *Revised FATCA Plus Carried Interest Taxation*, Sullcrom (Dec. 11, 2019), https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Revised_FATCA_Plus_Carried_Interest_Taxation.pdf.
[65] H.R. 3933, 111th Cong. (2009).
[66] See Avi-Yonah, *supra* note 53.
[67] W.H. Office of the Pr. Sec., Fact Sheet: Obama Administration Announces Steps to Strengthen Financial Transparency, and Combat Money Laundering, Corruption, and Tax Evasion, Obama White House Archives (May 5, 2016), https://obamawhitehouse.archives.gov/the-press-office/2016/05/05/fact-sheet-obama-administration-announces-steps-strengthen-financial.
[68] This is a standardized computerized way of exchanging information between countries.
[69] Armando Mombelli, *The day UBS, the biggest Swiss bank, was saved*, SWI (Oct. 16, 2018, 8:00

also bothered many foreign nations.[70] However, FATCA proved to be effective and led directly to the development of this multilateral forum for the exchange of tax information.

Even though the U.S. did not join the multilateral efforts for the automatic exchange of tax information, their impact has remained significant. Because of the underlying fear that some banks will report the illegality of the accounts, it has made it more difficult for people to engage in the same level of tax evasion as they once did. However, because not all countries participate with these new rules, money still flows where there is non-compliance.[71]

Nonetheless, there are other interesting developments for corporate tax income, which is why it is important to look back on the great financial crisis of 2008-2009 within the U.S. To cope with the crisis, banks were bailed out by the government, leading to a deep recession. However, the situation was very different in Europe, where, unlike most governments, countries do not get to print their own money. Instead, the Euro is controlled by the European Central Bank, which is known to be relatively penurious. Combined with the 2008-09 great recession, this resulted in widespread austerity and cutbacks on government services. At the same time, there were also parliamentary hearings in the UK which revealed that many multinationals were illegally avoiding paying significant amounts of tax.[72] These instances were examples of tax avoidance rather than tax evasion.[73]

AM), https://www.swissinfo.ch/eng/2008-crisis_the-day-ubs--the-biggest-swiss-bank--was-saved/44474630.

[70] Avi-Yonah, *supra* note 53.

[71] At the moment it seems Singapore is the main international culprit. And they have gained some income flow, but nevertheless they have imposed significant transaction costs.

[72] Eric Pfanner, *British Lawmakers Accuse Multinationals of 'Immorally' Avoiding Taxes,* N.Y TIMES (Dec. 3, 2012), https://www.nytimes.com/2012/12/04/business/global/british-lawmakers-accuse-mulitnationals-of-immorally-avoiding-taxes.html.

[73] For example, Starbucks in the UK sent most of its income to Luxembourg where the Starbucks main brand was registered by way of royalties for using the Starbucks name. This perfectly legal payment was deductible under the EU rules and could also not be subject to any kind of withholding tax. Luxembourg did not tax the income, but the result was that Starbucks was also not paying tax to the United States in the UK. Starbucks was so embarrassed by these hearings that they actually began making voluntary payments to the UK Treasury when this was discovered. Since World War Two, the Organization for Economic Cooperation Development (OECD) has been in charge of tax matters primarily within Europe. They created the base erosion and profit shifting project that they ran initially from 2013 to 2015, which involved significant series of actions that were designed to mitigate corporate tax avoidance.

B. Double International Taxation

The problem of double international taxation has also been difficult to address. Double international taxation refers to the situation where two jurisdictions are trying to tax the same income that was generated abroad. One proposed solution would be to implement credits for foreign taxes paid, where each credit would be the difference in paid foreign taxes with respect to that income and would make overall tax liability determinable. Usually there is up to a 10% return on tangible assets. Before 2018, this return could have been deferred and there was no participation exemption for individual taxation on a worldwide basis.

The United States has already started to exempt interest incomes that belong to the category of non-business income of non-residents. Other countries followed suit and now interest income that is non-business income is exempt, either by domestic laws or treaties, worldwide.

This exemption, however, has added to the problem of round-trip investments because wealthy investors from other countries can get tax free interest income from the U.S., so there is an incentive to set up offshore accounts. The income would not only be hidden, but they can also escape taxation in their home countries. The Base Erosion Anti-Abuse Tax ("BEAT"), as enacted in 2017, interacts with the business income aspect of non-residents, as well as residents by making it more difficult for taxpayers to decrease tax payments.[74] Reinstating taxation of interest income at its source will solve two problems: first, the global tax evasion by wealthy foreigners, and second, the ability of United States taxpayers to obtain an exemption by pretending not to be United States taxpayers.

For business income of non-residents to be taxed, the income must have had some nexus to the taxing jurisdiction. In the U.S. the nexus is the activity that rises to the level of conducting a legal business in the U.S. and the income has to be effectively connected to that legal business.[75] The treaty concept, though, similar, is not identical. If a non-resident has a permanent establishment in the U.S., the income should be attributable to that permanent establishment. It is imperative to strengthen the ability of host countries to view certain connected activities and strengthen that non-personal nexus to the taxing jurisdiction. With the advancement of the digital economy, it is easier to conduct business without having a physical presence in the country. Therefore, some reforms are needed to protect taxation of

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[74] *See* Tax Justice Network, *infra*, note 87 and accompanying text.
[75] I.R.C. § 864 (2021)

cross-border income.

III. SOLUTIONS TO TAX PROBLEMS

In December 2017, the United States passed the Tax Cuts and Jobs Act ("the Act"),[76] the most significant tax code reform in over three decades.[77] The support for this legislation stems in part from the idea that corporate income should be taxed somewhere, therefore preventing double non-taxation.[78] The Act includes two interesting, fundamental concepts that are going to significantly change the international tax landscape in a way that benefits developing countries: the Global Intangible Low-Tax Income ("GILTI") and Base Erosion Anti-Abuse Tax ("BEAT").[79]

GILTI is a concept that involves a new category of foreign income intended to dissuade corporations from shifting profits out of the United States.[80] Primarily applied to the United States multinational corporations, GILTI mandates that if the foreign tax rate on a corporation's foreign subsidies is not high enough, the corporation will be taxed by the United States at a rate, that is at least half of the normal rate.[81] The driving equitable principle is that the host countries of multinational corporations should impose tax when the foreign tax rate is too low.

BEAT was designed to prevent tax revenue loss by limiting payments from U.S.-based companies to their foreign affiliates.[82] BEAT works as an alternative tax mechanism that prohibits certain deductions, such as interest and royalties, paid to foreign related parties in order to reduce the U.S. tax base. This scheme, therefore, makes it more difficult for companies to avoid taxation in the United States through their foreign affiliates.

GILTI and BEAT, the main innovations of the Act, are U.S. rules that were

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[76] The Tax Cuts and Jobs Act is major tax legislation that affects individuals, businesses, tax exemptions and government entities. The IRS states that they are "working on implementing" the Act. See IRS, *Tax Reform*, https://www.irs.gov/tax-reform.

[77] Tax Foundation, *Everything You Need to Know About the Tax Cuts and Jobs Act*, https://taxfoundation.org/tax-reform-explained-tax-cuts-and-jobs-act/.

[78] Double non-taxation means not being taxed anywhere.

[79] The basic idea behind both concepts is that there should be one tax level imposed on global flows of corporate income. Budget Fiscal Year, 2018, PL 115-97, December 22, 2017, 131 Stat 2054.

[80] Tax Foundation, *What's up with Being GILTI?*, https://taxfoundation.org/gilti-2019/.

[81] *Id.* ("GILTI is subject to a worldwide minimum tax of between 10.5 and 13.125 percent on an annual basis.")

[82] Mindy Herzfeld, *Can GILTI + BEAT = GLOBE?*, 47 INTERTAX 504 (2019), https://scholarship.law.ufl.edu/cgi/viewcontent.cgi?article=1892&context=facultypub.

adopted unilaterally and facially have little to do with developing countries. However, since 2017, the Organization for Economic Cooperation and Development ("OECD") has been engaged in BEPS 2.0.[83] BEPS 2.0 is designed to supplement some of the oversights (like the failure to reach consensus on the digital economy) which were present in the first version of BEPS. Fundamentally, the idea again is to disallow deductions when there is no corresponding tax on the recipient side.[84]

These developments, particularly FATCA and GILTI, are very promising, as they have the potential of benefiting the revenue raising capacity of developing countries despite being passed in an effort to benefit the United States. This increased capacity can, in turn, help these countries decrease the global wealth gap.

IV. Criticisms of Recent Solutions

There are, however, legitimate criticisms of these developments. First, an argument can be made on the basis of national sovereignty. Critics argue that developing countries should have the autonomy to decide whether it is in their best interest to provide multinational corporations with tax breaks. The argument asserts that developing countries should be free to engage in their own cost-benefit analysis, allowing them to determine if potential benefits, such as job growth, outweigh the costs.

To an extent, this is an empirical issue. However, it is likely that developing countries feel extreme pressure to take deals with these multinational corporations, because failure to do so will result in heavy political criticism for not bringing jobs to their countries when the opportunity presents itself.[85] Therefore, these developing nations are not truly exercising their sovereign will if they give tax

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[83] BEPS 2.0 is the second version of BEPS.

[84] Take a company like Intel, for example. Companies like Intel have traditionally gone to countries like Costa Rica and proposed plans to build a factory on the condition that the country provides them with a tax break, or they will build the factory in another country. Under the GILTI rule, Costa Rica can counter that even if they provide a tax deduction, Intel will still be paying the tax in the United States, so there is no real benefit to Intel in receiving the tax deduction. Instead, Intel will be incentivized to build the factory on the basis of other non-tax related considerations. *See* Herzfeld, *supra* note 83.

[85] In cases like the Intel and Costa Rica deal, scientists said the money given to Intel would have been more beneficial if spent in another manner, such as on small, local start-ups. However, the political advantage of a large job boom was seen to outweigh this empirical information, likely due to these aforementioned public pressures to bring corporations such as Intel into the country.

breaks to multinational corporations solely to prevent them from going to another country. The multinational corporations clearly have the bargaining power in these situations and are forcing developing countries to offer them the best deal. Taking that power away from the multinationals, through GILTI and other tax reforms, evens the playing field for developing countries and prevents the race to the bottom.

Second, some critics argue that it may not be wise to provide governments in many developing nations with resources, as they will waste them either because they are corrupt or non-democratic. This argument holds weight to an extent but is not applicable across the board. Many of the world's developing nations have become democracies within the last 20 years, so for those nations, such an argument is unconvincing. Additionally, even when developing countries remain undemocratic, the alternative to providing them with any resources is to withhold *all* resources. This cannot remain a legitimate alternative. However, it is important to limit the ability of elites in those nations to engage in capital flight and filtering the money to their own accounts, which, to an extent, is exactly what FATCA has been able to achieve. By and large, these developments have operated as a fulcrum for the ability of developing countries to raise resources.

However, these developments are also not without their faults. Notably, an information exchange of this kind may not be the most successful response to issues like tax evasion. Since the exchange is not a global network, it may not be enough for one country not to comply. The money will ultimately go to one of the few wealthier economies, such as the United States, the European Union, or Japan. These countries should ideally coordinate a withholding tax enabling them to ensure that the money is collected. This will help prevent situations where it is unclear whether tax was paid in the country where the investor is a resident.

Even the global minimum tax, which is the global application of GILTI, has issues. For example, there is an exemption from GILTI which, in practice, encourages migration of jobs out of the United States and into developing countries because it means loopholes for tax holidays and exemptions.[86] Many argue that the Biden administration[87] will need to address these shortcomings of current tax schemes and help mitigate those harms. Others argue that the Treasury Department should work on strategies.[88]

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[86] *See* Reuven S. Avi-Yonah, *Biden's International Tax Plan*, 100 TAX NOTES INT'L 525 (Oct. 26, 2020) (with G. Mazzoni).
[87] *Id.*
[88] Tax Foundation, *supra* note 81.

Another focal point should be cross crediting, which averages high tax countries with low tax countries and encourages a tax obligation. The OECD draft report addresses some of these issues.[89] While the responses are not perfect and there is still work to be done, the situation has significantly improved in the last ten years.[90] Significant reform has taken place since 2010, when the situation was at its worst, and developing countries have since been more greatly enabled to raise resources.

CONCLUSION

Ultimately, until wealthier nations further assist the developing world by ridding themselves of the unequitable consequences of tax evasion and resource hoarding, emerging global issues will continue to highlight and exacerbate the wealth gaps between these states. Nevertheless, despite the evasion of approximately 20 trillion dollars annually in global taxation, the recent development and implementation of programs like FATCA and GILTI, along with the OECD's engagement with formulating BEPS 2.0, has significant value as both a starting point and blueprint for developing countries to begin increasing their revenue raising capacities. Still, state governments, regardless of their country's economic status and corporate favorability, must ensure that these programs do not result in excessive round-trip investments, the flow of money into areas of noncompliance with the programs, or misappropriated windfalls to non-democratic states. Looking ahead, particularly during a pandemic in which most countries are falling into budgetary deficits, increasing inequity from these issues only further emphasizes the need to establish tax programs with the authority to mandate compliance, punish the exploitation of tax loopholes, and fundamentally ensure that the wealthiest beneficiaries of global trade (i.e., multinational corporations), are paying their fair share.

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[89] OECD (2020), *Transfer Pricing Guidance on Financial Transactions: Inclusive Framework on BEPS Actions 4, 8-10, OECD*, Paris, www.oecd.org/tax/beps/transfer-pricing-guidance-on-financial-transactions-inclusive-framework-on-beps-actions-4-8- 10.htm.

[90] 2010, ten years ago, was the tail end of the financial crisis.