FORMATIVE YEARS OF A NEW GLOBAL TAX ARCHITECTURE: WHAT IS THE ROLE OF LEGITIMACY?

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The reality for international tax law is that after the 2008 financial crisis its substantive norms are under permanent discussion. This fluidity of norms has entered a new dimension, with a new platform for norm production and the rise of the UN as an alternative to the OECD. Consequently, a field previously dominated by discussions on technicalities is now confronted with an era in which the production of the norms themselves is critically assessed. In fact, it has even attracted the attention of Nobel Laureates in other disciplines, who conclude that the system tax lawyers work with is 'fundamentally broken'.[1]

The despair is remarkable, especially considering the optimism surrounding the first steps more than a decade ago. A broad group of countries expectantly joined the OECD members, first as BEPS Associates, then with an invitation to sign the BEPS Multilateral Instrument, and finally through the Inclusive Framework ('IF') to build rules that would see the profits of large (digital) multinationals no longer go untaxed.

The main question in this contribution is how the relationship between legitimacy and international tax rulemaking has changed over time and may change in the future. What does this mean for assessing the legitimacy of the norms produced and the process wherein they are produced? The aim is to untangle both to achieve some clarity in this discussion and see what role legitimacy should play in future discussions on the global tax architecture.

WHAT HAS CHANGED AND WHAT IS NEW

As the stream of updates on the process is constant and could hardly have been missed by international tax lawyers, one can be brief in summarising the current developments and delve into deeper issues relatively quickly. Relevant for the following is to know that a dichotomy has surfaced in global tax governance, with a group of countries aiming to (partially) shift global rulemaking towards the UN, emphasising the need for a fair and inclusive process and an outcome that actively takes account of the need for resources of the developing world.[3]

The dichotomy identified is that with the latest rules of the OECD's BEPS project,[4] in the form of the global minimum tax of Pillar II,[5] this project of global tax governance has shifted from combatting abusive situations in international tax law to anti-competitive measures in a global economy.[6] Since the latter measures were promoted under a package that would also lead to greater revenue mobilisation, but the package did not deliver its promise of that revenue mobilisation, mainly because of the (current) non-adoption of Pillar I,[7] the legitimacy of the entire project is questioned.

We can identify two main problems that put the legitimacy of the OECD's project in question: (1) the outcome of the application of the rules that have actually been adopted by the participating countries, so Pillar II without Pillar I, which is not delivering on its promised outcome of mobilising more revenue; (2) the process seemed unable to remedy the imbalance of goals in the formulation of these rules in the stage of production.

WHAT IS LEGITIMACY IN INTERNATIONAL TAX LAW?

Legitimacy has a strong 'buzzword' pedigree; you cannot really do any harm by stating that you value legitimacy. It is not an understatement to say that it is a popular statement but also a somewhat hollow one, often misused in global governance, especially when combined with the adjective 'democratic.' Considering the state of democracy in the world today, combining the two is more to be seen as a moral disposition than any statement of fact relevant to the global context, at least if one aims to be inclusive and not pre-emptively exclude half of the globe.[8]

To avoid that trap in defining legitimacy for this brief column, a better definition can be found in the work of Bernstein: "what constitutes legitimacy results from an interaction of the community of actors affected by the regulatory institution, i.e. the public who grant legitimacy, with broader institutionalized norms—or social structure—that prevail in the relevant issue area."[9] This is a general description, but Bernstein also acknowledges that "interactions create different legitimacy requirements across different issue areas and forms of governance."[10] Nevertheless, it is important to acknowledge Bernstein's non-formalistic turn: it is not (solely) the legal set of rules that dictate the process that can give it legitimacy, but the (informal) interaction of actors and the affected. Bernstein's speaking of 'norms' instead of laws also points in that direction.

A subsequent logical question is: what are the specific legitimacy requirements for international tax law and governance, with the knowledge that we should search for it in the interaction between the community of actors affected by the regulatory institution with the broader institutionalised norms that prevail in tax rulemaking? Here, the democratic moral disposition creeps in for some states; with the people being the final democratic arbitrator in the (liberal-democratic) political process, they are the sacrosanct players in the community of affected actors. However, with the acknowledgement of the importance of that actor differing per jurisdiction, it is hardly a universal value that can be projected onto the entirety of the process. A process that aims for inclusivity cannot give centre stage to such a divisive factor.[11]

Propelling the actors and the affected to the legitimacy-granting authority in both the process and the outcome provides conceptual clarity. The actors are dictating the process, and this group consists of the states and the framework they utilise to achieve their goals. This framework can open doors to other actors, for example, through public consultation. The affected are more difficultly established, as the ones subjected to the rules are clearly identifiable within a legal situation; the effects of that subjectification can, however, have ramifications for a much broader group in a tax constellation. The primary function of taxation is to fill the state coffers to allow for public spending; by requiring a distribution of that collective burden, an increase of the burden on one group can have repercussions for the contribution asked of the others.

THE THEORETICAL DIFFICULTY OF MEASURING LEGITIMACY WITH THE AFFECTED

In the BEPS scenario, the prospect of having multinational companies pay more taxes obviously is enticing to (most of) the general public: it would, at least theoretically, shrink their tax bill. The subject itself, the multinational that would have to pay the tax, can be expected to be less happy with the prospect of being confronted with additional taxes and the compliance burden of another extremely complex piece of legislation. It shows that the legitimacy puzzle is rather enigmatic on the level of the affected and becomes perceptive very quickly. Because, except for the result (also sometimes called 'output legitimacy'), what can the affected actually make of the process in which the rules come to being (meaning both the transparency of the process and the possibility to comprehend the technical nature of what is being discussed)? Further, and scientifically even more problematic, how can we measure with the tools we have as legal scholars what we seek in this scenario? It shows that any perceptive value of legitimacy has little value for legal studies and is often speculative because equating legitimacy with belief can exclude the possibility of legitimacy beyond people's beliefs.[12] Less theoretically formulated: legal scholars simply miss the tools to assess legitimacy in this process and ask the wrong questions.

From a purely legal perspective, the subjects are not subjected to the rules formulated within global tax governance but to the national implementing measure. The other affected, i.e. the other taxpayers, are distanced from the international process because they are no 'actors' in the strict sense: they are only represented by their respective governments.[13] They can become an actor in the national constellation if they have any credible power over establishing the national tax policy to wield any influence (represented by a parliament) on the delegation of powers to the executive to negotiate rules that will indirectly influence them. This is a far-fetched and artificial constellation, especially now this group is only indirectly part of the community of interacting players and only indirectly subjected to the effects of the adoption of the norms if the lowering of their tax burden actually is achieved and the money is not used for increased spending (or is just used to take the edge off already existing budgetary gaps). All these variables already show that the correlation or the eventuality of any effect for those who are effectively, under the procedures used in international tax law-making, the tertiary party in this whole ordeal, the country's citizens, is difficultly established.

A final variable is again to do with the citizens as actors within this paradigm and the fact that they themselves do not represent a stable factor whatsoever. The primary way of measuring their preference is through elections, at least in half the world. Roughly half of those elections are free and fair, and even if one would assume that international tax policy plays a role in the voting booth, which I think we can credibly doubt, the preferences of those voters are highly volatile. In other words, where the public, as the authority that grants something legitimacy, can think one thing in one election, it can think the complete opposite in the next election. It is hard to propel such a volatile actor to the apex of one's considerations in assessing highly technical tax reforms.

The above is not to say that this author holds anything against legitimacy, or democratic legitimacy, on the contrary.[14] But, for tax lawyers, it is a deceitful category of reference in building any scientifically valid claims that must be approached with caution. Therefore, let us focus on a route that can more credibly establish legitimacy claims.

LEGITIMACY AND THE ACTORS IN INTERNATIONAL NORM-FORMULATION

There is very little evidence in international tax law, past and present, that refutes the suggestion that states effectively treat multilateral frameworks as marketplaces that merit a visit only based on the prospect of a beneficial exchange. This transactional nature of global tax governance is not easily surpassed. From a legitimacy perspective, the outcome thus is a prime indicator for the leading actor on the stage: the states that gather to strike new deals. Ultimately, the outcome is a legal deal, signed, ratified and implemented per the national legal procedures.

Typically, such a deal would be ratified by the national legislature if deemed beneficial to its dealings. In this instance, specific rules of Pillar II blur that process because they effectively force countries to either implement or lose revenue to others.[15] Statements that base the legitimacy of the project on the overwhelming adoption of Pillar II rules do

not seem to take account of that reality, especially if compared with Pillar I, which will most likely not see the mass adoption required for its coming into force. It must be remembered that the rules were agreed upon as a package, and the non-adoption of one part of that deal actually puts the other part in jeopardy, too. In effect, the holistic view of the adoption of both Pillars as an indicator of the legitimacy of the rules as viewed through the eyes of states as a legitimacy-granting actor is rather bleak.

Without implying any intentionality on the side of the OECD itself, it did, however, become clear that a framework/platform that invites developing countries but is provided by an organisation that, in its general dealings, exclusively serves the interests of the developed world, has not been able to credibly establish itself as the governance platform that can cater the needs of those developing countries. The first statement, on the general exclusivity of the OECD, is demonstrated by its accession framework,[16] but also reported in the literature.[17] The second statement, the ability to cater for the needs of the developing world, can credibly be believed to correlate with the fact that a broad group walked out on the BEPS project and found a new framework in the form of the UN.

With developed countries turning their backs to the rules (Pillar I) and developing countries to the process (the move to the UN), a few questions can help prevent further misunderstanding in making sense of these developments in the future and their relation to questions of legitimacy. Firstly, in line with the idea of rules adoption and, thus, effects-based, it is imperative to ask what countries seek to gain from their participation in global tax governance. Judging from the Pillar II rules and the non-adoption of Pillar I, developed countries seemed to have joined the talks to limit tax-based competition. Suppose one agrees that the walkout of a large group of countries from the OECD project towards the UN correlates with the legitimacy of the process as perceived by the actors. In that case, one should ask why these states identify the UN as the forum where they can achieve their pursued goals. Judging from the constant emphasis in the UN process on the need for resources for development,[18] the logical conclusion is that the OECD deal seems to have underperformed in that respect.

CONCLUSION

The main question on which light was (supposed to be) shown was how the recent developments have informed the tax discourse on legitimacy and how that debate can better be structured. The above shows that legitimacy is no easily established value, mainly due to the limitations of the field of inquiry (tax law). As legitimacy has an empirical taste, the instruments of legal inquiry often lack the possibility to pick up its thread. Where the behaviour of actors does have legal consequences, and thus output that can be part of a legal argument, legitimacy is such an ill-defined term that, at the current point, its incautious use in the debate is probably doing more harm than good.

That conclusion might seem pessimistic; however, this author believes it is good first to define the terms on which discursive discussions in tax law occur before continuing the collective scientific pursuit to make sense of the world of international taxation.

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[1] Joseph E. Stiglitz, "The International Tax System Is Broken." Foreign Affairs, July 3, 2024. https://www.foreignaffairs.com/world/international-tax-system-broken.
[2] See for a good overview and summary of the stages of tax governance: Mosquera Valderrama, I. J., Global tax governance: legitimacy and inclusiveness: why it matters. Leiden, 2023. Retrieved from https://hdl.handle.net/1887/3621136 on 07-08-2024.
[3] United Nations General Assembly, 78th Session, Resolution 78/230. on "Promotion of inclusive and effective international tax cooperation at the United Nations", A/RES/78/230, 22 December 2023 & United Nations Secretary-General, Report of the Secretary-General on "Promotion of inclusive and effective international tax cooperation at the United Nations", A/78/235, 26 July 2023.
[4] Also referred to as 'BEPS 2.0'. See also: OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy – 8 October 2021, available online at: https://www.oecd.org/en/about/news/announcements/2021/10/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.html (last accessed 11-08-2024).
[5] Ibid.
[6] Most convincingly argued in: Galendi Junior, Ricardo André, The Justification and Structure of the GloBE Model Rules, PhD thesis, Universität zu Köln, 2023. Accessible online at: https://kups.ub.uni-koeln.de/71906/ (last accessed 09-08-2024).
[7] The Pillar I rules are rather fuzzy, working with an 'Amount A' and an 'Amount B', the relevance of which is negligible here. The Amount A application is further in its process, but still far from becoming reality. The most comprehensive and concise summary of the rules is to be found in the Statement cited supra at fn 4: "There will be a new special purpose nexus rule permitting allocation of Amount A to a market jurisdiction when the in-scope MNE derives at least 1 million euros in revenue from that jurisdiction." Amount A "provides jurisdictions in which consumers and users are located (hereafter 'market jurisdictions') a new taxing right over a portion of the residual profits of the largest and most profitable multinational enterprises (MNEs) in the world." (An explanation found in: OECD, FACT SHEET AMOUNT A - Progress Report on Amount A of Pillar One, 11 July 2022, available online at: https://www.oecd.org/content/dam/oecd/en/topics/policy-issues/cross-border-and-international-tax/pillar-one-amount-a-fact-sheet.pdf (accessed 08-08-2024).
[8] See also: Bastian Herre (2021) - "The 'Regimes of the World' data: how do researchers measure democracy?" Published online at OurWorldInData.org. Retrieved from: 'https://ourworldindata.org/regimes-of-the-world-data' on 01-08-2024.
[9] Bernstein, Steven. "Legitimacy in Intergovernmental and Non-State Global Governance." Review of International Political Economy 18, no. 1 (2011): 17–51.
[10] Ibid.
[11] Whereby it must be mentioned that this author is not in any way aiming to suggest that this is a preferable state, however, it is sheer realism that demands this position.
[12] See also: Dyzenhaus, David. 'The Legitimacy of Legality'. ARSP: Archiv Für Rechts- Und Sozialphilosophie / Archives for Philosophy of Law and Social Philosophy 82, no. 3 (1996): 324–60.
[13] In the case of individuals. An important difference again is whether that representation is democratic or not.
[14] In fact, it is only the restriction of scope of this brief column that is keeping the author from delving deeper into the ideas that would make the legal forum wherein tax norms are decided (the national parliament, either by itself or through delegation) more democratic, see: van der Vlugt, Sam. 'The Principle of Legality of Taxation as a General Principle of EU Law: National and Supranational Differences of Interpretation and Potential Difficulties'. EC Tax Review 32, no. Issue 5 (1 September 2023): 214–28. https://doi.org/10.54648/ECTA2023027.
[15] In what is branded as 'diabolical mechanics', see: Mason, R. 'A Wrench in GLOBE's Diabolical Machinery', 19 September 2022, Tax Notes, accessed online via: https://www.taxnotes.com/special-reports/digital-economy/wrench-globes-diabolical-machinery/2022/09/16/7f3pt (accessed on 22-11-2022).
[16] Statements such as 'the OECD need not be universal to be effective', and ', the OECD does not aim to become a universal organisation in terms of its size but rather to ensure that the OECD's standards and policies are applied and implemented on a global scale' do not help in that regard, see paras. 10 and 17 of: OECD, Framework for the Consideration of Prospective Members, Meeting of the OECD Council at Ministerial Level Paris, 7-8 June 2017.
[17] See: Brauner, Yariv, "Serenity Now! The (Not So) Inclusive Framework and the Multilateral Instrument," Florida Tax Review, 2023: Vol. 25, Article 1.
[18] See supra at 3.