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Origin and Differentiation in International Income Allocation

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The present international tax rules are typically justified by origin-based theories. These theories align countries' tax entitlements with the geographical location of the economic factors that contribute to the creation of income. Two recent phenomena have rendered origin-based approaches limited in scope. First, the economic integration of multinational corporations and the relevance of intangibles have made it infeasible to precisely pinpoint the factors contributing to the generation of income. Second, the growing disputes between countries about which economic factors should be considered relevant for sharing the international tax base have recently led to increased consideration of distributional consequences, thus moving tax policy discussions away from a clear origin-based rationale toward a consequentialist one. The limitations of origin-based criteria for allocating taxing rights warrant an alternative normative standard. This article puts forth the differential approach as a suitable normative basis. It requires that the allocation of tax entitlements be based on distributive justice considerations, particularly when origin-based approaches fail to provide satisfactory normative support.

Les règles fiscales internationales actuelles sont généralement justifiées par des théories fondées sur l'origine. Ces théories alignent les droits fiscaux des pays sur la localisation géographique des facteurs économiques qui contribuent à la création de revenus. Deux phénomènes récents ont rendu les approches basées sur l'origine limitées dans leur portée. Premièrement, l'intégration économique des sociétés multinationales et l'importance des biens incorporels ont rendu impossible l'identification précise des facteurs contribuant à la création de revenus. Deuxièmement, les différends croissants entre les pays sur les facteurs économiques à considérer comme pertinents pour le partage de l'assiette fiscale internationale ont récemment conduit à une prise en compte accrue des conséquences distributives, éloignant ainsi les discussions de politique fiscale d'une logique claire fondée sur l'origine pour les rapprocher d'une logique fondée sur les conséquences. Les limites des critères fondés sur l'origine pour l'attribution des droits fiscaux justifient l'adoption d'une nouvelle norme. Cet article propose l'approche différentielle comme base normative appropriée. Cette approche exige que l'attribution des droits fiscaux soit fondée sur des considérations de justice distributive, en particulier lorsque les approches fondées sur l'origine ne parviennent pas à fournir un soutien normatif satisfaisant.

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Introduction

One of the main functions of international tax law is determining how to allocate rights to tax international income among states. The distribution of taxing rights has been historically justified by what can be generally called origin-based approaches. Origin-based allocation purports that states should be entitled to tax income generated in their territories or arising from the resources they control. A variety of theoretical approaches entails the allocation of taxing rights according to the origin of income, such as the benefits theory, the costs theory, the entitlement theory, the faculty theory, the economic allegiance theory and, more recently, the idea of allocating income according to value creation. These theories ultimately imply that taxing rights must align with the location of the factors contributing to the generation of income.

Recent developments in the international tax scene suggest a re-examination of the normative underpinnings of the current distribution of the international tax base. The global changes arising from the digitalization of the economy have motivated countries to reconsider the allocation of taxing rights. Furthermore, the challenges to determine where income

is created have spurred skepticism about the suitability of origin-based theories to justify the allocation of taxing rights.

This article argues that origin-based approaches still hold valid as normative criteria but are significantly limited in scope. Origin-based theories overestimate the feasibility of determining the origin of income and take for granted some of the complexities resulting from economic globalization. A great part of the global production today flows from supply and demand chains that span across multiple sectors and countries. Accurately pinpointing the factors that gave rise to a given income, and their relative contribution, is a difficult if not impossible task. Moreover, the strong disagreement between countries about which economic factors should determine the allocation of taxing rights has recently led to a greater consideration of distributional consequences. Tax policy discussions on how to allocate taxing rights increasingly rely on impact assessments, suggesting a continued move from an origin-based toward a consequentialist approach. The increasing role of the distributional implications of different tax design choices requires normative criteria that go beyond an origin-based rationale and include distributive justice considerations.

An alternative normative approach, which can be called the differential approach, warrants that the distribution of rights between states promotes global distributive justice. From this perspective, taxing right allocation should aim to address the existing economic inequalities between countries. The article's main argument is that the diminished scope of, and continued departure from, origin-based approaches give rise to a normative claim that the disputed portion of the international tax base should be allocated to the benefit of less affluent countries to help address their development needs.

The remainder of the article proceeds as follows. Part I explains the normative foundations of origin-based theories, which still predominate in international tax circles, and discusses some of their practical limitations. Part II analyzes the differential approach and discusses how it reconciles with origin-based approaches. Part III presents the implications of this alternative normative standard, particularly in proposals that incorporate formulary approaches to the allocation of global business profits.

I. *Origin-based approaches*

1. *Entitlement theories and the principle of origin*

A variety of theories attempt to explain the existing rules for entitling countries to tax a given income. They can be broadly categorized as origin-based theories because they generally align tax entitlement with the location

of the factors that have contributed to the generation of income. Perhaps one of the clearest and most long-standing explanations for the current international allocation of taxing rights is the *economic allegiance theory.* It was notably advanced in the 1920s by four economists commissioned by the League of Nations to evaluate the then-current international tax system.[1] Their report is widely considered to have formed the basis of the present international tax rules.[2] The economic allegiance theory submits that income should be allocated among countries according to "the origin of the income or the place where the earnings are created."[3] This came to be known as the *principle of origin.*[4] The underlying rationale is that individuals and corporations benefit from and have economic interests in the states where their income is produced, possessed and disposed of.[5] As far as they benefit from services, infrastructure, and market and labour access from these states, they build a connection that implies a duty to pay taxes.[6]

Alternative explanatory theories build on similar normative reasoning. The *benefits theory* requires the allocation of taxing rights according to the benefits derived from each country's provision of public goods and *services.*[7] It is often justified by the ethical obligation of a taxpayer to pay for the benefits conferred by the government and the notion of an implied

1. Bruins et al, *Report on Double Taxation, submitted to the Financial Committee*, League of Nations, Geneva, 1923, League of Nations Doc EFS 73 [1923 Report].

2. See Michael J Graetz, "Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies" (2001) 26:4 Brook J Int'l L 1357 at 1358.

3. 1923 Report, *supra* note 1 at 24. For an overview, see RSJ Martha, *The Jurisdiction to Tax in International Law* (Deventer: Kluwer Law and Taxation, 1989) at 23-41.

4. See Eric CCM Kemmeren, *Principle of Origin in Tax Conventions: A Rethinking of Models* (Dongen, The Netherlands: Pijnenburg, 2001).

5. See 1923 Report, *supra* note 1 (defining production of wealth as encompassing "all the stages up to the point when the physical production has reached a complete economic destination and can be acquired as wealth," possession of wealth as the "range of functions relating to establishing the title to the wealth and preserving it [which takes place] between the actual fruition of production into wealth and the disposing of it in consumption" and disposition of wealth as "the stage when the wealth has reached its final owner, who is entitled to use it in whatever way he chooses. He can consume it or waste it, or re-invest it; but the exercise of his will to do any of these things resides with him and there his ability to pay taxes is apparent" at 22-23). See also Klaus Vogel, "Worldwide vs. Source Taxation of Income—A Review and Re-evaluation of Arguments (Part I)" (1988) 16:8-9 Intertax 216 at 223-228 (explaining that the origin of income "refers to a state that in some way or other is connected to the production of the income in question, to the state where value is added to a good").

6. 1923 Report, *supra* note 1 at 18. See also Klaus Vogel, "Worldwide vs. Source Taxation of Income—A Review and Re-Evaluation of Arguments (Part III)" (1988) 16:11 Intertax 393 at 398 (pointing out that a taxpayer integrated in the economic life of a state owes a certain degree of economic allegiance to its government as a compensation for the costs incurred to provide the benefits that contributed to the earning of the income).

7. Richard A Musgrave & Peggy B Musgrave, "Inter-Nation Equity" in Richard M Bird & John G Head, eds, *Modern Fiscal Issues: Essays in Honor of Carl S. Shoup* (Toronto and Buffalo: University of Toronto Press, 1972) 63 at 71-72.

contract between the taxpayer and the country imposing the tax.[8] The *costs theory* takes the perspective of the state and aligns tax entitlement with the cost of the services performed by the state rather than the benefits derived from these services.[9] The benefits and the costs theories are considered two variants of the *exchange theory*, which premises on the economic rationale that states and taxpayers exchange services and tax payments.[10] The *entitlement theory* is considered to go beyond the benefits theory for including not only services provided by the government but also other factors (such as access to markets and productive resources) that contribute to the creation of income.[11] The *faculty theory*, commonly known as the *ability-to-pay theory*, is also considered a more comprehensive substitute for the benefits theory.[12] According to the faculty theory, in addition to the benefits provided by the government to the acquisition of income, the allocation of taxing rights should consider the costs incurred by the government to allow for the consumption of that income.[13] A more recent attempt to explain the alignment of taxing rights with the place of economic activity is the *value creation theory.* It has been advanced in international tax circles as a basis for aligning taxing rights with where economic activities leading to the creation of income are performed.[14] The value creation theory is considered to expand the scope of the existing criteria for distributing the international tax base to include the location of consumers and users of goods and services, premised on the idea that they contribute to the creation of income.[15]

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8. Nancy H Kaufman, "Fairness and the Taxation of International Income" (1998) 29 Law & Pol'y Intl Bus 145 at 184; Reuven S Avi-Yonah, "All of a Piece Throughout: The Four Ages of U.S. International Taxation" (2005) 25:2 Va Tax Rev 313 at 315. Adopting a similar view, some have argued for a principle of membership, according to which "individuals and companies should be viewed as members in those countries where they benefit from the public services and infrastructure" and therefore "polities should have an effective right to tax individuals and companies as they see fit" (Peter Dietsch & Thomas Rixen, "Tax Competition and Global Background Justice" (2014) 22:2 J Pol Phil 150 at 157-158).

9. 1923 Report, *supra* note 1 at 18.

10. Richard Abel Musgrave, "The Voluntary Exchange Theory of Public Economy" (1939) 53:2 QJ Econ 213 at 214-215.

11. Thomas Rixen, *The Political Economy of International Tax Governance* (Basingstoke: Palgrave Macmillan, 2008) at 59.

12. See e.g. 1923 Report, *supra* note 1 at 18; Edwin RA Seligman, "The Theory of Progressive Taxation" (1893) 8:2 Pol Sci Q 220; Kaufman, *supra* note 8 at 184; J Clifton Fleming Jr, Robert J Peroni & Stephen E Shay, "Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income" (2001) 5 Fla Tax Rev 299.

13. 1923 Report, *supra* note 1 at 18.

14. OECD, *Addressing the Tax Challenges of the Digital Economy: Action 1—2015 Final Report* (Paris: OECD, 2015).

15. See e.g. Itai Grinberg, "User Participation in Value Creation" (2018) 2018:4 Brit Tax Rev 407. But see Johannes Becker & Joachim Englisch, "Taxing Where Value Is Created: What's 'User Involvement' Got to Do with It?" (2019) 47:2 Intertax 161. For critical remarks on how the principle

These theories have been used in tax scholarship to explain two main principles for how to allocate tax entitlement. The *source principle* recognizes the entitlement of a state to tax all income arising within its borders. The tax entitlement of the source country derives from the benefits it provides to the economic factors that contribute to the generation of income, such as services, infrastructure, natural resources, educated or low-cost labour, and access to market.[16] The *residence principle* entitles the state where an individual or corporation resides to tax its worldwide income. Residents are held to owe taxes as a return for the rights and privileges they receive as residents, as well as for the benefits accruing to their productive factors prior to foreign investment.[17]

Although there is no clear consensus as to which theory provides the most adequate normative basis for taxing right allocation, what these theories hold in common is that they all rely on some variant of the principle of origin, that is, the broad notion that the location of the factors that contributed to the creation of income should determine which state is entitled to tax it.

2. *Normative basis*

Origin-based approaches can be justified by the notion of sovereignty. Sovereignty requires states to respect the independence and autonomy of other states and recognize their territorial integrity.[18] The sovereignty of a state reflects in its jurisdiction, which comprises its legal powers within an international society of states.[19] States are thus entitled to the productive factors within their territories.[20]

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of value creation is generally interpreted, see David Quentin, "Corporate Tax Reform and 'Value Creation': Towards Unfettered Diagonal Re-allocation across the Global Inequality Chain" (2017) 7 Acc Econ & L 1; Allison Christians & Laurens van Apeldoorn, "Taxing Income Where Value is Created" (2018) 22:1 Fla Tax Rev 1; Michael P Devereux & John Vella, "Value Creation as the Fundamental Principle of the International Corporate Tax System" (2018) European Tax Policy Forum Working Paper, online: <ssrn.com/abstract=3275759> [perma.cc/QWC4-NJ5L].

16. Peggy B Musgrave, "Combining Fiscal Sovereignty and Coordination: National Taxation in a Globalizing World" in Inge Kaul & Pedro Conceição, eds, *The New Public Finance: Responding to Global Challenges* (Oxford: Oxford University Press, 2006) 167 at 172 [Musgrave, "Combining"].

17. *Ibid* at 168-169.

18. Territorial integrity is generally regarded as a foundational principle of international law given the major role of territorial disputes in enduring interstate rivalries and war. See Mark W Zacher, "The Territorial Integrity Norm: International Boundaries and the Use of Force" (2001) 55:2 Int'l Org 215. See also JL Brierly, "Règles générales du droit de la paix" (1936) 58 Recueil des Cours 1 (pointing to the fundamental relationship between jurisdiction and state territory). For a broader discussion, see Cedric Ryngaert, *Jurisdiction in International Law* (Oxford: Oxford University Press, 2008).

19. Frederick A Mann, "The Doctrine of Jurisdiction in International Law" (1964) 111 Recueil des Cours 1.

20. Laurens van Apeldoorn, "International Tax Co-operation in an Unjust World: Do States Have an Entitlement to Tax Income Arising in Their Territory?" (2019) 4 British Tax Review 528 at 530.

The source and the residence principles of international tax law are deeply rooted in the two fundamental cornerstones of international law, territoriality and nationality, respectively. Territoriality establishes that a state has jurisdiction over events, persons or things in its territory, including cross-border events that are only partially in its territory and external acts that produce effects within its territory.[21] Nationality establishes a connection based on the relationship between an individual and a sovereign and extends state authority over events taking place beyond national borders. Although conceptually different, nationality (in general international law) and residence (in international tax law) derive from the same normative rationale, namely the personal, rather than territorial, connections between a state and an individual as a source of authority.[22]

Sovereignty, thus, generally implies that states should be entitled to the wealth generated in their territories or arising from the resources they control. From this perspective, establishing tax entitlements entails determining the causal relationship between economic factors and the income arising from these factors. According to origin-based approaches, this relationship between the entitlement to a given income and the origin of that income is the fundamental standard for distributing the international tax base.

3. *Limitations*

Two circumstances limit the scope of origin-based approaches as normative criteria for allocating taxing rights. The first problem is that they are difficult to implement in practice. Origin-based approaches need to determine where the income was generated (which generally requires considering every factor without which such income would not have come to exist)[23] and establish how much each factor has contributed to

21. Alex Mills, "Rethinking Jurisdiction in International Law" (2014) 84:1 Brit YB Intl L 187 at 194-196.

22. See DW Bowett, "Jurisdiction: Changing Patterns of Authority over Activities and Resources" (1982) 53:1 Brit YB Intl L 1 at 8-9 (noting that the resident's links with a state are as close as those of a national for the purposes of particular areas of regulation, such as taxation, currency and military service obligations). One reason why residence usually substitutes for nationality in tax law is the prevalence in tax law of economic allegiance over political attachments (see 1923 Report, *supra* note 1 at 20). Another reason is that adopting nationality would encourage individuals to abandon their citizenship in exchange for another in a low-tax jurisdiction (see Reuven S Avi-Yonah, "International Tax as International Law" (2004) 57:4 Tax L Rev 483 at 485-486).

23. The origin of income should include any and all antecedents, active or passive, which were factors actually involved in producing the consequence (generation of income). This approach is usually called the "but for" test, or *conditio sine qua non*, and has long been investigated in the legal scholarship on causation in tort law. For an overview, see Richard W Wright, "Causation in Tort Law" (1985) 73:6 Cal L Rev 1735.

the creation of such income.[24] Determining these factors in a globalized, multinational scenario is complicated and often infeasible. A great part of global production today flows from interdependent supply and demand chains that span across multiple sectors and countries. Some of the income generated in global chains derives precisely from the reduction in costs associated with sharing of resources across business activities throughout the chain. The contribution of the concurrent factors that lead to cost reduction can hardly be accurately assigned to specific locations.[25] Intangibles pose a similar problem because they lack physical location and benefit the firm as a whole.[26]

Whenever origin-based entitlement theories fail to accurately determine the location and degree of contribution of the factors that give rise to a given income, a decision about how to allocate taxing rights requires an additional moral judgment to be regarded as normatively legitimate. In the absence of clear moral criteria, such a decision will be made by either some form of dispute resolution or political negotiation. If the former is adopted,

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24. Devereux & Vella, *supra* note 15 at 10.

25. Seee.g. Peggy B Musgrave, "Principles for Dividing the State Corporate Tax Base" in Charles E McLure Jr, ed, *The State Corporation Income Tax: Issues in Worldwide Unitary Combination* (Stanford: Hoover Institution Press, 1984) 228 at 243 ("These firms are interrelated through economies of scale and scope, joint costs, and other factors that render an attempt at separation of activities meaningless."); Reuven S Avi-Yonah & Ilan Benshalom, "Formulary Apportionment—Myths and Prospects: Promoting Better International Tax Policies by Utilizing the Misunderstood and Under-Theorized Formulary Alternative" (2011) 3:3 World Tax J 371 at 379 (noting that multinationals flourish by integrating functions in different jurisdictions and reducing costs through synergy that takes advantage of economics of scope and scale, including research and development costs, transactions costs, informational costs, managerial costs, and finance costs); Musgrave, "Combining," *supra* note 16 at 176 (pointing out that with the prevalence of interconnected business operations, economic theory cannot alone can be claimed to correctly assign profits between countries); Michael P Devereux & John Vella, "Are We Heading towards a Corporate Tax System Fit for the 21st Century?" (2014) 35:4 Fiscal Stud 449 (noting that in the context of a multinational the numerous factors that contribute to the creation of income are often spread over a number of countries, making it impossible to pinpoint where the creation of income took place); Michael P Devereux et al, "Residual Profit Allocation by Income" (2019) Oxford University Centre for Business Taxation Working Paper No 19/01, online: <https://ssrn.com/abstract=3358291> [perma.cc/A4ZB-72FU] at 13 (explaining that the synergies resulting from the combination of different production factors from all parts of a multinational, spread across the world, are not only hard to capture in practice but impossible to allocate to specific corporate units or geographical locations).

26. See Mitchell A Kane, "Transfer Pricing, Integration and Synergy Intangibles: A Consensus Approach to the Arm's Length Standard" (2014) 6:3 World Tax J 282 at 285 (pointing out that intangibles are impossible to locate spatially and, although often extremely valuable, appear to be immune to accurate valuation); Jerome R Hellerstein, "Federal Income Taxation of Multinationals: Replacement of Separate Accounting with Formulary Apportionment" (1993) 60:10 Tax Notes 1131 at 1141-1142 (arguing that given the difficulties to determine a location for intangibles, they might be ignored as a factor for the purposes of allocating taxing rights); Charles E McLure Jr, "U.S. Federal Use of Formula Apportionment to Tax Income from Intangibles" (1997) 14:10 Tax Notes Intl 859 at 868 (similarly arguing that it would be advisable to disregard intangibles in the determination of taxing rights given the difficulties to establish their geographical location).

a purportedly technical solution will eventually conceal a political or moral judgment,[27] since a straightforward answer based on the stated normative standard (namely, an origin-based approach) is, in this case, unavailable. If the latter is adopted, the final decision will be ultimately made on the basis of influence and power. The resulting allocation of taxing rights will eventually favour more powerful countries, compounding global inequality.[28] Both solutions are problematic for lacking a sound normative basis.[29] This realization calls for an alternative normative standard when an origin-based approach fails to accurately allocate income among states.

A second limitation of origin-based theories arises from a continued shift away from an origin-based approach toward distribution-based considerations in tax policy discourse. The sharp disagreements about which economic factors should be considered relevant for allocating taxing rights have led to a greater consideration of distributional consequences. Recent discussions about how to adequately allocate taxing rights among states have increasingly relied on economic impact assessments to determine which countries will gain and which will lose as a result of alternative proposals.[30] These discussions suggest that distributional

27. For a discussion on the relevance of political and moral biases in legal interpretation, see e.g. Gillian K Hadfield, "Bias in the Evolution of Legal Rules" (1992) 80 Geo LJ 583; Eric A Posner, "Does Political Bias in the Judiciary Matter?: Implications of Judicial Bias Studies for Legal and Constitutional Reform" (2008) 75:2 U Chicago L Rev 853; Jill Anderson, "Misreading like a Lawyer: Cognitive Bias in Statutory Interpretation" (2014) 127:6 Harv L Rev 1521.

28. For a discussion about how influence and power affect matters of distributive justice in international tax policy, see Ivan Ozai, "Two Accounts of International Tax Justice" (2020) 33:2 Can JL & Jur 317. Analyzing the different strands of tax competition, Hugh Ault notes that besides the more commonly observed competition for investment, the recent disagreements about how to allocate taxing rights to deal with the challenges posed by the digitalization of the economy has unveiled the concurrent competition for revenues, which despite largely unnoted, goes back to the work of the League of Nations in the 1920s. See Hugh J Ault, "Tax Competition and Tax Cooperation: A Survey and Reassessment" in Jérôme Monsenego & Jan Bjuvberg, eds, *International Taxation in a Changing Landscape: Liber Amicorum in Honour of Bertil Wiman* (Alphen aan den Rijn: Wolters Kluwer, 2019).

29. This problem is also similar to the concept of causation in tort law. See William M Landes & Richard A Posner, "Causation in Tort Law: An Economic Approach" (1983) 12:1 J Leg Stud 109 at 110 (doubting whether it is possible to use an autonomous concept of cause to decide legal cases and arguing that the idea of causation is a result rather than a premise of the analysis of cause). See also Devereux & Vella, *supra* note 15 at 10 (noting that the continued pursuit of origin in complex cases poses additional hurdles for countries without substantial capacity and resources and that the use of arbitrary measures that may proxy for origin brings into question the choice of the normative principle in the first place).

30. See e.g. Christoph Spengel et al, "A Common Corporate Tax Base for Europe: An Impact Assessment of the Draft Council Directive on a CC(C)TB" (2012) ZEW Working Paper No 12-039, online: <www.econstor.eu/bitstream/10419/59576/1/718573498.pdf> [perma.cc/9RDS-69RV] (assessing the impacts on different EU member states resulting from the adoption of a common corporate tax base); International Monetary Fund, "Spillover in International Corporate Taxation" (2014) IMF Policy Paper, online: <www.imf.org> (discussing how the choice of allocation rules will affect advanced, developing and "conduit" countries); Tommaso Faccio & Valpy Fitzgerald,

considerations will at least in part replace the role of the traditional origin-based rationale in the final decision on the criteria for allocating taxing rights. This shift requires a normative justification that the economic reasoning behind origin-based theories fails to provide.

II. *The differential approach*

1. *Differentiation*

An alternative normative approach for allocating rights between nations can be called differentiation.[31] The differential approach distributes rights so as carry out a universal moral objective, in particular one that aligns with a concern about global justice.[32] A differential approach to international tax law would take taxing rights allocation as a significant tool for addressing global inequality and propose a distribution according to countries' characteristics such as per capita income or number of inhabitants. Although the use of differentiation is still relatively unorthodox, it has been embraced in some areas of international law. In international labour

"Sharing the Corporate Tax Base: Equitable Taxing of Multinationals and the Choice of Formulary Apportionment" (2018) 25:2 Transnat'l Corp 67 (analyzing the various distributional consequences of different formulas under formulary apportionment); Ruud A de Mooij, Li Liu & Dinar Prihardini, "An Assessment of Global Formula Apportionment" (2019) IMF Working Paper No 19/213, online: <imf.org/en/Publications/WP/Issues/2019/10/11/An-Assessment-of-Global-Formula-Apportionment-48718> [perma.cc/2K96-3ZYM] (assessing the revenue implications for individual countries under alternative formulas under a unitary tax system); Alex Cobham, Tommaso Faccio & Valpy FitzGerald, "Global Inequalities in Taxing Rights: An Early Evaluation of the OECD Tax Reform Proposals" (October 2019), online: <osf.io/preprints/socarxiv/j3p48> [perma.cc/N68A-KW3S] (discussing the revenue impacts of tax reform proposals considered by the OECD on lower-income countries); "OECD Presents Analysis Showing Significant Impact of Proposed International Tax Reforms" OECD (13 February 2020), online: <www.oecd.org> (reporting the economic implications expected from the reform proposals recently advanced by the OECD over low-, middle-, and high-income countries); Sebastian Beer et al, "Exploring Residual Profit Allocation" (2020) IMF Working Paper No 20/49, online: <imf.org/en/Publications/WP/Issues/2020/02/28/Exploring-Residual-Profit-Allocation-48998> [perma.cc/LR8B-WWNL] (discussing the tax revenue impacts on investment hubs and lower-income countries resulting from a reallocation of residual profits).

31. For a discussion on the relationship between the concept of inter-nation equity and differentiation, see Ivan Ozai, "Inter-Nation Equity Revisited" (2020) 12:1 Colum J Tax L 58, which also offer specific normative requirements for a legitimate use of differentiation in international tax policy design.

32. Alexander Cappelen calls this the assignment approach. See Alexander W Cappelen, "The Moral Rationale for International Fiscal Law" (2001) 15:1 Ethics & Intl Aff 97 at 108 ("A characteristic feature of international fiscal law is that considerations of international income distribution do not have any role in the distribution of tax rights. The assignment approach would challenge this feature of international fiscal law based on what we could call the distributional objection. In its general version this objection points out that benefits arising from special relationships might work to the disadvantage of those who are most in need.").

law,[33] law of the sea,[34] international trade law,[35] international climate law,[36] and international patent law,[37] the concept of differential treatment has been explicitly used as a way to foster substantive equality among states with varying levels of capacity.

Differential treatment typically comprises non-reciprocal arrangements aimed at promoting substantive equality between countries.[38] The rationale behind differentiation in international law lies in the recognition that formal equal treatment can secure equality only among parties at an identical or similar level of economic and political power, and that differentiated treatment is warranted to correct inequalities among different parties.[39] Differentiation can also foster cooperation and facilitate the effective implementation of international norms.[40]

2. *Normative basis*

The differential approach builds mostly on distributive justice considerations. The international tax regime constitutes a strong and largely non-voluntary economic association between countries, which raises *special associative duties*—duties owed to parties with whom one stands in a robust relationship or interaction[41]—one of which is the requirement that

33. *Constitution of the International Labour Organization*, 1 April 1919 at Article 19(3) (entered into force 28 June 1919).
34. *United Nations Convention on the Law of the Sea*, 10 December 1982, UNTS 1883-1885 at Articles 61-62 (entered into force 16 November 1994).
35. *General Agreement on Tariffs and Trade*, 30 October 1947, 58 UNTS at Article XVIII (entered into force 1 January 1948).
36. *United Nations Framework Convention on Climate Change*, 9 May 1992, at Article 3(1).
37. *Agreement on Trade-Related Aspects of Intellectual Property Rights*, 15 April 1994, at Articles 65(2), 65(4), 66(2), and 67.
38. Differential treatment recognizes the limits of a system based on a fiction of legal equality between states that imposes reciprocity of commitments by all state parties to any treaty. See Daniel Barstow Magraw, "Legal Treatment of Developing Countries: Differential, Contextual, and Absolute Norms" (1990) 1:1 Colo J Intl Envtl L & Poly 69. For a discussion in international taxation about rules that are nominally reciprocal but substantively asymmetrical, see Steven A Dean, "More Cooperation, Less Uniformity: Tax Deharmonization and the Future of the International Tax Regime" (2009) 84 Tul L Rev 125.
39. See Oscar Schachter, "The Evolving Law of International Development" (1976) 15:1 Colum J Transnat'l L 1 (grounding differential treatment on a consideration of need as basis for entitlement); Philippe Cullet, "Differential Treatment in International Law: Towards a New Paradigm of Inter-state Relations" (1999) 10:3 EJIL 549 at 550; Frank J Garcia, *Trade, Inequality, and Justice: Toward a Liberal Theory of Just Trade* (New York: Transnational Publishers, 2003) (taking differentiation as a mechanism to achieve wealth redistribution in the face of substantial inequalities); Eduardo Tempone, "Special and Differential Treatment" in Rüdiger Wolfrum, eds, *Max Planck Encyclopedia of Public International Law* (Oxford: Oxford University Press, 2014).
40. Cullet, *supra* note 39; Tempone, *supra* note 39. For a related discussion in the context of tax competition, see Ivan Ozai, "Tax Competition and the Ethics of Burden Sharing" (2018) 42:1 Fordham Intl LJ 61.
41. These duties are sometimes called *relational duties*. See Andrea Sangiovanni, "On the Relation Between Moral and Distributive Equality" in Gillian Brock, ed, *Cosmopolitanism versus Non-*

international institutions do not become sources of privileges to wealthier, more powerful participants.[42] More broadly, the current level of economic integration of nations has made the global economy a substantial presence in the lives of all states, and economic regulation and policy decisions today take place in a global setting that is significantly interdependent. The fact that rules made by a state (or by a supranational rule-making body) are consequential to other states raises the need for some degree of coordination and equity beyond the national level.[43]

3. *Application*

The origin-based and the differential approaches lead to markedly distinct distributional outcomes. The latter aims to reduce international inequalities by allocating greater rights to lower-income states, whereas the former tends to maintain or increase the existing inequalities. The question about which of these normative approaches should apply to taxing right allocation leads to the more fundamental question about whether principles of distributive justice should be constrained to the domestic realm or extend to the international domain.[44] Within the spectrum of the various normative accounts of global justice, this article takes an intermediary stance that recognizes the existence of some duties of distributive justice

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Cosmopolitanism: Critiques, Defenses, Reconceptualizations (Oxford: Oxford University Press, 2013) 55 [Brock, "Cosmopolitanism"].

42. Darrel Moellendorf, "Cosmopolitanism and Compatriot Duties" (2011) 94:4 Monist 535. See also Brock, "Cosmopolitanism," *supra* note 41, 222.

43. Joshua Cohen & Charles Sabel, "Extra Rempublicam Nulla Justitia?" (2006) 34:2 Phil & Pub Aff 147 at 165.

44. This discussion is generally referred to as the problem of global justice. On one end stands *global cosmopolitanism*, which argues that normative requirements of distributive justice should apply at the global level. Cosmopolitan theorists generally share the belief that human beings—and not families, cultures, or nations—are the ultimate units of moral concerns and thereby should be treated equally regardless of nationality or citizenship. On the other end stands statism, which typically claims that no duty of egalitarian distributive justice exists outside the state. Statists usually accept that we have universal duties to humanitarian assistance to those in desperate need, but these duties are limited and not grounded on principles of distributive justice. Early works embracing global cosmopolitanism are Charles Beitz, *Political Theory and International Relations* (Princeton: Princeton University Press, 1973) and Thomas W Pogge, *Realizing Rawls* (Ithaca: Cornell University Press, 1989). More recent theories of global cosmopolitanism include Darrel Moellendorf, *Cosmopolitan Justice* (Boulder, CO: Westview Press, 2002); Kok-Chor Tan, *Justice without Borders: Cosmopolitanism, Nationalism and Patriotism* (Cambridge: Cambridge University Press, 2004); Simon Caney, *Justice Beyond Borders: A Global Political Theory* (Oxford: Oxford University Press, 2005). One important representative of statism is Thomas Nagel, "The Problem of Global Justice" (2005) 33:2 Phil & Pub Aff 113. Frequently deemed as representatives of a moderate statist view include Michael Blake, "Distributive Justice, State Coercion, and Autonomy" (2001) 30:3 Phil & Pub Aff 257; Samuel Freeman, "The Law of Peoples, Social Cooperation, Human Rights, and Distributive Justice" (2006) 23:1 Soc Phil & Pol'y 29. For a discussion about the statist view applied to international tax policy, see Laurens van Apeldoorn, "A Sceptic's Guide to Justice in International Tax Policy" (2019) 32:2 Can JL & Jur 499.

beyond state borders but takes these duties to differ in content and scope to those applied domestically.[45]

Applied to the problem of allocating taxing rights between states, this middle ground position on global justice entails a normative compromise between an origin-based approach (which is premised on state sovereignty) and a differential approach (which allows for considerations of global justice). The fundamental question is how to reconcile these two normative approaches.

This article does not provide a full answer to this question, but it argues that a differential approach should apply at least in cases where an origin-based approach fails to serve as a normative guide for distributing the international tax base. This may happen when one of the two cases discussed in Section I.3 takes place. First, the differential approach is warranted in cases in which it is impossible to accurately pinpoint the factors that contributed to the creation of a given income and, more importantly, the degree of contribution of each of these factors. Whenever this practical difficulty arises, a decision about how to allocate taxing rights will be arbitrary from a moral standpoint unless it is based on some other normative criteria. In these cases, the differential approach seems to be the most compelling alternative normative basis. In the absence of a justifiable normative criterion for allocating taxing rights, priority should be given to a solution that promotes, rather than departs from, distributive justice.

The differential approach is also warranted whenever tax policy design gives priority to distributional considerations over a clear origin-based rationale. When the decision about how to allocate taxing rights depends more on its distributional consequences than on criteria clearly justifiable by an origin-based principle, such decision will be normatively arbitrary in the absence of alternative normative criteria. Once again, this gives rise to a claim for the differential approach. More importantly, a decision based on distributional consequences requires a normative rationale that takes distributive justice into consideration. If the criteria for allocating taxing

45. It is mostly aligned with what Laura Valentini has called the "third wave" of global justice, which provides "a sustained critical discussion of cosmopolitanism and statism, and a fresh perspective helping us to steer a middle course between them" (Laura Valentini, *Justice in a Globalized World: A Normative Framework* (Oxford: Oxford University Press, 2011) at 3-4. According to Valentini, two representatives of this position are Gillian Brock, *Global Justice: A Cosmopolitan Account* (Oxford: Oxford University Press, 2009) and David Miller, *National Responsibility and Global Justice* (Oxford: Oxford University Press, 2007). Yet, as she notes, these authors explicitly place themselves respectively in the cosmopolitan and statist traditions. See also Jon Mandle, *Global Justice* (Cambridge, UK: Polity Press, 2006); Sebatiano Maffettone, "Global Justice: Between Leviathan and Cosmopolis" (2012) 3:4 Global Pol'y 443; Mathias Risse, *On Global Justice* (Princeton: Princeton University Press, 2012).

rights are to be decided upon how they will benefit or disadvantage different countries, the underlying normative principle for this allocation must more broadly consider whether the resulting distribution will improve or worsen the relative welfare across these countries.

III. *Practical implications*

Having established that the differential approach should apply when origin-based approaches fail to serve as a normative guide, the next logical step is determining when the latter is sufficiently inaccurate or inapplicable as to trigger the former. This determination requires settling the degree of failure of the origin-based approach with which we can come to terms. On one end of the spectrum, one could tolerate an absolute degree of failure and take the existing proxies for origin of income as acceptable from a normative standpoint. This is the view implicitly adopted, for example, by those who consider that the current allocation of taxing rights is normatively justified. The main problem with taking this stance is that the more complex it is to determine the underlying factors of income generation, the more inaccurate origin-based approaches are in establishing proxies for origin of income. Similarly, the more reliant the decision about taxing rights allocation is on political and distributional considerations, the less aligned such proxies are to the origin-based rationale. It follows that these proxies become increasingly arbitrary. On the opposite end, one could be as strict as to conclude that any origin-based approach will be arbitrary to some degree as to require its replacement altogether for another normative approach.[46] The main problem with this stance is that it fails to acknowledge the normative validity of origin-based theories and the importance of state sovereignty in today's state of affairs. If one is to stand, however, somewhere in the middle of these two extremes, it is difficult to draw a bright-line test for when to shift from an origin-based to a differential approach.

A pragmatic solution is to begin by applying the differential approach in cases where the failure of origin-based criteria is most evident. The allocation of corporate profits through formulary apportionment is a case in point. The following will discuss why a differential should apply in those cases and what it would entail.

1. *Profit apportionment in a global unitary system*

In recent years, many scholars have called for a departure from separate accounting under the arm's-length principle toward a unitary taxation

46. This case is made, for example, in Adam Kern, "Illusions of Justice in International Taxation" (2020) 48:2 Phil & Pub Aff 151.

system with formulary apportionment. This shift would change how profits earned by multinational corporations are allocated among jurisdictions. A unitary taxation system under formulary apportionment would allocate multinationals' profits based on a formula that considers the location of economic factors. The shift toward unitary taxation is generally touted as a way to eliminate the complexity of transfer pricing rules and associated administrative and compliance costs, as well as to reduce economic distortions caused by the current system and incentives for tax avoidance practices.[47]

One important and challenging aspect of adopting a unitary tax scheme, however, is settling on the formula that will determine how profits are allocated among jurisdictions. Proposals for formulary apportionment frequently take an origin-based approach and suggest a multi-factor formula based on a combination of the economic factors that contributed to the generation of the profits, such as the place of sales, payroll expenses, and physical assets. Different proposals suggest varying weights to each of these factors.[48] Similarly, jurisdictions that adopt formulary apportionment in intra-state allocation of income use a variety of formulas. The United States and Canada provide prominent examples. These two countries adopt the formulary apportionment model to allocate profits among states and provinces. The experience from these countries points to a considerable arbitrariness from a normative standpoint in how formulas and weights are chosen. Canadian provinces have adopted a formula that weights equally on payroll and gross receipts.[49] US states have each used different formulas that seem to significantly rely on pragmatism. Over time, states have gradually shifted to sales as the main allocating factor, not because of

47. See e.g. Jinyan Li, "Global Profit Split: An Evolutionary Approach to International Income Allocation" (2002) 50:3 Can Tax J 823; Walter Hellerstein, "Income Allocation in the Twenty-First Century: The End of Transfer Pricing? The Case for Formulary Apportionment" (2005) 12:3 Int'l Transfer Pricing J 103; Susan C Morse, "Revisiting Global Formulary Apportionment" (2010) 29:4 Va Tax Rev 593; Reuven S Avi-Yonah, Kimberly A Clausing & Michael C Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split" (2009) 9:5 Fla Tax Rev 497.

48. For a brief analysis of the distributive outcome of different formulas, see Heinz-Klaus Kroppen, Roman Dawid & Richard Schmidtke, "Profit Split, the Future of Transfer Pricing? Arm's Length Principle and Formulary Apportionment Revisited from a Theoretical and a Practical Perspective" in Wolfgang Schön & Kai A Konrad, eds, *Fundamentals of International Transfer Pricing in Law and Economics* (Heidelberg: Springer, 2012) 267 at 273-276.

49. See Joann Martens Weiner, "Formulary Apportionment and Group Taxation in the European Union: Insights from the United States and Canada" (2005) Directorate-General for Taxation and Customs Union Taxation Paper No 8/2005, online (pdf): <ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/gen_info/economic_analysis/tax_papers/2004_2073_en_web_final_version.pdf> [perma.cc/G48X-R8XF].

its normative appeal but to reduce the incentives for corporations to move jobs and property out of state.[50]

It is largely accepted that any possible combination will be significantly arbitrary from a normative point of view, given the impossibility of determining the degree to which each factor contributes to the generation of a multinational's profits.[51] Yet, the formula ultimately chosen for apportioning profits will have major distributional implications for countries.[52] It is thus unsurprising that impact assessment studies, however limited they may be, given data constraints, have grown in importance in tax policy discussions about whether to adopt unitary taxation and how to determine the appropriate formula.[53]

These two factors (the insufficiency of origin-based criteria to apportion profits and the increasing role of distributional considerations in the tax policy decision-making) give rise to the normative priority of the differential approach. The differential approach requires that the distribution of the international tax base improve rather than worsen global inequality. It requires that one or more international development indicators be included as a contributing factor to the apportionment formula. Including a direct measure of international inequality in the formula is perhaps the

50. See Michael Mazerov, "The Single-Sales-Factor Formula: A Boon to Economic Development or a Costly Giveaway?" (2001) 20 State Tax Notes 1775 (noting the weak economic rationale behind the shift toward a single-sales-factor formula); Jack Mintz, "Europe Slowly Lurches to a Common Consolidated Corporate Tax Base: Issues at Stake" in Wolfgang Schön, Ulrich Schreiber & Christoph Spengel, eds, *A Common Consolidated Corporate Tax Base for Europe* (Berlin, Heidelberg: Springer, 2008). For some legal implications of a sales-based formula at the international level, see Charles E McLure Jr & Walter Hellerstein, "Does Sales-Only Apportionment of Corporate Income Violate International Trade Rules?" (2002) 27 Tax Notes Int'l 1315. The shift toward a single-sales factor is also attributed to the difficulty of accurately valuing property. See Morse, *supra* note 47.

51. See Peggy B Musgrave, "Interjurisdictional Equity in Company Taxation: Principles and Applications to the European Union" in Sijbren Cnossen, ed, *Taxing Capital Income in the European Union: Issues and Options for Reform* (Oxford: Oxford University Press, 2000) ("There does not appear to be any objective, single answer to the question of how company profits should be divided in a multijurisdictional setting" at 46); Tim Edgar, "Corporate Income Tax Coordination as a Response to International Tax Competition and International Tax Arbitrage" (2003) 51:3 Can Tax J 1079 ("formulary allocation approaches cannot be justified as realizing some correct allocation defined in any precise normative sense" at 1154); Avi-Yonah, Clausing & Durst, *supra* note 47 at 516-517 (acknowledging that any formula can produce arbitrary results in a given industry but arguing that the present separate accounting system is equally or more arbitrary); James R Hines Jr, "Income Misattribution Under Formula Apportionment" (2010) 54:1 Eur Econ Rev 108 (showing that formulas included in proposals for formulary apportionment are not strongly correlated with determinants of business incomes).

52. Faccio & Fitzgerald, *supra* note 30.

53. See e.g. International Monetary Fund, *supra* note 30; Alex Cobham & Simon Loretz, "International Distribution of the Corporate Tax Base: Implications of Different Apportionment Factors under Unitary Taxation" (2014) International Centre for Tax and Development Working Paper No 27, online: <https://ssrn.com/abstract=2587839> [perma.cc/J6BW-HVUQ]; Faccio & Fitzgerald, *supra* note 30.

only feasible way to achieve a consistent normatively justified approach.[54] This differential approach is more suitable for addressing global justice concerns and brings greater transparency regarding normative rationale and distributional outcomes.

2. *Residual profit allocation*

Rather than a complete overhaul of the current international tax system, some have argued for incremental use of formulary apportionment. In this case, formulary apportionment would only apply to the residual portion of multinationals' profits in excess of a standard rate of return, that is, the portion of the profits that exceeds what a third party would expect to earn for performing functions and activities on an outsourcing basis.[55] Its proponents argue that the adoption of formulary apportionment for residual profits would improve the current transfer pricing regime by reducing opportunities for tax avoidance and eliminating relevant compliance and administrative costs.[56]

Compared to proposals for unitary taxation, the idea of a formulary allocation of residual profits seems to present fewer objections by supporters of the current transfer pricing regime, mostly because transfer pricing rules would still apply to routine profits, that is, to the portion of profits that is deemed to correspond to a normal return. Proponents of residual profit approaches often prefer a formula heavily weighted on the location of final sales. The main reasons for a sales-based formula are generally the reduced incentives for businesses to move payroll or assets to low-tax jurisdictions, smaller distorting influence on real economic decisions, and greater likelihood of international coordination.[57]

In a context where the transfer pricing regime is maintained, apportioning residual profits on a formulaic basis seems a promising approach. It also seems correct to argue that an origin-based approach

54. Although the most common approach would be to use per capita income as a reference, other indexes may be more appropriate to measure and compare international inequality. See Anthony C Infanti, "Internation Equity and Human Development" in Miranda Stewart & Yariv Brauner, eds, *Tax Law and Development* (Cheltenham, UK: Edward Elgar, 2012) at 209 (arguing for expanding the focus of inter-nation equity beyond economic growth to incorporate other non-economic considerations, such as feminist, social or strategic, and proposing the use of other indexes which include non-economic dimensions as criteria for a differential approach, such as the Human Development Index (HDI), the Inequality-adjusted HDI (IHDI), Gender Inequality Index (GII), and the UK Department for International Development (DFID)). See also Kim Brooks, "Global Distributive Justice: The Potential for a Feminist Analysis of International Tax Revenue Allocation" (2009) 21:2 CJWL 267 (arguing that one of the implications of a feminist analysis of international tax policy is the requirement to allocate greater taxing rights to lower-income countries).

55. See e.g. Avi-Yonah, Clausing & Durst, *supra* note 47; Devereux et al, *supra* note 25.

56. Avi-Yonah & Benshalom, *supra* note 25.

57. See Avi-Yonah, Clausing & Durst, *supra* note 25.

should account for the contribution of sales in the creation of income. The problem, however, is that there is no clear normative basis for allocating *residual* profits to jurisdictions where sales take place. Sales may be a relevant contributing factor for *routine* profits, but it is difficult to make a direct connection between sales contribution and the generation of residual profits.[58] Residual profits, by definition, are not directly attributable to any specific economic factor. Residual profit is the return resulting from the interaction of the constituent parts of a multinational that cannot be assigned to any of its components without a significant degree of arbitrariness.[59] A residual profit approach based on sales seems to effect a political compromise. Instead of integrating sales contribution in the allocation of routine profits, which would be normatively sound, it promotes a corrective measure through the allocation of residual profits. From a political viewpoint, this might loosely appease the demands of sales jurisdictions for greater taxing rights (see Section III.3). But from a normative perspective, the proposal is problematic because it benefits sales jurisdictions while disfavouring countries with narrower consumer markets with no clear underlying normative justification from a distributive justice perspective.

The impossibility to allocate residual profits adequately on the basis of origin makes for a stronger case for a differential approach. Although an origin-based approach could be used to determine the states to which residual profits are allocated (nexus), it is unable to provide any guidance for how to distribute the residual profits between these states allocation). A differential approach seems to provide a more appropriate normative basis for allocating residual profits. It would require the assignment of residual profits to the relevant jurisdictions based entirely on a direct measure of international inequality. A differential approach should also provide the same practical advantages of sales-based residual profit allocation as to its reduced susceptibility to tax avoidance and distortion on economic decisions due to the absolute immobility of development indexes to business decisions.

3. *The OECD's "new taxing right"*

In October 2019, the OECD Secretariat advanced a proposal for a "unified approach."[60] The unified approach adopts a formulary approach to partially

58. See Devereux & Vella, *supra* note 15 at 10 (pointing out the difficulties in allocating residual profits according to origin-based approaches).
59. See Reuven S Avi-Yonah, "The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation" (1995) 15:1 Va Tax Rev 89 at 148-149.
60. OECD, *Secretariat Proposal for a "Unified Approach" under Pillar One: Public Consultation Document* (Paris: OECD, 2019) [OECD, *Secretariat Proposal*].

shift the allocation of multinationals' profits to "market jurisdictions."[61] The proposal has come as a response to demands from various countries to update the current allocation of profits generated by digitalized businesses. The phrase "unified approach" indicates the OECD's stated intention to achieve a compromise solution that satisfies all conflicting proposals at the table, namely the European Union's focus on user participation, the US preference for considering marketing intangibles, and the Group of Twenty-Four's proposal for allocating income based on multinationals' significant economic presence.[62] The unified approach allocates only a portion of residual profits to market jurisdictions, thus creating what was labelled as the "new taxing right."[63]

From a normative perspective, the "new taxing right" presents a similar problem to proposals for residual profit allocation discussed in the previous section. Origin-based approaches do not provide a satisfactory normative basis for allocating residual profits. Several aspects of the OECD's proposal demonstrate the lack of a solid normative rationale. The stated goal of addressing the interests of specific states, namely countries with large consumer markets, and the stated concern about potential unilateral measures from these countries are evidence that political motivations were more significant than normative considerations.[64] Two main aspects of how the new approach has been advanced also make this clear. First, the portion attributable to market jurisdictions is not based on any clear economic criteria but will likely be determined by an agreed-upon fixed percentage.[65] The final share of market jurisdictions will thus rely on some form of political agreement rather than on a normative stand. And discussions about the appropriate fixed percentage will be,

61. According to the OECD, the phrase refers to the jurisdiction where customers or users are located. See OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy: Inclusive Framework on BEPS* (Paris: OECD, 2019) at 23.

62. For a detailed discussion about the political struggles and distributional implications involving these proposals, see Allison Christians & Tarcisio Diniz Magalhaes, "A New Global Tax Deal for the Digital Age" (2019) 67:4 Can Tax J 1153.

63. In addition to this formula-based approach (which the OECD calls Amount A), the unified approach includes a fixed baseline return for routine market-facing activities (Amount B) and incremental return attributable to a jurisdiction when Amount B falls short of the market-based routine return assumed under the application of the arm's-length principle (Amount C). For an overview, see Kartikeya Singh, W Joe Murphy & Gregory J Ossi, "The OECD's Unified Approach—An Analysis of the Revised Regime for Taxing Rights and Income Allocation" (2020) 97 Tax Notes Int'l 549.

64. See OECD, *Secretariat Proposal*, *supra* note 60 (explicitly acknowledging the need to achieve a compromise solution to avoid encouraging "more jurisdictions to adopt uncoordinated unilateral tax measures," which "would undermine the relevance and sustainability of the international tax framework, and would damage global investment and growth" at 4).

65. *Ibid* at 15.

from a normative point of view, a fairly arbitrary exercise. Second, the unconcealed consideration of the distributional consequences of the proposal as a condition for achieving a final agreement shows a move from an origin-based approach (which allocates taxing rights based on the relevance of each economic factor to the generation of profits) toward a distribution-based approach (which allocates taxing rights based on the actual distributional outcome of the possible alternatives).[66] This shift towards distributional considerations requires a re-evaluation of current normative criteria for allocating profits among states. The departure from an origin-based rationale implies that origin-based principles cease to provide normative guidance for allocating taxing rights.

In a context where distributional implications take precedence over other considerations, principles of distributive justice become even more relevant. Although the distributional impacts of the "new taxing right" are still unclear, it will likely disfavour low-income countries with small consumer markets.[67] Conversely, a differential approach requires that a reallocation of taxing rights benefit countries based on their relative development needs.

Conclusion

The current international tax regime is generally guided by origin-based approaches, which distribute taxing rights between states based on the location of the factors that contribute to the creation of income. Although normatively justifiable in theory, origin-based theories fail to provide satisfactory guidance for allocating taxing rights both when it is impossible to pinpoint the factors that gave rise to a given income and when tax policy

66. The importance of impact assessments of the proposal is emphasized by the OECD and by commentators' analyses. See e.g. OECD, "Webcast: Update on Economic Analysis and Impact Assessment" 13 February 2020, online: <oecd.org/tax/beps/webcast-economic-analysis-impact-assessment-february-2020.htm> [perma.cc/CTS9-K7C4]; OECD, "Tax Challenges Arising from the Digitalisation of the Economy Update on the Economic Analysis & Impact Assessment," online (pdf): <oecd.org/tax/beps/presentation-economic-analysis-impact-assessment-webcast-february-2020.pdf> [perma.cc/DJP5-7C32]; Allison Christians, "OECD Digital Economy Designers: Share Your Work!" (2020) 97 Tax Notes Int'l 1251 (noting that the information provided in February 2020 by the OECD was only partial—a webcast and a few slides outlining its findings—and the underlying data that led to these results was not made publicly available, raising questions about transparency and inclusivity).

67. See Christians & Magalhaes, *supra* note 62 at 1173-1176 (showing that the shift of profits allocation toward location of consumers will mostly benefit countries with larger consumer markets such as EU countries, the U.S., and middle-income countries rather than lower-income ones); Cobham, Faccio & FitzGerald, *supra* note 30 (concluding that the reallocation of taxing rights deriving from OECD's proposal is likely to reduce revenues for several low-income countries). See also Stephanie Soong Johnston, "Politicians Refocusing on Global Tax Reform Talks, OECD Tax Chief Says" (2020) 98 Tax Notes Int'l 955 at 956 (reporting the acknowledgment by the OECD chief tax executive that least-developed countries may not benefit much from the proposal).

design moves away from an origin-based rationale toward one based on distributive considerations.

Recent proposals to allocate corporate profits through formulary apportionment serve as a point of focus for this article. Formulary approaches purportedly rely on an origin-based framework, but origin-based criteria have proven to be insufficient to establish the choice of the formula that will ultimately determine how income is assigned between countries. Moreover, recent tax policy discussions have demonstrated a shift from an origin-based approach (which distributes taxing rights based on economic rationale) to a distribution-based one (which gives a greater focus to the distributional outcomes resulting from the adoption of different formulas). The departure from origin-based principles requires a reconsideration of the normative foundations for distributing the international tax base.

Whenever origin-based theories fail as a normative guide for allocating taxing rights, the absence of alternative normative criteria leads to a significant degree of arbitrariness. As a consequence, the resulting allocation of rights tends to ultimately favour a few powerful countries. The differential approach put forward in this article offers a compelling normative alternative. By applying distributive justice principles, the differential approach also provides adequate guidance in a context where impact assessments and distributional implications assume increasing importance in international tax policy discussions.