

Tax Governance a model to reform IIAs

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Topics

**International
Taxation**

Proposals

Actors



1.1. What is international taxation?

International aspects of the tax laws of particular countries

- Tax sovereignty
- No international law of taxation
- No international organization that deals with international tax issues and disputes (unlike WTO trade regime)

Advisory bodies on tax policies

- Organization for Economic Cooperation and Development
- UN Committee of Fiscal Affairs

1.2. Importance of international taxation

- Globalization: Growth on trade, investment, communications, computer technology.
- Globalization influence on a country's domestic tax law: rules are adopted to remove obstacles for investment and reinforcing the capital market
- BUT while in other areas (trade) restrictions are removed, it is not possible to remove taxation. Taxation needs to be retained in some for the financing of the governments.
- International tax rules focus on income tax (major source of revenue) and of greatest concern to foreign investors and expatriate personnel.

1.3. International tax: Revenue vs Investment?

International tax rules to deal with cross-border (2 countries) situations. To bear in mind: Balance between the country's need to protect their base revenue and the country's need to attract foreign investment.

International tax includes issues arising under a country's tax law that include some foreign element:

- cross-border trade in goods and services,
- cross-border manufacturing by a MNE,
- cross-border investment by individuals or investment funds,
- taxation of individuals who work or do business outside the country where they actually reside.

1.4. International Tax Principles: Territoriality

In the past, territoriality principle:

Country has the right to tax all incomes and activities within its territory.

Tax policies by any one country could be pursued without much concern or thought about how they would affect other countries

1.4. International Tax Principles: Source vs. Residence

- Source principle: Link between the country and the economic activity
- Residence principle: Link between the country and the person
- Resident: Taxation of persons who belong to a country and work, enter into transactions or have property or income abroad. This person is resident (belong to a country) but carry activities in other country (cross-border) therefore in the other country the person can be regarded as non-resident.
- Non-resident: Taxation of persons from outside a country who work, enter into transactions or have property or income abroad. Non-residents will be only taxed on the income sourced in that country.

1.5. Tax treaties

- Tax treaties international agreements entered by countries and subject to the general international law on treaties (Vienna Convention on the Law of Treaties. Most of the treaties involve two countries (thus bilateral)
- Tax treaties (more than 2000) impose significant limitations on the taxation powers of the treaty partners.
- Tax treaties do not impose tax but it provides tax relief.
- Objectives to prevent double taxation, tax evasion and aggressive tax planning (treaty shopping).

1.5. Tax treaties vs. Unilateral rules

Tax treaties vs. unilateral rules

Unilateral: State give up their taxation rights created in national law one-sided. The Netherlands where no double tax treaty, or the tax treaty does not include a specific provisions (tax, taxpayer, income, property, estate, gift) the unilateral rules laid down in the Decree on the Avoidance of Double Taxation are applicable.

Tax treaties: OECD and UN Model

- OECD Model (latest version 2017)
- UN Model (latest version 2017) for developing countries (mandatory arbitration, exchange of information, rules for dividends, interest and royalties).
- Both OECD and UN: Commentary- dynamic, static interpretation.

1.5. Tax treaties: Purpose

- Tax treaty: To facilitate cross-border trade and investment by eliminating the tax impediments to these cross-border flows

Three primary objectives:

- To reduce the risk of double taxation to taxpayers engaged in cross-border transactions and
- To mitigate the risks of under-taxation and tax evasion by promoting cooperation among countries around the world.
- To prevent double non-taxation and tax treaty shopping)

Ancillary objectives;

- Prevention of discrimination, exchange of information and mutual cooperation in the resolution of disputes.

1.6. Challenges international taxation

- Main problem: Double taxation or double non taxation (no tax at all)
- Double taxation: More than one country seek to tax without reference to the other tax levied in the other country (discourages investment- barrier to international transactions)
- Double non-taxation: No country may tax: assumption that another country is taxing or as a result of tax planning, tax evasion or tax avoidance. (revenue loss).
- How to tax? If there is no linkage to the country or it is difficult to know what kind of activities the other person is carrying abroad.

1.6. Challenges international taxation



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Challenges: To find the income, to tax it, to enforce the tax and to make companies to comply with tax.

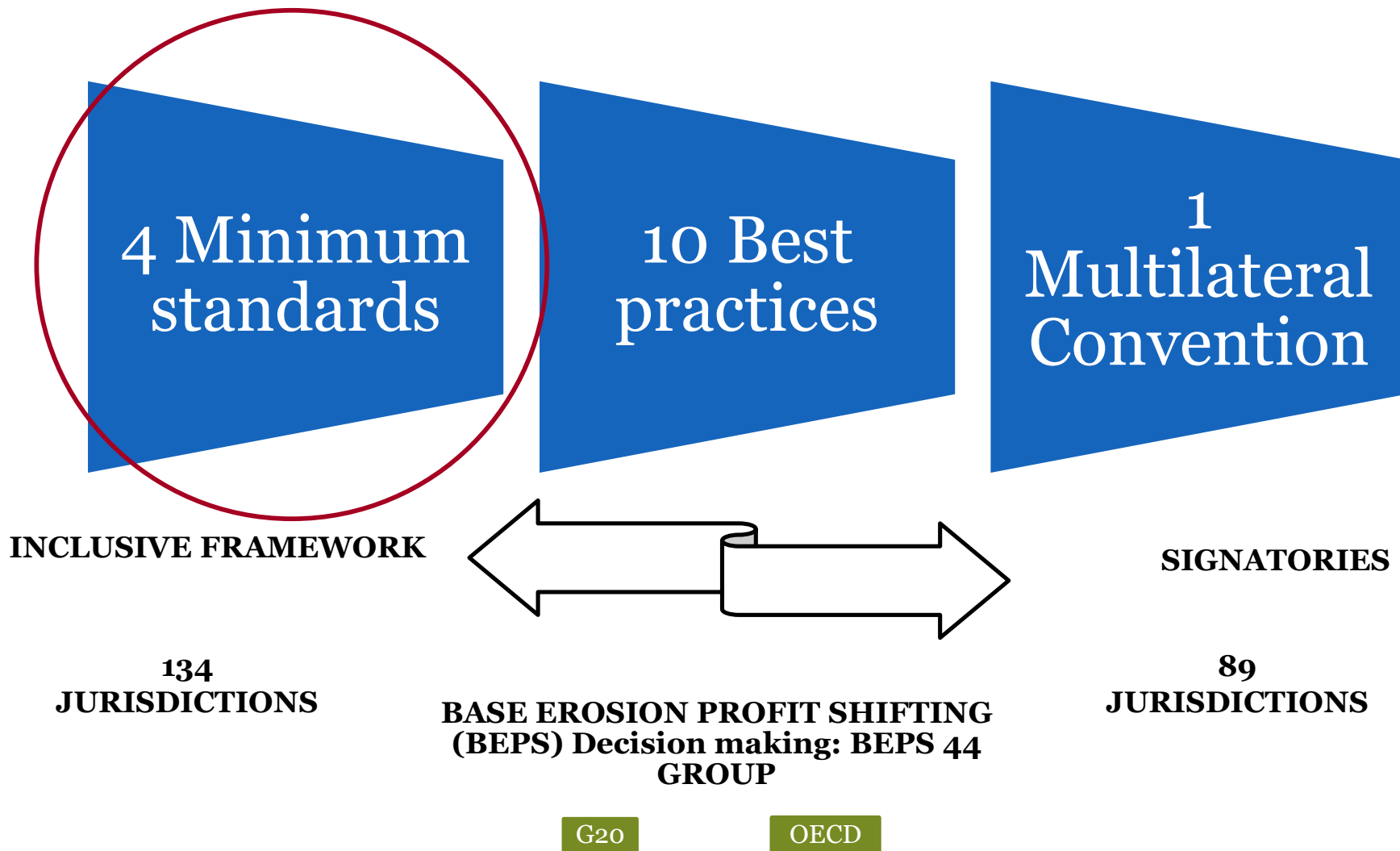
- Complexity of the transactions resulting in double non-taxation, or low taxation.
- Lack of information exchange between tax administrations
- Use of tax havens: Barbados, Cayman

Challenges different for developing and developed countries. Developing countries lack of resources, and advance knowledge of international taxation to tackle complex transactions.

2. Current instruments/proposals

1. League of Nations, OECD and UN Models. Failure to have a multilateral instrument. (developed vs. developing countries). Some OECD projects e.g. Transfer Pricing Guidelines, 1998 Report on Harmful Tax Competition.
2. Financial crisis: Need for revenue, and to tackle tax evasion and bank secrecy. Exchange of Information: On request and then automatic (financial account information). Global Transparency Forum
3. BEPS tackle base erosion and profit shifting by multinationals (see next slide) – EU also following these developments.
4. BEPS Taxation of Highly digitalized business
 1. Pillar 1 –3 proposals and 9th October proposal Unified Approach OECD Secretariat – Allocation of taxing rights: Nexus (where) and allocation (how)
 2. Pillar 2- introduction of a minimum income tax – consequences for tax incentives).

TAX GOVERNANCE – OECD and G20: BEPS

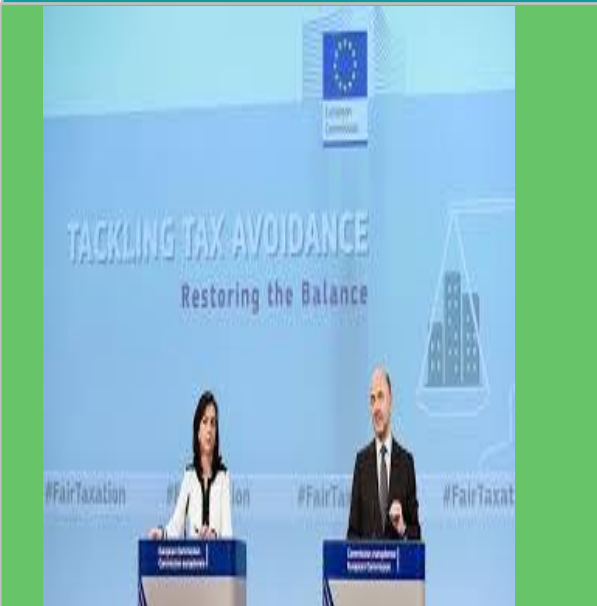


Legitimacy deficits

1. BEPS Inclusive Framework: Peer review input limited from peers due to technical capacity among others. IF only for implementation of BEPS 4 Minimum Standards. MLI different mismatches – bilateral negotiations.
2. Different needs of developing countries, speed of the reforms and the need to balance raising revenue vs attracting investment
 - IMF 2019 Corporate Taxation in the Global Economy
 - IMF 2019 The Rise of Phantom Investments
3. Alignment with Sustainable Development Goals and the 2030 SDG Agenda
 - Ensure responsive, inclusive, participatory and representative decision making at all levels (SDG 16.7)
 - Develop effective, accountable and transparent institutions at all levels (SDG 16.6)

TAX GOVERNANCE: EU AND THIRD COUNTRIES

Anti-Tax Avoidance Directive



State Aid Investigations

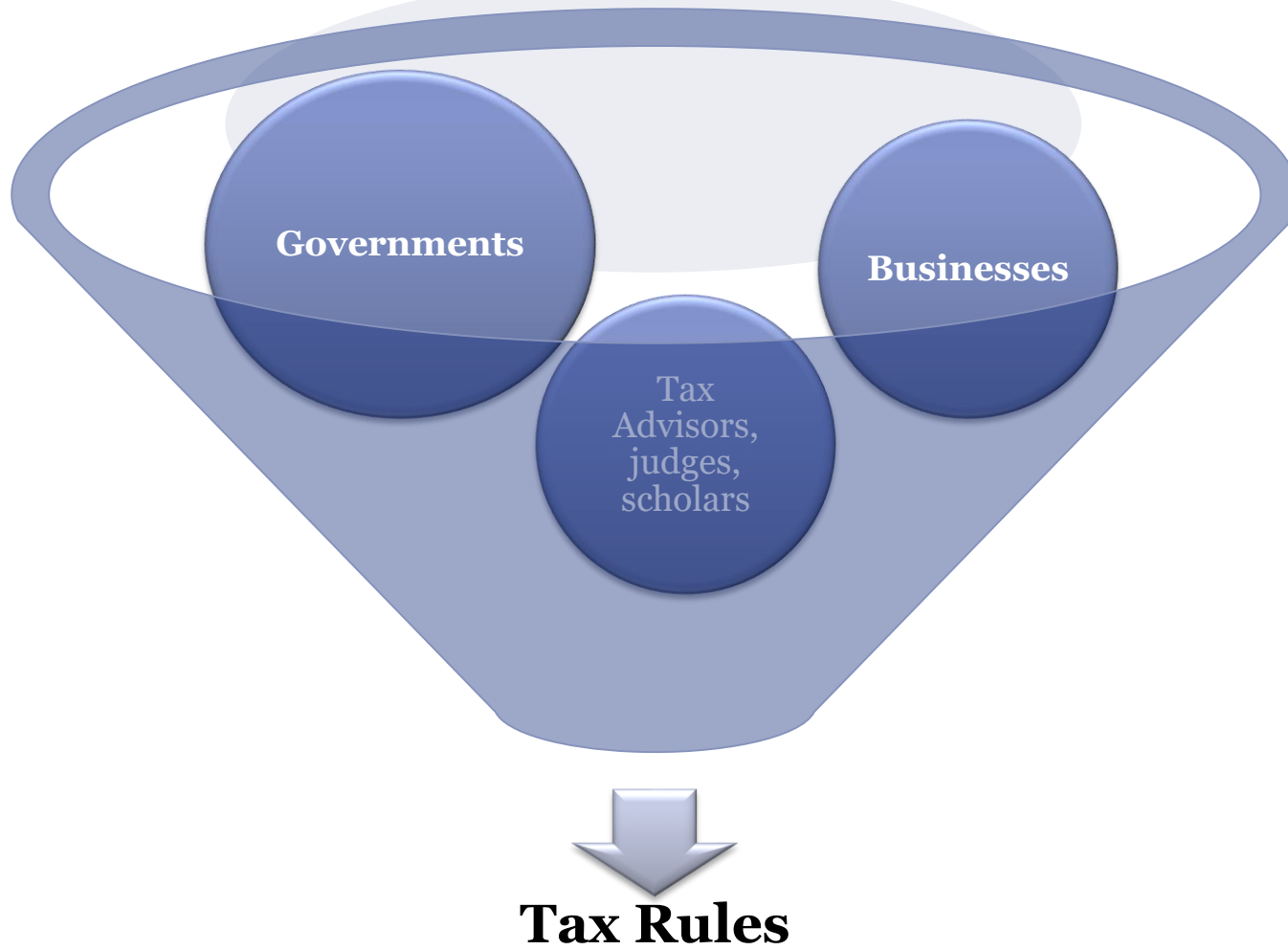


Standard of Good Tax Governance



ACTORS

International Tax Rules/Standards



3. Multilateral instrument

Multilateral instrument to modify bilateral tax treaties. Coexistence of bilateral and multilateral instrument.

Convention in force (July 2018), but only in force for the country after deposit instrument of ratification (more than 30 jurisdictions)

Literature

W. Alschner: The OECD Multilateral Tax Instrument: A model for Reforming the International Investment Regime;

N. Bravo. The Multilateral Tax Instrument and its Relationship with Tax Treaties).

Text MLI <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>

3. Multilateral instrument

- a) Mechanics: Opt-in, opt out convention. Covered tax agreements
- MLI Clauses: Replace DTT language (art 7), modify parallel clauses (art. 5) and other complement them (-in the absence of art. 16(4)(b)(i).
 - Two Minimum Standards: BEPS Action 6 (PPT) and 14 (MAP). By default if not choice then, the minimum standard will apply.
 - Problem: Mismatches: Both countries need to choose the provision and the covered tax agreement (e.g. PPT and LOB simplified).
 - Countries ratifying even if very few tax treaties. How this influence negotiation in the future of tax treaties.
 - Some countries wait and see, before deposit of instrument ratification
 - No text consolidation by countries; OECD online toolkit
 - Future toolkit OECD Tax treaty Negotiation- No clear how this will dealt with MLI, and relationship OECD vs. UN Model Commentary

3. Multilateral instrument

b) Content

One substantive and procedure minimum standard (BEPS Action 6 and 14)

Substance: Closes loopholes: Hybrid mismatches –subject to tax rules; to prevent DTT used for treaty shopping (e.g. preamble and PPT); broadens and clarifies the definition of p.e.

Procedural: mutual agreement procedures, complementary arbitration procedure

Challenges

- Provisions to tackle tax avoidance (already in tax treaties e.g. p.e. but needed some refinement artificial avoidance p.e. status – commissionaire arrangements, splitting of contracts). Still some countries in ratification decided not to adopt the provision until a clear dispute resolution mechanism is available (e.g. the Netherlands – commissionaire arrangements).
- Arbitration- time limit –mutual agreement solve procedure within a period of 2 years. If not arbitration. Baseball arbitration panel of 3 arbitrators selects the solution proposed by one of the contracting parties. No reasons, proceedings are confidential, final award no precedential effect and the parties remain bound by the decision unless they can agree on an alternative solution. see Alschner p. 45)

3. Multilateral instrument

c) Design

Varying preferences with the setting of minimum standards. PPT and LOB simplified or detailed. Except PPT if a similar provision (conduit tax arrangements)

Flexibility also creates mismatches and in some cases result in bilateral negotiations

- Position of Malta: BEPS Inclusive Framework vs. MLI excluded CTAs (Bulgaria and the United States)
- Match: Also excluded by Bulgaria in the MLI; thus bilateral negotiation (Preamble/PPT)
- The United States: no signatory MLI (Preamble/Detailed LOB and domestic anti-conduit rules (conduit financing arrangement rules: IRC Title 26 See IRC § 1.881-3)
- Position of Malta: CTA with Curaçao. No yet in force.
- Match: Also included by Curaçao

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