THE APPROPRIATENESS OF INTERNATIONAL TAX NORMS TO DEVELOPING COUNTRY CONTEXTS

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MARTIN HEARSON, JOY W. NDUBAI and TOVONY RANDRIAMANALINA

FINANCIAL ACCOUNTABILITY TRANSPARENCY & INTEGRITY

CONTENTS

LIST OF ACRONYMS

AAAA	Addis Ababa Action Agenda
ALP	Arm's Length Principle
ASEAN	Association of South-East Asian Nations
ATAF	African Tax Administration Forum
BEPS	Base Erosion and Profit-Shifting
CAN	Andean Community (Comunidad Andina)
CBC MCAA	Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports
CBCR	Country-by-Country Reporting (by MNEs)
ECOWAS	Economic Community of West African States
EAC	East African Community
EU	European Union
DST	Digital Services Tax
FACTI Panel	High Level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda
FDI	Foreign Direct Investment
FHTP	Forum on Harmful Tax Practices
ICRICT	Independent Commission for the Reform of International Corporate Taxation
IMF	International Monetary Fund
ISDS	Investor-State Dispute Settlement
MAP	Mutual Agreement Procedure
MCMA	Multilateral Convention on Mutual Administrative Assistance in tax Matters
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("Multilateral Instrument")
MNE	Multinational Enterprise
OECD	Organization for Economic Co-operation and Development
SAARC	South Asian Association for Regional Cooperation
SDGs	Sustainable Development Goals
TPGs	OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
UNCTAD	United Nations Conference on Trade and Development
VAT	Value-Added Tax

1. Background

1.1. Introduction

Taxation is critical to meeting the Sustainable Development Goals (SDGs) financing gap. As part of the 2030 Agenda, countries have committed, under target 17.1, to "strengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection." There is a long way to go to meet the commitment set out in the 2015 Addis Ababa Action Agenda (AAAA) to "make sure that all companies, including multinationals, pay taxes to the Governments of countries where economic activity occurs and value is created."[1] It is tempting to reduce the connection between international tax norms and achieving the SDGs simply to capacity building so that countries can fully implement those norms, thus achieving the AAAA commitment. This paper takes a quite different view: capacity constraints, along with other salient differences between developing and developed countries, mean that international tax norms must be adapted to developing countries' needs, as must the institutions through which they are created, maintained and disseminated.

Effective taxation of multinational enterprises (MNEs) is not merely a matter of revenue raising tied to SDG 17. It can contribute directly to a global tax system that reduces inequalities within and between societies (SDG 10), supports stronger and more accountable political institutions (SDG 16), steers economic behaviour in a more sustainable direction (SDGs 12 to 15), and promotes gender equality (SDG5). Women and girls suffer from the lack of state ability to fund public services, and the reliance on regressive taxes whose incidence falls more heavily on them than taxes on MNEs. International tax norms can give MNEs a competitive advantage over domestically owned firms, which can disadvantage micro, small and medium sized enterprises, many of which may be owned by women. The social impact of tax decisions and their linkage to redistribution and other benefits are complex.[2] In order to effectively address the impact that tax policy decisions can have on gender inequality, policymakers need to better analyze their policies against substantive equality (focused on equality of outcomes) and reform them to avoid violating fundamental rights.[3]

In this paper we consider six sets of international tax norms: tax treaties (often known as double taxation agreements), transfer pricing rules, mutual assistance agreements between states, state-state and investor-state tax dispute resolution mechanisms, coercive mechanisms that oblige states to adopt international tax norms or face sanctions from powerful states, and finally the embryonic framework for applying these norms to the digitalizing economy.[4] We are primarily concerned with the extent to which these norms help or hinder countries in enforcing their tax laws and preventing tax avoidance by MNEs, as well as in the constraints they impose, by design, on revenue raising from MNEs.

Today there are more opportunities than ever for developing countries to participate in the development of these norms, in particular through the strengthened United Nations Committee

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[1] United Nations (2015). *Addis Ababa Action Agenda of the Third International Conference on Financing for Development.* New York: United Nations.

[2] Sandra Fredman, *Taxation as a human rights issue* in Philip Alston & Nikki Reisch, *Tax, Inequality and Human Rights*, OUP,2019, p.94

[3] Ibid

[4] We have not considered wasteful tax incentives in this paper, as we have focused on the international norms that affect developing countries. But see, for example, IGF and OECD, *Minimizing the Risks of Tax Incentives in Mining,* 2018. http://www.oecd.org/tax/beps/tax-incentives-in-mining-minimising-risks-to-revenue-oecd-igf.pdf;

of Experts on International Cooperation in Tax Matters ("UN Tax Committee") and the OECD/G20 Inclusive Framework on Base Erosion and Profit-Shifting ("Inclusive Framework"). Our discussion of 'developing countries' focuses on lower-income countries, an emphasis that does not include large emerging markets in the G20, or international financial centers, such as Mauritius and the Seychelles, in developing regions. Lower-income countries' priorities for tax norm reform frequently differ from these two groups, as well as from those of OECD countries.

Developing countries face a triple disadvantage in global tax negotiations: (1) the starting point for any discussion is an existing set of norms developed largely without their input, (2) the G20 and OECD states still dominate agenda-setting at the system level, and (3) capacity mismatches limit developing countries' ability to make the most of opportunities to negotiate. Ultimately, the failure to integrate effective amendments in the international tax framework in response to the administration, policy and interactions amongst developing countries has continued to threaten commitments to multilateralism.[5] It is here that the United Nations, with its inclusive membership and its remit covering norm shaping and capacity building, can provide a distinctive contribution. To respond to this challenge comprehensively will require a body with funding and status commensurate with the challenge.

This paper considers several proposals for policy and institutional change, recognizing that there is not a comprehensive off-the-shelf agenda for guaranteed success. We recommend a combination of interventions along a spectrum from practical, short-term measures based on existing experience, through to long-term interventions where the FACTI panel can help stimulate the work necessary work to determine desirable end points. We urge the panel to think not in terms of a single, monolithic policy agenda that will benefit all diverse constituencies within the label "developing countries." The incorporation of developing countries into global tax governance creates the need for a system that embraces the diversity in countries' needs and policy priorities, while providing for mutual accountability where it is necessary to achieve them. This is all the more important following the COVID19 crisis, when governments are under increased pressure to raise revenues and there is appetite for a 'new deal' on international tax cooperation.

1.2. A brief history of international tax cooperation

Countries cannot tax cross border economic activity in isolation. Cooperation is essential: to prevent double taxation, to enable enforcement, and to curb tax competition. For OECD countries, domestic laws and international instruments have developed in parallel. The foundational norms governing double taxation relief and the allocation of taxing rights were created a century ago, when income tax regimes were being consolidated by League of Nations countries.[6] Over time, a network of bilateral tax treaties grew up, drawing on the League's work, and influenced by the administration, policies and interactions amongst the developed countries that concluded them. When the OEEC (predecessor of the OECD) grabbed the mantle of tax standard setter in the 1950s, it did so on the basis that a group of likeminded and influential countries were better equipped to forge a consensus than a globally representative body – the League and the United Nations having failed in different ways in this early era. The OECD Model Convention (a template for

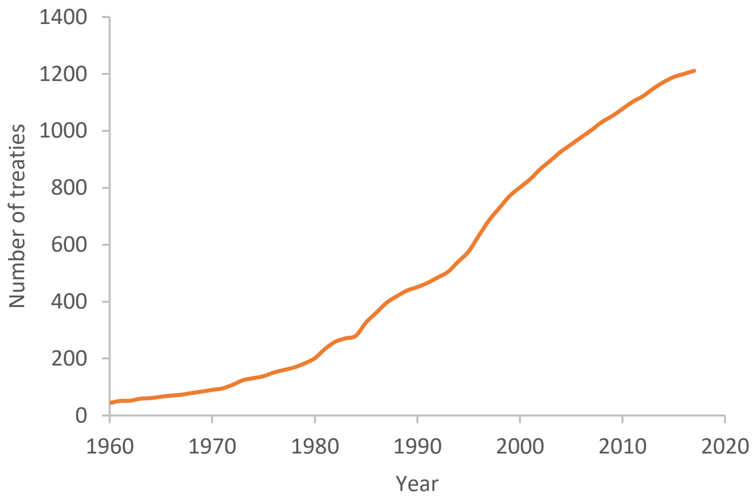
[5] For a comprehensive evaluation of the BEPS project from a developing country perspective, see Irma Johanna Mosquera Valderrama, 'Output Legitimacy Deficits and the Inclusive Framework of the OECD/G20 Base Erosion and Profit Shifting Initiative', *Bulletin for International Taxation* 2018, no. March (2018): 160–70.

[6] For historical accounts, see Sunita Jogarajan, *Double Taxation and the League of Nations* (Cambridge: Cambridge University Press, 2018); Sol Picciotto, *International Business Taxation : A Study in the Internationalization of Business Regulation* (London: Weidenfeld & Nicolson, 1992).

bilateral tax treaties) was first agreed in 1963, and first published in 1977, followed by its transfer pricing guidelines ("TPGs") in 1979.

For developing countries, meanwhile, the story is different. Many had not yet won their independence when the foundations for international tax coordination were laid. Newly independent countries inherited bilateral tax treaties imposed on them during colonial times, and began to renegotiate and expand their treaty networks from the late 1960s onwards (figure 1). The United Nations emerged almost immediately as a focal point for discussion on the inadequacies of international norms for the needs of developing countries. During the 1970s, several UN bodies turned their attention to tax avoidance by MNEs in ways that prefigured work that has taken place at the OECD in the last few years: they analysed transfer pricing challenges resulting from royalty and interest payments, and developed the first proposal for country-by-country reporting.[7] An *ad hoc* group of experts, now the UN Tax Committee, was created in 1968, first publishing its own Model Convention in 1980.

Figure 1: Tax treaties in force in lower-income countries



Source: IBFD

The focus on tax avoidance by MNEs in the UN reflected the general approach to foreign direct investment in the 1970s. The G77 and the UN launched the New International Economic Order (NIEO) to transform the "inequitable international economy, biased against the south", through a process of global redistribution both in policy and economics, including by regulating MNEs.[8] By the 1990s, however, perceptions had shifted from concern about foreign investors' influence over national policy to increasing efforts to attract them. This was ultimately reflected in the emerging use of bilateral investment treaties and free trade agreements. The increased willingness of countries to provide competitive rates and rules to attract investment has played a significant part in the proliferation of tax competition and harmful tax practices.

[7] Matti Ylönen. "Back from oblivion? The rise and fall of the early initiatives against corporate tax avoidance from the 1960s to the 1980s." *Transnational Corporations*. 2016;23(3):33-65. 2.

[8] Jennifer Bair, "Corporations at the United Nations: Echoes of the New International Economic Order?" *Humanity Journal*, Spring 2015, p.159

By the turn of the century, the pendulum had begun to swing back towards addressing weaknesses in the existing international tax norms, through a greater emphasis on transparency and exchange of information between authorities, revision of transfer pricing rules, and amendments to address treaty abuse. Insofar as this concerns MNEs, much of it has taken place under the banner of Base Erosion and Profit Shifting (BEPS). This was a G20 and OECD project designed to tackle "tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax."[9] A new set of rules (referred to here for ease as 'BEPS 2') is currently under discussion in the Inclusive Framework, containing two pillars, one intended to address the tax challenges of the digitalization of the economy, and the other to introduce global minimum taxes. Both BEPS processes emerged from a combination of legal innovations in powerful states and international negotiations to reconcile them.

This expansion in the substance of cooperation has coincided with a proliferation of norm-setting institutions. At global level, the UN Tax Committee was strengthened following the Addis Ababa summit in 2015, and has expanded its subgroups to cover, *inter alia*, the extractive industries, the challenges of digitalization, dispute resolution and BEPS. The UN Tax Committee is not a mirror image of the OECD, since it comprises members from developed and developing countries.[10] The UN Model began life as an adaptation of the OECD Model, and continues to selectively adopt amendments made to it. Its transfer pricing manual is written explicitly to be compatible with the OECD's transfer pricing guidelines. On issues where developed and developing countries are divided, it can be challenging for the latter to carve out a distinctive approach given the committee's balanced composition and weakly resourced secretariat. For example, the issue of withholding tax on fees for technical services was discussed at the ad hoc committee in the 1970s, adopted quite widely by developing countries in their treaty practice, but only became a part of the UN model as Article 12A in 2017. OECD countries thus continue to benefit from the first mover advantage that comes from the unique position of the OECD Model and TPGs.

After the financial crisis of 2007-9, the OECD began to receive a political mandate from the G20. In 2016 it created the Inclusive Framework (IF) - which at the time of writing has 137 members - as well as two binding global conventions, the multilateral Convention on Mutual Administrative Assistance in Tax Matters ("MCMA") and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("Multilateral Instrument" or "MLI"). The IF emerged in part because OECD member states opposed a stronger role for the UN Tax Committee, most dramatically when developing countries proposed the creation of an intergovernmental UN tax body at the Addis Ababa summit on Financing for Development in 2015.

Regional cooperation has also intensified in recent years, Many regional bodies now have their own model tax treaties and multilateral conventions, while the African Tax Administration Forum (ATAF) and Intergovernmental Group of Twenty Four (G-24) have emerged as collective voices for developing countries in international negotiations.[11] In addition, the African Union (AU) has been involved in profiling the role of illicit financial flows in depriving countries of tax revenue. Yet this too has yet to bear significant fruit in terms of more radical innovations in international tax norms, whether at global or regional level. In this environment, developing countries must prioritize their efforts towards the institutions of cooperation in which they can achieve the most.

[9] OECD, *What is BEPS.* OECD website. https://www.oecd.org/tax/beps/about/
[10] For example, an article permitting withholding tax on fees for technical services was discussed at the ad hoc committee in the 1970s, adopted quite widely by developing countries in their treaty practice, but only became a part of the UN model in 2017.
[11] G24 members include Algeria, Argentina, Brazil, China, Colombia, Congo, Cote D'Ivoire, Ecuador, Ethiopia, Gabon, Guatemala, Haiti, India, Iran, Kenya, Lebanon, Mexico, Morocco, Nigeria, Pakistan, Peru, Philippines, South Africa, Sri Lanka, Syria, Trinidad and Tobago and Venezuela.

1.3. Making tax norms relevant to developing countries

Why might tax norms based on a long history of cooperation among developed countries lack relevance for developing countries? We focus here on three components that help to identify their deficits: economic structure, state capacity and tax policy priorities.

Economic structure. Global tax rules have historically been built around a distinction between capital importing (source) countries and capital exporting (residence) countries. The OECD is not a homogenous bloc of capital exporters, but its members' interests have converged on a model of cooperation based on curtailing countries' source taxation rights. The emphasis on residence has resulted in a greater compromise on the part of developing countries that have traditionally been capital-importing. The UN model convention unsurprisingly tempers this emphasis. Being capital importers also affects other aspects of developing countries' needs from international tax norms, for example their need to access information on MNEs headquartered elsewhere, and for assistance to collect taxes from companies overseas. Developing countries are also frequently exporters of raw materials and low value-added manufactures, and importers of services - especially digital services – and finished goods. This means they are affected differentially by the design of transfer pricing rules, as notably expressed by China and India in their comments in the 2012 UN Practical Manual on Transfer Pricing in Developing Countries ("Transfer Pricing Manual").[12] As BEPS 2 moves taxing rights towards 'market' jurisdictions, the UN Tax Committee cautioned that this may not benefit lower income countries, and especially urged that extractive industries be excluded from this shift.[13]

State capacity. The literature critiquing international tax norms is strongest in its assessment of administrative capacity, an area to which this paper will devote significant discussion. Since the original OECD model convention, the complexity of international tax norms especially in transfer pricing has spiraled, as the foundational arm's length principle (ALP) struggles to keep up with intensifying international economic integration. Tax administrations are only one part of the state that is challenged by the complexity of international tax norms, however. Prior to the enforcement of tax laws, developing countries also face challenges engaging with them at the policymaking level, given the intensity of multilateral tax negotiations and the need for numerous bilateral negotiations and updates to international instruments.[14] These constraints exist within the political executive, the civil service, and the legislature. Since international tax norms have led to a proliferation of disputes, the judicial level is also important. Some countries lack sufficient jurisprudence to develop interpretation, often as a result of technical deficiencies amongst judges.

Tax policy priorities. Prioritization in the development or implementation of tax policy is determined by administrative needs and capacity, political objectives, economic needs and international commitments. International norms can prevent the adoption of appropriate tools as determined based on these factors. For example, tax treaties signed many years in the past may constrain governments' ability to implement new taxes which have a cross-border dimension or affect non-residents, such as on certain capital gains or digital services, which may not have been foreseen when the treaty was first concluded. International coercive mechanisms such as blacklists and peer review may oblige countries to prioritize the adoption of legislative or

[12] Committee of Experts on International Cooperation in Tax Matters, 'Practical Manual on Transfer Pricing in Developing Countries' (New York: United Nations, 2012).
[13] UN Tax Committee, *Comments Submitted to the OECD Secretariat on the "Unified Approach" as Proposed by the Secretariat in in Its Public Consultation Document of 9 October* (OECD, 2019).
[14] Catherine Ngina Mutava, *Review of Tax Treaty Practices and Policy Framework in Africa*, International Centre for Tax and Development Working Papers 102 (Brighton: Institute of Development Studies, 2019)

administrative requirements from which they benefit little, which carries an opportunity cost in terms of the legislative and bureaucratic time required.

1.4. Determining what is at stake

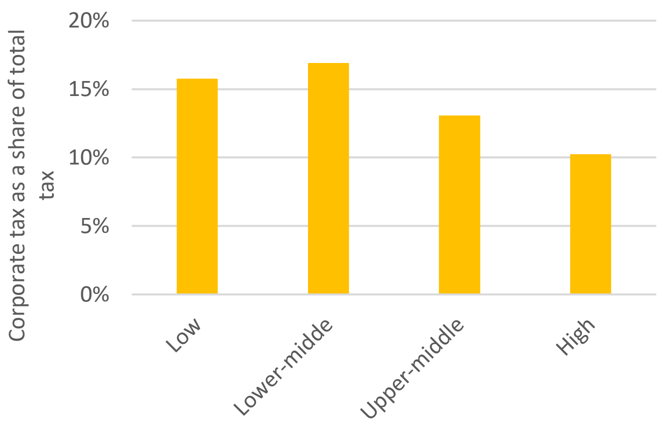
Estimating the revenue at stake from inappropriate tax norms is challenging, given data limitations. It is a different exercise to estimating the cost of international tax avoidance, and the figures should be larger. This is because the estimate comprises two elements:

- An enforcement gap (tax avoidance and evasion) that could be addressed through simplification and cooperation
- A reallocation dividend resulting from a change in norms that gives a greater share of the tax base to developing countries.

1.4.1 Enforcement gap

The costs to developing countries of corporate tax avoidance are significant, but should not be overstated. To understand the order of magnitude, we can look first at the revenue that is raised from MNEs, which we have done here focusing specifically on Africa. Corporate tax represents a more important share of government revenue in developing countries than in OECD countries (figure 2), mainly because African countries are unable to raise as much revenue from personal income tax and social security contributions. One sixth of governments' tax revenue in developing countries is raised through corporate taxation.[15] UNCTAD (2015) estimates that between 25 and 33 percent of this comes from the affiliates of foreign MNEs. Combining the two figures produces an estimate that around 5 percent of government revenue in developing countries comes from corporation tax paid by MNEs. This is an important comparator when considering estimates of the tax lost.

Figure 2: Average share of corporate income tax in total tax by income group, 2016



Source: ICTD/UNU-WIDER Global Revenue Dataset

In 2015, the OECD estimated that tax avoidance by MNEs costs between 4 percent and 10 percent of corporate income tax revenue, although it did not publish underlying country estimates.[16] Two

[15] Author's calculation using ICTD/UNU-WIDER, 'Government Revenue Dataset', UNU-WIDER, 2018
[16] OECD, *Measuring and Monitoring BEPS, Action 11 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD Publishing, 2015)

other published estimates come within this range.[17] It implies that the corporate income tax lost through tax avoidance by MNEs is between 12% and 40% of that already paid by MNEs. Other widely cited studies produce estimates an order of magnitude larger.[18] Their figures for Africa translate to a revenue loss corresponding to 300-400% of corporate tax currently paid by MNEs, or 100% of total corporation tax revenue. Unlike the smaller estimates, these studies are not based on data about the foreign affiliate activity that creates profit-shifting vulnerability, and so it is possible that they are less reliable at the country level. The OECD/UNDP Tax Inspectors Without Borders capacity-building programme claims to have helped developing countries raise $500 billion between 2015 and 2019.[19]

1.4.2 Reallocation dividend

If international tax norms changed, the impact on developing countries' revenues would not only be through its effect on profit-shifting, but also through changes to the distribution of the corporate tax base and to incentives for investment. For example, if tax treaty norms did not require such large reductions in source taxation, the revenue foregone by developing countries from participating in the tax treaty regime might be lower. A number of studies have tried to estimate more directly the revenue foregone from reductions in dividend and interest withholding tax in tax treaties, which is only one component of the cost of tax treaties. One study of 14 developing countries estimated the revenue foregone to be around two percent of corporate income tax revenue, although there is a very wide variation.[20] The OECD's forecasts of the revenue gains to developing countries from a redistribution of taxing rights to developing countries under Pillar One, Amount A has a wide range, but could be anywhere between up to 2%. This is a similar order of magnitude to its estimate for Pillar Two, where the gains come from constraining tax avoidance.[21]

2. Key international tax norms affecting developing countries

2.1. Tax treaties

Tax treaties are agreements between states that divide up the right to tax cross-border economic activity. They set limits on when, and in some cases at what rate, signatories can tax the income from that economic activity, primarily by imposing restrictions on countries' ability to tax the foreign direct investment that they receive. There are over 3000 in force worldwide, covering 96

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[17] Thomas Tørsløv, Ludvig Wier, and Gabriel Zucman, 'The Missing Profits of Nations' (Cambridge, MA: National Bureau of Economic Research, June 2018); Petr Janský and Miroslav Palanský, 'Estimating the Scale of Profit Shifting and Tax Revenue Losses Related to Foreign Direct Investment', *International Tax and Public Finance* 26, no. 5 (1 October 2019): 1048–1103

[18] Alex Cobham and Petr Janský, 'Global Distribution of Revenue Loss from Corporate Tax Avoidance: Re-Estimation and Country Results', *Journal of International Development* 30, no. 2 (2018): 206–32; Ernesto Crivelli, Ruud A Mooij, and Mr Michael Keen, 'Base Erosion, Profit Shifting and Developing Countries', IMF Working Papers (Washington, DC: International Monetary Fund, 2015).

[19] Tax Inspectors Without Borders, 'Four Years on and Half a Billion Dollars Later', 2019, http://www.tiwb.org/resources/news/four-years-on-and-half-a-billion-dollars-later-tax-inspectors-without-borders.htm.

[20] Petr Janský and Marek Šedivý, 'Estimating the Revenue Costs of Tax Treaties in Developing Countries', *The World Economy*, 7 December 2018.See also Katrin McGauran, *Should the Netherlands Sign Tax Treaties with Developing Countries?* (Amsterdam: SOMO, 2013); IMF, *Spillovers in International Corporate Taxation*.

[21] OECD, 'Update on Economic Analysis and Impact Assessment', 13 February 2020, http://www.oecd.org/tax/beps/webcast-economic-analysis-impact-assessment-february-2020.htm.

percent of foreign direct investment.[22] Many developing countries, especially in Africa, inherited treaties imposed by colonial powers, a few of which are still in force today. Tax treaties are commonly referred to as Double Taxation Agreements, because one of their main functions is to prevent companies and individuals from incurring tax in more than one country on the same income.

Tax treaty law is commonly discussed in terms of 'taxing rights', a term that immediately demonstrates the curbs that tax treaties impose on the sovereignty of their states parties. In concluding a tax treaty, a state cedes some of its 'taxing rights', that is, its sovereignty to determine the tax liability of taxpayers covered by the agreement through its tax law. As an IMF report argues, "tax treaties usually reallocate taxing rights over foreign investment income from the host country to the home country [of the investor or corporation] (…) Since developing countries are usually net capital importers with little if any outbound investment, they stand to lose significant revenue from the lower [withholding tax rates] negotiated in tax treaties."[23]

Tax treaty shopping is a form of tax avoidance through which international investors from third countries exploit tax treaties to obtain benefits to which the signatories did not intend them to be eligible.[24] In such cases, firms reduce their tax liabilities in developing countries by structuring their activities through intermediate jurisdictions such as the Netherlands and Mauritius. These countries have wide treaty networks, both with the home countries of MNEs and the developing countries in which they invest. Those treaties impose restrictions on developing countries' ability to tax inward investment, often more restrictions than a treaty signed directly between the home and host country would do.

In addition, tax treaties provide a basis for exchange of information and mutual assistance in tax administration, although these benefits can be gained without the sacrifice of taxing rights, for example through the MCMA. Whilst tax treaties are bilateral in legal form, they are highly multilateralized: they are based on models developed by international organizations, and, where countries have endorsed it, they can be modified using the MLI.

2.1.1 Recent developments

The model tax treaties are updated in an incremental fashion, with many small changes over time. In this section we consider a few key changes in the two major global models, dating from 2007 (the 7th edition of the OECD Model) to 2017 (the 4th edition of the UN Model, 10th edition of the OECD model, and signature of the MLI at the OECD). We focus here on changes that can be considered to have strengthened the position of developing countries.[25]

The 2017 edition of the UN Model introduced a new article (12A) covering the taxation of technical service fees. This article drew from a clause found in over 100 tax treaties signed by developing countries, which permitted them to levy withholding taxes on such fees. A large proportion of developing countries levy such a tax in their domestic law, and the inclusion of this article in a treaty allows them to retain this taxing right unambiguously. In the presence of a tax treaty that does not have such a clause, it is commonly considered that the income of a foreign

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[22] Author's own estimate, based on IBFD online database of tax treaties, and IMF Coordinated Direct Investment Survey.

[23] IMF, *Spillovers in International Corporate Taxation* (Washington, DC, 2014).

[24] Francis Weyzig, "Tax Treaty Shopping: Structural Determinants of Foreign Direct Investment Routed through the Netherlands," *International Tax and Public Finance* 20, no. 6 (December 11, 2013): 910–37, https://doi.org/10.1007/s10797-012-9250-z.

[25] One less welcome for developing countries were the changes made to Article 7 of the OECD model in 2010. These shifted the balance of taxing rights away from capital-importing countries, by expanding the role of transfer pricing rules into the relationship between MNEs' headquarters and their permanent establishments.

contractor who provides services to a client in a country can only be taxed by that country under Article 7, that is, if the contractor meets the permanent establishment threshold.[26] The inclusion of article 12A in the UN model will serve to bolster developing countries' position in any often-contentious area of negotiations. In an increasingly services-based global economy, it will allow them to receive an appropriate share of the tax base, and protect them against profit-shifting.

Protections from tax treaty shopping in both major models have been significantly strengthened through the introduction of numerous changes to individual articles, as well as general anti-abuse rules.

Most tax treaties already signed by developing countries will be unaffected by these beneficial changes unless treaties are renegotiated, a process during which treaty partners are at liberty to request concessions in return, or through the multilateral instrument. Most developing countries have chosen not to sign the MLI, and very few have ratified it. In part, this reflects the enduring difficulty of gaining political support, but it is also reflects the way in which treaty partners have engaged with the MLI: many treaty partners have taken out reservations against provisions that would have benefitted developing countries, not listed treaties with them as covered agreements at all, or opted for an approach to preventing treaty abuse that conflicts with the preferences of developing countries.

The UN Tax Committee has strengthened its manual for the negotiation of tax treaties, as well as its capacity building work. In 2016, the G20 Development working group mandated four international organizations (the IMF, OECD, UN and World Bank Group) as the "Platform for Collaboration on Tax" to develop a series of toolkits to help guide developing countries, and a toolkit on tax treaty negotiation is under development. Another toolkit recently published by the Platform addressed the taxation of indirect transfers of assets, including the treaty issues.[27] Many developing countries' treaties are missing article 13(4) that protects countries' right to capital gains tax on the sale of real property via an offshore indirect transfer. The MLI provides a means of introducing this into bilateral treaties.

Meanwhile, developing countries have not stood idly by. Indonesia, Senegal, South Africa, Rwanda, Argentina, Mongolia, Zambia, and Malawi are among those that have cancelled or renegotiated tax treaties in recent years, while others, such as Uganda, have undertaken reviews.[28] In some cases, treaties that had been poorly negotiated in the first place have been cancelled outright. At the regional level, the examples of ASEAN, ATAF, the Caribbean Community and the East African Community, show that model treaties can be developed both to encourage negotiations among regional members and as a template for negotiations with other countries. These models do offer some stronger protections for source taxing rights than the OECD model and in some cases the UN model, but they are not radical departures from the existing models. Looked at overall, there has been no sustained strengthening of source taxing rights in treaties negotiated by developing countries: permanent establishment definitions are becoming more expansive, especially in treaties excluding OECD countries, but this is balanced by an across-the-board fall in treaty withholding tax rates.[29]

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[26] Some countries, such as Kenya, consider that it may be possible to impose a withholding tax under Article 21 covering 'other income'

[27] The Platform for Collaboration on Tax, *The Taxation of Offshore Indirect Transfers - A Toolkit,* April 2020.

[28] Catherine Ngina Mutava, *Review of Tax Treaty Practices and Policy Framework in Africa*, International Centre for Tax and Development Working Papers 102 (Brighton: Institute of Development Studies, 2019); Martin Hearson, *Tax Treaties in Sub-Saharan Africa: A Critical Review* (Nairobi: Tax Justice Network - Africa, 2015)

[29] Martin Hearson, 'Measuring Tax Treaty Negotiation Outcomes : The ActionAid Tax Treaties Dataset', ICTD Working Paper 47 (Brighton: Institute of Development Studies, 2016).

2.1.2 Suitability

There is a strong argument that the tax treaty regime, grounded in international norms embodied by the model treaties, is wholly unsuited to developing countries given their economic position.[30] To begin with, since developing countries are almost by definition in an overwhelmingly capital-importing mode, a system that redistributes taxing rights away from them in return for largely procedural gains (harmonization of definitions, dispute resolution, mutual assistance) is unfair. Considering the rather equivocal evidence that tax treaties stimulate investment flows into developing countries, tax treaties appear to be poor value for money.[31] This is not to say that they some of the changes ushered in to tax systems by tax treaties would not be welcomed by investors, but in many cases they may be better achieved by making changes to domestic law directly, accompanied by a lightweight approach to tax cooperation that is not premised on the curtailing of source taxation rights.

Tax treaties as a form of cooperation also presume strong negotiating capacity. This extends beyond the moment of negotiation, since tax treaty dispute resolution is also a "semi-diplomatic" process,[32] and treaties should be updated on an ongoing basis. While there are very capable individuals engaged in international tax negotiations on behalf of developing countries, the historical record shows that the quality of negotiation across developing countries is inconsistent, and has frequently been poor.[33] Structural constraints play a significant role in these deficits, including the resources available to build internal knowledge, the turnover of experienced negotiators, and the absence of a policy framework and of effective political scrutiny.[34] While developing countries could and should strengthen all these aspects, the decision to participate in the bilateral treaty regime has an often under-appreciated opportunity cost for government itself that should be set against the benefits.

2.2. Transfer pricing rules

Transfer pricing refers to domestic law provisions through which states allocate the tax base of MNEs to themselves. The OECD's transfer pricing guidelines (TPGs) occupy a hegemonic position here, both through their ubiquity as the basis of national law, and through their formal connection to the OECD Model Convention. The ALP, as interpreted in the TPGs, is a key international norm affecting the tax base of developing countries. It is promoted as an international agreed standard, although historically there has been very limited input from developing countries, and countries face pressure to introduce it in their domestic tax legislation, rather than challenging the OECD

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[30] Tsilly Dagan, "The Tax Treaties Myth," New York University Journal of International Law and Politics 32 (2000): 939–939; Victor Thuronyi, "Tax Treaties and Developing Countries," in Tax Treaties: Building Bridges between Law and Economics, ed. Michael Lang et al. (Amsterdam: IBFD, 2010), 441–58; Dimitri Paolini et al., "Tax Treaties with Developing Countries and the Allocation of Taxing Rights," European Journal of Law and Economics 42, no. 3 (December 2016): 383–404, https://doi.org/10.1007/s10657-014-9465-9; Kim Brooks and Richard Krever, "The Troubling Role of Tax Treaties," in Tax Design Issues Worldwide, ed. Geerten M. M. Michielse and Victor Thuronyi (Kluwer Law International, 2015), 159–178.

[31] For reviews, see IMF, Spillovers in International Corporate Taxation; Martin Hearson, "Do Tax Treaties Affect Foreign Investment? The Plot Thickens," 2014, http://martinhearson.wordpress.com/2014/06/19/do-tax-treaties-affect-foreign-investment-the-plot-thickens/.

[32] French Tax Administration, 'Mutual Agreement Procedure', impots.gouv.fr, 4 May 2017, https://www.impots.gouv.fr/portail/international-particulier/mutual-agreement-procedure.

[33] Martin Hearson, *The North-South Politics of Global Tax Governance* (Ithaca, N.Y.: Cornell University Press, Forthcoming).

[34] Jalia Kangave, "The Dominant Voices in Double Taxation Agreements: A Critical Analysis of the 'Dividend' Article in the Agreement between Uganda and the Netherlands," International Community Law Review 11, no. 4 (November 2009): 387–407, https://doi.org/10.1163/187197409X12525781476123; Charles R Irish, "International Double Taxation Agreements and Income Taxation At Source:," International and Comparative Law Quarterly 23, no. 2 (1974): 292–316, https://doi.org/10.1093/iclqaj/23.2.292; Catherine Ngina Mutava, Review of Tax Treaty Practices and Policy Framework in Africa, International Centre for Tax and Development Working Papers 102 (Brighton: Institute of Development Studies, 2019).

approach.[35] For example, there is some evidence that increased transfer pricing enforcement, unless internationally coordinated, affects the levels of FDI.[36] Yet, implementation of the TPGs can be exceedingly complex, especially when coupled with a lack of capacity and expertise in developing countries, leaving these latter open to abuse.

It is important to distinguish between theoretical and practical criticisms of the ALP. Theoretical critics emphasize that the ALP is an "economic fiction" that does not reflect the reality of MNEs. It is difficult to separate an MNE's various enterprise relationships for tax purposes in place of the reality, which is one of dependent relationships. Noting this theoretical criticism of the ALP itself, we focus in this paper on the practical difficulties of implementing it in a manner consistent with the TPGs. It can be a very complex task for tax administrations to hypothesize an arm's length price in the face of the reality of typically highly integrated MNEs, and any price they arrive at can easily be contested. Developing countries therefore need approaches to determining the arm's length price that are simple and predictable.[37] The five methods accepted in the TPGs have neither of these virtues, which is why there is mounting evidence that MNEs are able to minimize their global tax liabilities by somewhat aggressively interpreting the TPGs.

We would also reiterate that, from the perspective of developing countries, the primary objective of transfer pricing rules should be to provide the tax administration with the legal and administrative tools needed to protect the country's tax base. This objective has not been always attained in practice with the existing transfer pricing rules. Evidence shows that this situation creates conflicts and many disputes.[38] The High Level Panel on Illicit Financial Flows from Africa reported that abusive transfer pricing was occurring on a substantial scale in Africa,[39] and African tax administrations have reported that the defects of TP rules represent one of the highest risks to their tax base.[40]

2.2.1 Recent developments

2.2.1.1. The BEPS project

A new concept has emerged to renew the old ALP, a framework based on "aligning transfer pricing outcomes with value creation."[41] In interpreting this, the OECD has continued to emphasize the separate entity principle, while attempting to counteract its harmful consequences. The work within the BEPS project that led to this update focused on problem areas such as transactions involving intangibles, allocation of risk, and profit allocation in contexts lacking a commercially viable rationale.[42] In addition to the limited inclusion of some simplification measures (see below), arguably the most important and major advance for developing countries was the template for Country by Country Reporting (CBCR), which could for the first time enable tax

[35] See Picciotto, Sol (2018), Problems of Transfer Pricing and Possibilities for Simpification, ICTD Working Paper 86, Brighton: International Centre for Tax and Development.
[36] de Mooij, R.A. and Liu, L. (2018) At a Cost: The Real Effects of Transfer Pricing Regulations, Working Paper 18/69, Washington DC: IMF.
[37] Picciotto, Sol (2018), "Problems of Transfer pricing and Possibilities for Simplification", ICTD Working Paper 86, Brighton ; International Monetary Fund, (2019). "Corporate Taxation in the Global Economy", Policy Paper 19-007.
[38] Caroline, Silberzstein (2013), « Les différends en matière de prix de transfert et leurs causes », Rev. Droit fiscal, No. 3, 60.
[39] 'Mbeki Panel', AU/ECA Conference of Ministers of Finance, Planning and Economic Development (2015), Illicit Financial Flows, Report of High Level Panel on Illicit Financial Flows from Africa, p.27.
[40] Monkam Nara (2015). 4th International Workshop on Domestic Revenue Mobilization: "Cross Border Taxation in Africa Challenges – Main Challenges for ATAF Member", African Tax Administration Forum, p.25.<https://www.diegdi.de/uploads/tx_veranstaltung/5-Monkam_ATAF_Challenges_in_Taxation_and_ATAF_s_response.pdf>.
[41] OECD (2015), Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 – Final Reports 2015, OECD, Paris, 2015.
[42] Idem

authorities to assess tax risks based on a fuller picture of MNEs' operations.[43] We discuss CBCR further in section 3.

2.2.1.2. Toolkit on comparables

In the area of transfer pricing, the Platform for Collaboration on tax elaborated a toolkit for handling the lack of comparables.[44] Since the pricing of transactions between related parties in the extractive industries is an issue of particular relevance to many developing countries, the toolkit also addresses the information gaps on prices of minerals sold in an intermediate form.[45]

2.2.1.3. The UN Practical Manual

The United Nations entered the sphere of transfer pricing policy in 2009, when the Tax Committee's Subcommittee on Transfer Pricing was given a mandate to produce the Transfer Pricing Manual, published in 2012 and updated in 2018. At 500 pages, it is intended to educate developing countries about the issues involved in transfer pricing - from the conceptual framework to the effective application of transfer pricing rules. For example, it offers a step-by-step approach to adopting and implementing TP legislation in developing countries.

It must be noted that the UN did not challenge the OECD guidelines, which had come to occupy a dominant global position in comparison to the situation in the 1970s. It stated that "consistency with the OECD Transfer Pricing Guidelines has been sought" and that "a key 'value added' of the manual is to be its practicality."[46] This stance means that the UN Tax Committee has not been given the opportunity to act as an incubator for simpler alternative approaches to the TPGs, even though there is a clear demand for such alternatives from developing countries. An exception is the chapters that present the various practices of emerging countries such as Brazil, India, China, Mexico and South Africa, some of which do offer a critique of orthodox approaches.

2.2.2 Alternative approaches

As the UN Manual highlights, to do transfer pricing effectively under the current system, developing countries need to invest massively in expert resources, but the Manual cautions that transfer pricing resources of all types tend to be expensive.[47] Only a few developing countries have dedicated transfer pricing units.[48] One major challenge unanimously recognized is the lack of relevant information to apply the ALP, in particular the absence of reliable comparables in many cases.[49] Contrary to the experience of OECD countries, this is not just an issue in certain

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[43] OECD (2017), Country-by-Country Reporting: Handbook on Effective Implementation, OECD, Paris. In our view, CBCR (BEPS Action 13) has produced the final outcome that is the most potentially transformative from the perspective of developing countries. A UN committee survey in 2014, while the BEPS project was still ongoing, demonstrated that there was also significant interest in work on transfer pricing, interest deductibility, permanent establishment and mandatory disclosure rules (Actions 4, 7, 8-10 and 12).

[44] The Platform for Collaboration on Tax (2017), A Toolkit for Adressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses", IMF/OECD/UN/WBG.

[45] The Platform for Collaboration on Tax (2017), Supplementary Report Addressing the Information Gaps on Prices of Minerals Sold in an Intermediate Form, IMF/OECD/UN/WBG.

[46] The "Practical Manual on Transfer Pricing for Developing Countries: Foreword" is available at the UN website, http://www.un.org/esa/ffd/tax/eighthsession /Foreword-20120928_v5_ML-accp.pdf.

[47] UN Manual on TP, 2017: C.5.6.4.4.

[48] UN Manual on TP, 2017: B.1.10.4- B.1.10-B.1.10.11.

[49] Platform for Collaboration on Tax (2017), A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses", IMF/OECD/UN/WBG; UN Economic Commission for Africa (2018), Base erosion and profit shifting in Africa: reforms to facilitate improved taxation of multinational enterprises, Economic Commission for Africa, Addis Ababa, Ethiopia, p.17; p.26; p.41; ATAF (2015), Outcomes Documents: Cross Border Taxation Technical Committee – 2nd Meeting (3-4 March 2015); G20 Development Working Group (DWG), Two-Part Report To G20 Developing Working

circumstances, such as where non-standard profits are derived from intangible assets. In the case of developing countries, comparables can be challenging to find even for routine activities.

The rest of this section describes the simplified methods that have been developed by some developing countries and emerging economies, which rely less on the intensive search for comparables. These States allow for the determination of the ALP in unorthodox ways. Whereas the OECD guidelines recommend that MNCs' transactions are examined in a case-by-case analysis, tax administrations in these countries instead use predetermined mathematical formulas set down in the tax law to calculate margins, mark-ups, or thresholds and thereby arrive at an arm's length price. In some instances, international norms have been adapted to give some tacit endorsement to these approaches.

It should be stated that in addition to simplification concerns, a few countries also adapt their application of the TPGs for the purposes of global redistribution. These countries argue that, even when concerns about profit-shifting are put aside, the TPGs do not adequately reflect the contribution to global value creation that MNEs' affiliates in their countries make. In their chapters of the UN Manual, China and India argue for a fairer distribution, which they explain can be achieved through the incorporation of their concepts of "marketing intangibles" and "location specific advantages" into transfer pricing assessments.[50]

2.2.2.1. Fixed margins

As the name suggests, the fixed-margins approach adopted by Brazil uses pre-established profit margins to indicate the level of profits that can be treated as the arm's length price (also called the parameter price).[51] As a result, the tax administration does not need to perform complex comparability analyses. The profit margins are determined by taking into account the economic sector, line of business or according to the kind of goods or services dealt with.[52] Current legislation sets forth different fixed margins per economic sector. A fixed-margins approach can reduce the number of legal disputes between taxpayers and the tax authorities[53], thereby removing the need for expert staff applying subjective judgments susceptible to corruption. It has been argued that Brazil's fixed-margins helps to protect the tax base[54] and could strengthen the taxing rights of developing countries[55].

Further, it requires less technical skill than performing a traditional comparability analysis. It also eliminates the need for the tax authority to access expensive databases, lessening their financial burden. This doesn't mean, however, that calculating the transfer price under the fixed-margins method is a straightforward task. The costs to which the fixed-margins are applied must still be determined by the tax authorities. This requires data from the other related parties, its providers, third parties, and in some instances from MNEs that may have similar transactions in a public database. However, this process is still simpler than the alternative comparability analysis that is common to the Arm's Length approach. A criticism that has been made of Brazil's approach is that it was adopted unilaterally, and so MNEs could suffer double taxation on their profits. For this reason, implementing it unilaterally is likely to suit only countries that have little difficulty

Group On The Impact Of Beps In Low Income Countries, OECD. Accessed in <http://www.oecd.org/tax/tax-global/report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf>

[50] UN Manu`al on TP, 2017: D.2.5.2, D. 3.7

[51] See for details: UN Manual on TP, 2017: Chapter 10.1.

[52] UN Manual on TP, 2012 at 372.

[53] Picciotto, Sol (2017), "What Have We Learned About International Taxation and Economic Substance?", ICTD Working Paper 9, at 11.

[54] Schoueri, Luis Eduardo and Galendi, Junior. (2017), "Brazil: Branch Reports" in General Reports, International Fiscal Association, Cahier de Droit Fiscal International, p.193.

[55] Ilarraz, Marcelo (2014), "Drawing upon an Alternative Model for the Brazilian Transfer Pricing Experience: The OECD's Arm's Length Standard, Pre-fixed Profit Margins or a Third Way?", *British Tax Review*, at 218

in attracting foreign investors, and strong tax administrations. Weaker tax administrations may be better off adopting the fixed-margin approach on a bilateral basis if acceptable to both parties. This might be facilitated if regional organizations could help formulate joint positions. For example, this role could be played by both the ATAF and the CIAT (Centro Interamericano de Administraciones Tributarias).

2.2.2.2. Deemed commodity transaction price

The 'sixth method' first codified by Argentina is targeted specifically at the commodity industry. It was triggered by the government's realization that the commodity industry was involved in aggressive transfer price manipulation.[56] Subsidiaries in Argentina traded raw materials for low prices to their related parties in countries with lower tax rates, which resulted in very low taxes paid in Argentina.[57] Most versions of the sixth method – which is implemented differently in different countries – specify that the transfer price must be determined according to the publicly quoted price of the commodity in a transparent market, and on the date of shipment of the goods traded. This makes it difficult for an MNE to report a fake transfer price, as the tax administration can check the date of shipment with the customs administration. If the date of transaction were used instead, for example, the parties could report a date with a more favourable price in order to engage in profit-shifting. In addition, this method can reduce the asymmetry of information between taxpayer and tax authority since they must use the same databases.

A difficulty may arise in the implementation of the sixth method if the reference prices of commodities do not exist in the public market. This can happen, for example, if a commodity is very specific to one country. There are two versions of this problem. First, if there is no pricing information in the public databases at all, then the Sixth Method will not be applicable. Alternatively, if there is pricing information in the public databases but it doesn't match the existing market conditions, then a price adjustment will be required. But we are not aware of an administrative tool which can clearly provide the formal procedure for such an adjustment.

This approach method has been acknowledged in both the Platform for Collaboration on Tax's toolkit concerning access to comparables, and in the UN Manual. It is popular in Latin American countries, and has been adopted by Zambia as well as being recommended by the ATAF.[58] A variation was included within the OECD's TPGs as a Comparable Uncontrolled Price method applied to commodity transactions.[59] The OECD version of the method does not specify the "date of shipment".

2.2.2.3. Safe Harbour Rules

A safe harbour provision is a statutory tax law that allows taxpayers to establish transfer prices by applying a simplified transfer pricing approach provided by the tax administration, in line with the 'arm's length principle', but relieving some of the comparability analysis, and the transfer pricing burdens. The taxpayer's transfer prices will be accepted by the tax administration providing they have met the eligibility conditions of, and complied with, the safe harbor provisions. Both the UN Transfer Pricing Manual and the World Bank Handbook on

[56] Baistrocchi, Eduardo (2017), "Argentine: Branch Reports" in General Reports, International Fiscal Association, Cahier de Droit Fiscal International, at.102.
[57] Baistrocchi, Eduardo et Roxan, Ian 2012, Resolving Transfer Pricing Dispute: A Global Analysis, Cambridge: Cambridge University Press.
[58] ATAF (2017), ATAF Suggested Approach to Drafting Transfer Pricing Legislation v.2, Section7, p.19.
[59] Known as "CUP method applied to commodity transactions" in the OECD TPG. See OECD TPG (2017), paras. 2.19-2.23. The sixth method is a home-grown method from Argentina.

Transfer Pricing and Developing Economies address the design of safe harbours, taking into account the capacity of developing countries.[60]

The 2017 edition of the TPGs also acknowledged the role of safe harbours, but with caveats.[61] OECD guidance now promotes bilateral and multilateral safe-harbours, recommends the scope of their provisions to low-risk activities although not prohibiting its adoption in another context.[62] In a survey conducted for the European Union, tax administrations in ECOWAS countries stated that this is unclear and not satisfactory, since high-risk activities pose significant BEPS issues.[63] A recent paper argued that safe harbour regimes in African countries are best applied to large taxpayers and high value-adding transactions, which are the main revenue-generating streams for these countries.[64] In theory, the safe harbour rule has many benefits such as greater certainty and simplicity, but the OECD's distinction between low and high risk has made it more complex and less clear.

Conversely, India's safe harbour provision introduced in 2009 is compatible with the standard set out in the TPGs, but differs from it in various respects, including that it is implemented unilaterally, not bilaterally, taxpayers availing of the safe harbour do not have access to MAPs, and they must continue to file transfer pricing documentation.[65] However, the Indian rules offer taxpayers the possibility to "opt-in and opt-out", which means that the law gives MNEs the choice of whether or not to enter into the safe harbour. We do not regard the Indian implementation as a success story, since these conditions made it unattractive for taxpayers. Some possible solutions could be to make the safe harbour non-elective. In that way, it must be mandatory for taxpayers and must offer a reasonable rate of return. Otherwise, it should be designed within concerted efforts and dialogue between taxpayers and tax administrations under a Memorandum of Understanding.

2.2.2.4. Unitary taxation

The unitary approach, which treats a MNE's affiliates together as a single firm, has existed as a proposal for as long as the arm's length principle itself.[66] It uses a formula to divide up profits, based on factors indicating economic activity, such as sales, assets, or employees in each jurisdiction. The challenge for this approach is to identify the most relevant factors and their respective weights in determining real economic activity. This approach has gained increased support from civil society stakeholders such as the ICRICT,[67] and qualified support from governments in view of the unitary approach advocated by the G-24 in its proposal to the OECD's BEPS 2 project (discussed below) and the European Commission's proposal for a Common Consolidated Corporate Tax Base.[68] Moreover, existing adoptions of the unitary approach across the various States in the United States, Canada and Switzerland have shown that it can provide

[60] World Bank Group. (2016). Transfer Pricing and Developing Economies. A Handbook for Policy Makers and Practitioners. Washington DC: World Bank.
[61] OECD (2017), Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, Paris, Section E, ch.4.
[62] OECD (2017), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, Paris, § 4.95-4.133.
[63] Charlet A, Silberztein C and Pointe G. (2017). Transfer pricing – Study on the feasibility of introducing safe harbour provisions in ECOWAS countries. European Commission, p.100. https://ec.europa.eu/europeaid/transfer-pricing-study-feasibility-introducing-safe-harbour-provisions-ecowas-countries_en.
[64] Ezenagu, Alexander (2019), Safe Harbour Regimes in Transfer Pricing: An African Perspective, ICTD Working Paper 100, p.19.
[65] India Income-Tax Act, Section 92CB
[66] Langbein, 1986 ; for an account and analysis see: Picciotto, Sol (2013), Is the International Tax System Fit for Purpose, Especially for Developing Countries?, ICTD Working Paper 13.
[67] International Commission for Reform on International Corporate Taxation (ICRICT), 2018, "A Roadmap to improve rules for taxing multinationals", https://www.icrict.com/icrict-documents-a-fairer-future-for-global-taxation
[68] CCCTB consists of a formulary apportionment approach within the EU market. http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/599395/EPRS_BRI(2017)599395_EN.pdf.

effective protection against base erosion.[69] More work, time, dialogue and global cooperation are needed to reflect on this proposal, which – depending on how it is designed – could benefit developing countries, developed countries and taxpayers. Developing countries could explore such approaches in a progressive way – meaning that an implementation within a regional organization such as ECOWAS, ASEAN, EAC and CAN Community is a possible approach.

2.3. Mutual assistance in administration and collection

"A tax system is totally meaningless if the state is unable to collect the tax due,"[70] and this can be a particular challenge for developing countries dealing with multinational taxpayers. International tax norms have therefore developed through which countries exchange information on taxpayers, and offer mutual assistance in administration and collection. This has increasingly included technical assistance to improve the effectiveness of tax administrations, particularly in developing countries. Since the framework on exchange of information is covered in a separate background paper, this section will deal only with mutual assistance in administration and collection of taxes.

In 1988 the OECD and Council of Europe developed the MCMA to provide "for all possible forms of administrative cooperation between States in the assessment and collection of taxes, in particular, with a view to combating tax avoidance and evasion."[71] The MCMA provides for all mutual assistance activities in direct tax matters that are carried out by public authorities, including the judiciary.[72] These include: simultaneous tax examinations conducted by two or more countries; participation in tax examinations abroad; assistance in recovery whereby one country collects tax on behalf of another; service of documents, including judicial decisions. A Protocol was issued in 2010 welcoming all countries, including developing countries, to sign and ratify the convention. To date, 137 countries are formally participating.[73]

Assistance in recovery is also provided for in the bilateral tax treaty framework. Article 27 on the assistance in the collection of taxes was included in the OECD Model Convention in 2003 and in the UN Model in 2005.[74] The UN Tax Committee recognized that the inability of states to receive support in the recovery of taxes constituted "a strict limitation to the taxing power of each State as regards its own borders, which facilitates tax avoidance and evasion."[75]

2.3.1 Recent changes

In 2013, ATAF, recognizing the lack of communication, capacity and capability of African competent authorities in exchange of information, established the ATAF Multilateral Agreement on Mutual Assistance in Tax Matters. Alongside improving the effectiveness of exchange of information, similar to the MCMA, the agreement included tax examinations abroad, simultaneous tax examinations and assistance in collection of taxes. The document was prepared

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[69] Siu et al. 2014, Unitary Taxation in Federal and Regional Integrated Markets, ICTD, Research Report 3.

[70] Paul Van Der Smitte, 'International Administrative Cooperation in the Tax Collection: The Paramount Importance of Tax Collection (in Relation with Automatic Exchange of Information), in Eva Andres Aucejo et al., *International Administrative Cooperation in Fiscal Matters and International Tax Governance*, Thomson Reuters Aranzadi (2018) p.234

[71] Council of Europe & OECD, *Explanatory Report to the Convention on Mutual Administrative Assistance in Tax Matters as amended by the 2010 Protocol*, European Treaty Series No.127 (2011), p.3. Available online at: https://rm.coe.int/16800cb345

[72] Ibid, p.3 – Commentary on the provisions of the Convention, Article 1, para. 1 and the preamble to the MAATM 1988

[73] Notably, the United States and the United Kingdom have signed but not ratified the MAATM 2010, whereas the MAATM 1988 (between OECD countries) is in force for both jurisdictions.

[74] This followed a 2003 meeting of the UN Tax Committee addressing the assistance in the collection of taxes where it was recommended that an Article be introduced in the UN MTC. For more see – Committee of Experts on International Cooperation in Tax Matters, 'Assistance in the collection of taxes', UN Economic and Social Council, 5 – 9 December 2005. Available online at: https://www.un.org/esa/ffd/wp-content/uploads/2014/10/1STM_assistance-in-the-collection-E-C18-2005-3.pdf

[75] Ibid, see statements of then Director General of Taxation Morocco, M. Noureddine Bensouda at para.2

with the assistance of 21 African countries. The South Asian Association for Regional Cooperation (SAARC) has had a multilateral agreement providing for mutual assistance since 2005, which is in force among its seven members.

A new element of the global mutual assistance framework is the exchange of country-by-country financial reports (CBCR) filed by MNEs, introduced following the BEPS project. The approach agreed under BEPS requires MNEs to file CBCR reports with their home jurisdictions, and host countries need an intergovernmental agreement to gain access to them. Although this can be achieved through bilateral treaties, the most effective way to do it is through a Multilateral Competent Authority Agreement (CBC MCAA), which is layered on top of the MCMA. The CBC MCAA gives its signatories automatic access to information regarding the global allocation of income, taxes paid and indicators of economic activity among tax jurisdictions in which MNEs operate.[76]

2.3.2 Alternative approaches

For too long, international organizations, civil society and national governments have engaged in negotiating increased allocation of taxing rights for developing countries, improved efforts to tackle BEPS and now the impact of the digitalized economy in aggravating BEPS. This effort has not sufficiently engaged in scrutinizing the practical limitations for administration. Without addressing how revenue collection can be practically administered, it will be difficult to properly test the effectiveness of all the recommendations made under the BEPS project and beyond. Further, considering the future of taxation of a digitalized economy, the decreasing emphasis on physical presence will mean that tax administrators across different jurisdictions will need to work closely to support one another.

In spite of the availability of a strong legal framework to support the collection of taxes, countries appear hesitant to fully implement it. The MCMA has some significant limitations, which are consistent with concerns about the cost of compliance that were identified by countries during the first UN Tax Committee meeting to discuss the introduction and drafting of Article 27.[77] Although measures of conservancy[78] are available the tax authority must prove that there are reasonable grounds to believe a delay in collection would threaten the recovery of taxes.[79] In all other cases, it requires that claims need to be final and no longer capable of appeal, allows the jurisdiction receiving the request to deny its priority or to reject it on the grounds of public policy concerns or disproportionate costs. It also permits states to reserve the right to assist in collection at all in whole or in part. As of June 2020, more than 50 jurisdictions (both developed and developing) made full reservations to assistance in recovery of any form of taxes or administrative fines, and at least 30 jurisdictions entered reservations to the service of documents.[80] A reservation in the MCM does not prevent a country from providing mutual assistance in collection on a bilateral basis. Despite the flexibility of the bilateral framework, a significant number of countries also remain hesitant to conclude bilateral tax treaties that include

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[76] CBC MCAA Preamble

[77] Louse Parker, *International/OECD – Mutual Assistance in the Collection of Taxes*, Bulletin for International Taxation, (2017) Vol. 71, No.9

[78] Often referred to as interim or precautionary measures, are applied when the revenue claim is not yet enforceable, the objective is to prevent the taxpayer from disposing of assets. Measures include seizure, freezing, or placing a lien on taxpayer property.

[79] OECD, *Manual on the Implementation of Assistance in Tax Collection – General Module*,

[80] *List of Reservations and Declarations for Treaty No. 127 – Convention on Mutual Administrative Assistance in Tax Matters*, Council of Europe (2020). Available online at: https://www.coe.int/en/web/conventions/search-on-treaties/-/conventions/treaty/127/declarations

Article 27. Assistance today is most intense among neighbouring countries with strong economic ties like the EU or the Nordic frameworks.[81].

To move this regime onto a more universal footing, inspiration may be drawn from the mutual assistance regime for stolen asset recovery under the auspices of the UN Convention Against Corruption. The Stolen Asset Recovery Initiative recommends, *inter alia*, that countries "adopt and implement comprehensive strategic plans targeting asset recovery and provide sufficient resources and training", "provide a sound legal basis for a wide range of types of mutual legal assistance"[82] and "encourage, pursue and maintain all methods of informal assistance before initiation of a formal mutual legal assistance request."[83]

As for CBCR, data from the OECD website reveal that in May 2020 no low income countries had any activated exchange relationships, and among lower-middle income countries only four did: India, Indonesia, Nigeria and Pakistan.[84] In contrast, almost all OECD and G20 members now have access to CBCR reports from a wide range of jurisdictions. Clearly, a significant effort, to which the panel could contribute, would be required to broaden developing countries' access to CBCR under the current institutional framework. Three concerns about this framework, which have been expressed by officials from developing country governments and by civil society organisations, are the investment required to access CBCR through the exchange of information route, the lack of a breakdown of certain high risk types of related party transactions within the reports, and the turnover threshold of 750 million euros, which excludes smaller MNEs that may still be important to some lower-income countries.

Two alternatives to the current approach could be considered here beyond those relevant to mutual assistance in general. The first is a move towards public CBCR, which would eliminate the need for cumbersome exchange of information procedures. This would need the cooperation of MNEs' home countries, which seems unlikely at present. Alternatively, developing countries could develop among themselves a standardized approach to 'local filing' under which local subsidiaries of MNEs are required to file the full CBCR report for their parent country. It should be noted that the BEPS Minimum Standard for CBCR imposes strict curbs on local filing requirements, so Inclusive Framework members may find that such a move comes under criticism during the peer review process, as has been the case for Vietnam.[85]

2.4. Dispute resolution mechanisms

A unique feature of bilateral tax treaties is that, in some jurisdictions, they have direct effect under domestic law and, as a result, can be enforced through domestic courts.[86] This has led to a multitude of decisions issued by domestic courts on the interpretation and application of tax treaties creating uncertainty for revenue authorities, policymakers and taxpayers.[87] In comparison, despite having shared or connected objectives, dispute resolution mechanisms in the trade and investment space differ significantly. Whilst the World Trade Organization general agreements and international investment agreements introduced a framework for compulsory

[81] Parker (2017), n.72
[82] Ibid, at p.8
[83] Stolen Asset Recovery Initiative, *Towards a Global Architecture for Asset Recovery*, World Bank. Available online at: https://www.unodc.org/documents/corruption/Publications/StAR/StAR_Publication_-_Global_Architecture.pdf
[84] OECD, 'Country-by-Country Exchange Relationships', May 2020, https://www.oecd.org/tax/beps/country-by-country-exchange-relationships.htm.
[85] OECD (2019), *Country-by-Country Reporting – Compilation of Peer Review Reports (Phase 2): Inclusive Framework on BEPS: Action 13*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/f9bf1157-en.
[86] Zvi D. Altman, *Dispute Resolution Under Tax Treaties*, IBFD Doctoral Serise (2005), pg.4
[87] Ibid, at p.5

and binding procedures for dispute settlement, these have only recently entered the tax treaty space.[88]

Alongside access to domestic courts, dispute resolution mechanisms commonly available in bilateral tax treaties include Mutual Agreement Procedures (MAP) and mandatory binding arbitration. MAP is a treaty obligation carried out between the competent authorities of the two contracting states at the request of the taxpayer in order to resolve an international tax dispute. Disputes commonly arise from a failure to prevent double taxation and inconsistency in interpretation and application of treaty provisions. Despite being perceived as a means of resolving a dispute, most MAP provisions in bilateral tax treaties do not compel competent authorities to reach an agreement.[89]

The number of MAP cases has continued to increase, but mostly among developed countries and large emerging economies. The 2018 MAP statistics collected by the OECD revealed that the number of cases received prior to 1 January 2018 that had yet to be closed in 2018 amounted to 3,355, compared to 1,231 that had been closed.[90] Timing is still a challenge and the backlog appears to be increasing. The number of developing country cases, however, remains minimal, confirming that most have no or only limited experience with MAPs.[91] Nevertheless, the UN Tax Committee has taken steps to provide detailed guidance for developing countries to ensure that they are prepared to engage in MAPs.

The MAP mechanism relies heavily on the goodwill of the competent authorities, and is very much left to the discretion of the tax authorities.[92] However, MAP does not prevent a country from breaching its treaty obligations, it is not binding and therefore not enforceable by domestic courts, authorities can delay (at times intentionally) the conclusion of the process and the entire process can be highly politicized.[93] Perhaps as a result, the last few years have witnessed a sharp increase in investor state dispute settlement (ISDS) challenging the imposition of tax measures.[94] Between 1999 and 2015, over 30 cases challenging tax measures taken by host countries have been brought before ISDS arbitral tribunals.[95]

2.4.1 Recent changes

Since MAPs first emerged in the 20th century, governments have demonstrated a reluctance to agree on a framework for binding international tax arbitration.[96] But in response to the problems outlined above, they have begun to relent. The BEPS 1 outcomes include a minimum standard related to the MAP process and emphasized the need for increased training and support to developing countries. It also introduced mandatory binding arbitration through the MLI, which strengthened and accelerated the adoption of arbitration in tax treaties since it first introduction into the OECD model in 2008. Although tax treaty arbitration rules vary, the MLI framework is based on the appointment of three qualified arbitrators who are independent of both competent

[88] Altman (2005), n.34 at p.2 – 3
[89] OECD, *Manual on Effective Mutual Agreement Procedures*, OECD (2007), pg. 8.
[90] OECD, *Mutual agreement procedure statistics for 2018*, OECD (2018). Available online at: https://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics.htm
[91] Ibid
[92] Altman (2005), n.34 at p.254
[93] Altman (2005), n.34 at p.257 – 260
[94] Julien Chaisse, *Investor-State Arbitration in International Tax Dispute Resolution: A Cut Above Dedicated Dispute Resolution?* Virginia Law Review, January 2016.
[95] Chaisse (2016), n.47 at pg.170
[96] Altman (2005), n.34 at p.23 points out that the 1990 European Arbitration Convention, entered into by 12 jurisdictions and limited to permanent establishment and transfer pricing, was signed after the failure to adopt a Council Directive that proposed transfer pricing arbitration. Nearly all European governments did not want arbitration to have supranational legal status and the European Council faced a seriously deadlock when legislating on tax.

authorities and impartial.[97] Arbitration proceedings are confidential, and the costs of arbitration are to be split between the two jurisdictions based on mutual agreement.[98]

Almost all developing countries and several large economies that have signed the MLI have opted out of the arbitration provision, including Kenya, India, China, Argentina, South Africa, Indonesia and Chile. Concerns have arisen relating to sovereignty, potential violation of national constitutions, cost of arbitration and lack of resources, the potential for unfair outcomes and biased arbitrators, the lack of transparency, and lack of experience with overall international tax dispute settlement.[99]

This position has been motivated by the experience of countries in investor-state dispute settlement, where some of these limitations have given rise to expensive outcomes. As mentioned in a previous section, investors have often opted to initiate claims in investment arbitral tribunals, most notoriously in the dispute between Vodafone and India over a $2.2 billion capital gains tax liability.[100] In general, India has faced a high number of ISDS claims that are related to tax measures and this has influenced the decisions made in 2017 to terminate 58 BITs including with the Netherlands.[101] South Africa, Indonesia, Venezuela, Ecuador and Bolivia are also considering termination on similar grounds.[102] Given the experience in investment arbitration, it is unlikely that the position regarding arbitration is likely to significantly change amongst developing countries.

The most up to date proposals arising from the Inclusive Framework consultations on addressing the tax challenges arising from the digitalization of the economy emphasize the need for dispute mechanisms which were viewed as critical to a consensus-based solution.[103] In this regard, the OECD Secretariat's proposal for Pillar One recommends the adoption of a clear, administrable and binding process for early dispute prevention. Moreover, the Inclusive Framework is now considering the applicability of mandatory binding arbitration to resolve the inevitable disputes that will arise from the proposals under consideration. African delegates and some members of the G24 have expressed their opposition to this.[104]

2.4.2 Alternative approaches

Since an inadequate framework for tax dispute resolution may continue to see disputes spilling out into the trade and investment spaces, it is worth considering how developing countries' concerns could be allayed. At the UN Tax Committee, the Subcommittee on Dispute Avoidance and Resolution has developed additional guidance that includes: steps to prevent disputes in the first place, arbitration requested by the tax authority rather than the taxpayer, representative panels of arbitrators supported by the UN Tax Committee, and the use of mediation. Arbitration

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[97] Explanatory Statement to the MLI, para.234 – 236
[98] See Article 21 and 25 of the MLI
[99] For more see Commentary to Article 25 of the UN Model, at para 4 – 5
[100] Vodafone International Holdings BV v. Government of India India I – Dutch BIT Claim and II – UK BIT Claim
[101] Nihal Joseph & Nicholas Peacock, *Mixed messages to investors as India quietly terminates bilateral investment treaties with 58 countries*, Herbert Smith Freehills, 16 March 2017. Available online at: https://hsfnotes.com/arbitration/2017/03/16/mixed-messages-to-investors-as-india-quietly-terminates-bilateral-investment-treaties-with-58-countries/
[102] Ibid
[103] OECD/G20 Inclusive Framework, *Statement by the OECD/G20 Inclusive Framework on BEPS on the two-pillar approach to address the tax challenges arising from the digitalization of the economy*, OECD 29 – 30 January 2020, pg.
[104] ATAF, *ATAF's Opinion on the Inclusive Framework Pillar One (Including the Unified Approach) and Pillar Two Proposals to Address the Tax Challenges Arising from the Digitalisation of the Economy* (African Tax Administration Forum, 2019), https://events.ataftax.org/index.php?page=documents&func=view&document_id=44. & *Comments of the G24 on the OECD Secretariat Proposal for a Unified Approach to the Nexus and Profit Allocation Challenges Arising from the Digitalization (Pillar 1)*, G24, November 2019. https://www.g24.org/wp-content/uploads/2019/12/G-24_Comments-on-OECD-Secretariat-Proposal-for-a-Unified-Approach.pdf

frameworks may be revised, but it is unlikely that the confidence of developing countries in such processes will change. Instead, an international tax dispute settlement panel could be explored. This may entail the following:

- Regulation of operations, decision making etc. managed by the UN Tax Committee.
- Representative panel constituting experts nominated by countries.
- Fundamental values based on neutrality, fairness and certainty.

2.5. Coercive mechanisms

Given that the international tax framework is based on cooperation and the goodwill of countries to comply with the recommendations made by the OECD or the UN Tax Committee, coercing countries that are unwilling to participate has been controversial. Cooperation can be a useful strategy where unilateral efforts, in this case tax competition, result in inadequate outcomes for the majority or for key strategic players.[105] As a result, where "uncooperative strategic interactions harm both global and national welfare, cooperative measures could work to improve both".[106] Every country is entitled to design its own tax and transparency rules independently and this has inevitably led to increased tax competition between states, which bilateral cooperation alone cannot resolve.[107] In both promoting and coercing multilateral cooperation, powerful countries have taken a dominant position that has permitted them to advance their own interests and reap the most benefits.[108] Since a majority of international tax norms have emerged from the practices and interactions between OECD countries, in order to establish a status quo for themselves within the global order and reign in the type of tax competition that threatens that status quo. It should not be taken for granted that the EU and OECD practices are often mutually reinforcing and borrow heavily from one another. More importantly, in order to successfully execute the adoption of various internal principles[109] within the EU, competition with the rest of the world would need to be similarly reigned in via the OECD globalized initiatives.

The OECD 1998 report on Harmful Tax Practices set out an ambitious agenda to tackle harmful tax practices by large and small states alike. When the incoming Bush administration in the United States got cold feet, it was watered down to a focus on exchange of information targeted at small tax havens (addressed in another FACTI background paper).[110] The Forum on Harmful Tax Practices (FHTP), also established following the 1998 report, was mandated to assess preferential tax regimes and determine whether they could be harmful to the tax bases of other jurisdictions. Its work was not backed by the same threat of sanctions as for information exchange. It is only in recent years that developing countries have been subject to the same sorts of coercive measures, focused on their participation in the outcomes of the BEPS project.

2.5.1 Recent changes

Developing countries are increasingly being pushed to adopt measures through coercive mechanisms. At the OECD, Inclusive Framework membership brings with it peer reviews against the four BEPS minimum standards, although developing countries have in some instances been allowed to defer compliance deadlines. The expanded role for the FHTP following the BEPS 1 project has led to peer review and monitoring of transparency (particularly compulsory

[105] Tsilly Dagan, *International Tax Policy: Between Competition and Cooperation*, Cambridge University Press (2018).
[106] Ibid, at p.68
[107] Dagan (2018), n.53 at p.167
[108] Dagan (2018), n.53 at p.168
[109] For instance those contained in the EU Code of Conduct and generally the Fundamental Freedoms.
[110] J C Sharman, *Havens in a Storm: The Global Struggle for Tax Regulation* (Ithaca: Cornell University Press, 2006).

spontaneous exchange of relevant information on taxpayer-specific rulings) and reviews of 287 preferential tax regimes and the 'substantial activities' requirements for 12 low or no tax jurisdictions.

In 2017, the EU established its own 'blacklist' of non-cooperative jurisdictions, based on a mix of OECD transparency standards, BEPS measures and EU criteria for harmful preferential tax measures.[111] The first list, published in 2017, included countries that had not implemented the BEPS minimum standards or eliminated harmful tax regimes, including for example, Namibia on the blacklist and Botswana, Cape Verde and Eswatini on the grey list. This had notable implications for each of these countries. Although subject to frequent monitoring and review, inclusion in the list gave rise to reputational issues in the eyes of other countries and potential investors. More importantly, EU member states were considering coordinated sanctions.[112] Although membership of the Inclusive Framework is voluntary, these countries were effectively forced by the EU to comply with the BEPS minimum standards.

2.5.2 Suitability

Coercion is particularly undesirable where cooperation results in an expensive process to adopt standards that cannot be fully implemented without the necessary systems and tools within a tax administration and other authorities. Following its inclusion in the grey list, a country such as Botswana or Eswatini would be forced to make expensive amendments to its tax system in order to comply with the minimum standards, yet it poses a far smaller tax avoidance threat than some EU and OECD member states. Conversely, there is no coercive mechanism that begins from an assessment of the impact of jurisdictions' tax systems on lower-income countries, which themselves are unable to engage in effective coercion.

2.6. Digitalisation and the OECD's 'BEPS 2' project

There is a broad consensus that current international tax norms produce some perverse effects when applied to digitalized business models, preventing countries from taxing such MNEs adequately. According to the UN Transfer Pricing Manual, "In many developing countries, the digital economy currently plays a role as a key growth driver in their economic engine and it is therefore imperative for tax authorities to tackle transfer pricing issues related to it."[113] This has implications cutting across the other themes considered in this paper: for treaties, in particular the 'nexus' rules currently based on physical presence; for transfer pricing rules, given the global integration of digital business models; increased mutual assistance is likely to be necessary, as is dispute resolution.

Both the UN Tax Committee's Subcommittee on Tax Challenges Related to the Digitalization of the Economy and the Inclusive Framework have been considering what changes should be made, although to date it is the latter body that has set the agenda. The Inclusive Framework's project is neither comprehensive in its consideration of tax challenges from the developing country perspective, nor strictly limited to challenges from digitalization alone. G24 members submitted a proposal ahead of the Inclusive Framework's January 2019 meeting, which proposed a more radical set of reforms than were eventually taken forward. The work has been divided into two pillars. Pillar One would redistribute the tax base of businesses within its scope towards the

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[111] General Secretariat of the Council, 'Criteria and process leading to the establishment of the EU list of non-cooperative jurisdictions for tax purposes', Council of the European Union, 8 November 2016.

[112] Al Tamimi, 'A detailed look into the implications of the tax blacklisting of the UAE and Oman by the EU', Lexology, 12 March 2019. Available online at: https://www.lexology.com/library/detail.aspx?g=201a225c-d9b8-4d0d-b960-3deb29ce87f8

[113] UN Manual on TP (2017), B.1.10.13

jurisdiction in which they have sales or users. Pillar two would try to ensure that MNEs pay a minimum level of tax, addressing the transfer of profits to low-tax jurisdictions.

2.6.1 The Unified Approach (Pillar One)

Under Pillar One, the Inclusive Framework is currently proposing a three-tier profit allocation mechanism, as follows:

- Amount A – using a formula-based allocation mechanism to redistribute a portion of 'residual' profits to market jurisdictions based on a "new taxing right".
- Amount B – using a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction.
- Amount C – binding and effective dispute prevention and resolution mechanisms relating to all elements of the proposal, and any additional profit where in-country functions exceed the baseline activity compensated under Amount B.

This approach goes beyond the ALP, but largely retains the current transfer pricing rules, complementing them with formula-based solutions in areas where tensions in the current system are the highest.

2.6.2 The Global Anti-Base Erosion Proposal (Pillar Two)[114]

The 'GloBE' proposal is about determining the effective level of taxation of an MNE and comparing it with a minimum level of taxation yet to be agreed between states. If the effective level of taxation is below this threshold, it can be corrected by states. This leads to four rules, two of which apply in the host state, and two in the home state of the MNE. In each case, there is one rule enacted through domestic law, and one applying to treaties.

2.6.3 Suitability

It is beyond the scope of this background paper to offer a detailed critique of these proposals, as has been done elsewhere.[115] Rather, we can offer some general observations on their relationship with the other themes of this paper. We draw the Panel's attention to ATAF's concern that, "it is extremely challenging for many developing countries to fully participate in the Inclusive Framework process and to ensure the new rules are fit for purpose for African countries. We are concerned that these complexities may mean some countries may commit to new rules without a full understanding of the revenue and investment implications for them."[116]

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[114] OECD-Inclusive Framework (2019), Public consultation document : Global Anti-Base Erosion Proposal « GloBE ») : Tax Challenges Arising from the Digitalisation of the Economy.

[115] Martin Hearson, *Corporate Tax Negotiations at the OECD: What's at Stake for Developing Countries in 2020?*, Brighton, ICTD Summary Brief 20 (IDS, 2020), https://opendocs.ids.ac.uk/opendocs/handle/20.500.12413/15100; ATAF, *ATAF's Opinion on the Inclusive Framework Pillar One (Including the Unified Approach) and Pillar Two Proposals to Address the Tax Challenges Arising from the Digitalisation of the Economy* (African Tax Administration Forum, 2019), https://events.ataftax.org/index.php?page=documents&func=view&document_id=44; Intergovernmental Group of 24, *Comments of the G-24 on the OECD Secretariat Proposal for a Unified Approach to the Nexus and Profit Allocation Challenges Arising from the Digitalisation (Pillar 1)* (OECD, 2019); UN Tax Committee, *Comments Submitted to the OECD Secretariat on the "Unified Approach" as Proposed by the Secretariat in in Its Public Consultation Document of 9 October* (OECD, 2019). See also comments of the UNTC members – UNTC, *Tax Consequences of the digitalized economy – issues of relevance for developing countries*, June 2020. https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-06/CICTM%2020th_CRP.25%20_%20Digitalized%20Economy.pdf

[116] https://www.ataftax.org/media-brief-inclusive-framework-jan-2020. See also See also comments of the UNTC member – UNTC, *Tax Consequences of the digitalized economy – issues of relevance for developing countries*, June 2020, p.8. https://www.ataftax.org/media-brief-inclusive-framework-jan-2020

The Inclusive Framework discussions have some strengths from a developing country perspective. First, they have a seat on the table in the standard-setting process, illustrated for example by the high-profile proposal coming from the G-24 (discussed below). Second, there is a clear acknowledgement of the need to 'go beyond' the ALP. Third, the proposals explicitly target simplifications. Fourth, it is a stated aim to redistribute the tax base towards 'market' jurisdictions, which should, theoretically, benefit most developing countries to some degree. Finally, it proposes a systematic solution designed to ensure that all internationally operating businesses pay a minimum level of tax.

On the negative side, to begin with, the agenda and the timescale have been dictated by the priorities of developed and large emerging economies: they presume a significant commitment of human and financial resources to negotiation over a short period of time, at a point when developing countries are still considering their policy objectives. Second, there is a variety of concerns about thresholds and definitions that are likely to limit the extent of any redistribution to developing countries.[117] Third, because they are layered on top of existing rules, rather than replacing them, this tempers the benefits of any simplification. Fourth, the emphasis on mandatory and binding dispute settlement in Pillar One poses the risk that developing countries will be dragged into a system of arbitration that they have so far resisted. Finally, many of the discussions, including for example of which rules should take priority under Pillar Two, demonstrate that the goal of global consistency will continue to produce outcomes that are less beneficial for developing countries.[118]

These multilateral developments should be understood in context. A number of countries, including developing countries, had already acted to tax digital services, e-commerce and technology in general prior to the initiation of these consultations. Countries continue to innovate and emulate each other in this space outside of the global negotiations. These responses, though not always 'first best' solutions, are contextual responses based on countries' administrative and economic realities. They illustrate that the Inclusive Framework proposals are not the only options available to developing countries. Some of the main types of unilateral measure include:[119]

- Significant Economic Presence. A crucial element of the G-24 proposal on digital taxation to the Inclusive Framework was that MNEs providing digital services in an economy could become taxable on their profits if they had a significant economic presence, even without a physical presence.[120] Under the SEP framework, a company would have a taxable nexus in the presence of factors including the revenue from sales of goods and services effected through digital means, the user base and the associated data input, and the volume of digital content. Profits would be allocated to a country on the basis of four factors: sales (demand side factor), asset and employees (supply side factors) and users. This notion, a variation on that proposed by the European Commission, has been adopted by India and Nigeria as the preferred basis of determining whether a permanent establishment has arisen in their jurisdiction, and of attributing profits to it.
- Digital services taxes (DSTs) and equalization levies. A DST is a tax levied on selected gross revenue streams of large digital companies derived from the digital services they provide to users in a jurisdiction.[121] The Kenyan government has recently proposed the

[117] See for details: UNTC, *Tax Consequences of the digitalized economy – issues of relevance for developing countries*, June 2020, p.6-7.
[118] Idem, p.11.
[119] See Rukundo, S. (2020) Addressing the Challenges of Taxation of the Digital Economy: Lessons for African Countries, ICTD Working Paper 105, Brighton, IDS
[120] G-24 Working Group on tax policy and international tax cooperation, Proposal for Addressing Tax Challenges Arising from Digitalisation, January 17, 2019
[121] Source: KPMG, "Taxation of the digitalized economy," updated Mar. 21, 2020.

adoption of a DST, following in the footsteps of India, Turkey, the UK, New Zealand and several European Union members.

- Withholding taxes on digital transactions. Countries such as Peru, Turkey and Argentina require businesses that purchase digital services (such as advertisements) or payment platforms to withhold tax from payments made to digital service providers.
- Indirect taxes. In South Africa, the application of VAT to the supply of electronic services by foreigners became effective in 2014 and, as of 2019, has been expanded to additional forms of electronic services. Recently, numerous countries, including Angola, Nigeria, Indonesia, Bangladesh and Kenya, have also extended VAT requirements to tax the supply of digital services or e-commerce.[122]
- Digital transactions taxes. Since 2018, Uganda has collected the controversial social media taxes which have been perceived as having socio-political as well as revenue raising objectives. Several African countries, including Uganda, Kenya, Zimbabwe and Tanzania have been taxing mobile money services.

One implication of this list is that the Inclusive Framework discussions must have some regard for context and be very careful about any attempt to dictate the types of policies that countries can or cannot implement.

3. Recommendations

In our view, there exists an institutional deficit in international tax norm setting. The UN Tax Committee has not been given the space to explore the full potential of the UN system in this area, nor has regional collaboration among developing countries – especially at political level – matured in the area of taxation. The G20 and OECD have attempted to fill the vacuum through the Inclusive Framework, but we are not convinced that this can act as a substitute for a truly global tax body such as an intergovernmental UN committee. Whatever the institutional architecture, it must be responsive to the underlying conflicts of needs, priorities and interests on multiple axes, but, most pertinently for us, between lower-income countries and more powerful states. The notion that one body can simultaneously act as the space in which lower-income countries' needs are fully explored, and reconcile the competing interests of these different groupings, is hard to sustain. A common thread throughout these recommendations is therefore the need to explore new models of multilateralism that facilitate more innovation among developing countries, while defending a cooperative approach to international taxation. Given the FACTI panel's home within the UN system, we have focused on that venue in our recommendations. The panel will nonetheless need to form its own approach to balancing the complementary objectives of advocacy towards existing institutions, an agenda for institutional reform, and respect for countries' pragmatic choices to innovate individually or collectively.

3.1. Short-term reforms that could be put in place immediately

3.1.1 Encouraging reviewing, renegotiating and terminating harmful tax treaties

As the IMF advises, "considerable caution is needed in entering into any [tax treaty]. A critical decision for any primarily capital-importing country is whether it can achieve more by signing a treaty than it can simply through its own domestic law."[123] The panel can contribute to the promotion – especially at political level – of this note of caution. In terms of treaties already signed, the panel could urge governments to review their treaty networks and learn from the

[122] OECD Guidance on this topic was completed in 2015 and forms part of the OECD's 2017 *International VAT/GST Guidelines.*
[123] IMF, *Spillovers in International Corporate Taxation* (Washington, DC, 2014), 27.

experience of countries that have cancelled or renegotiated treaties in recent years. It should be important to emphasise that a treaty can be harmful either because it is exploited for treaty shopping, or because of the excessive source taxing rights foregone. The current consultation on a draft toolkit on tax treaty negotiations by the Platform for Collaboration on Tax provides an opportunity for the panel to engage with ongoing work by international organizations.

3.1.2 Promote alternative approaches to transfer pricing

Developing countries need transfer pricing rules that provide more clarity, predictability and simplicity than the TPGs currently provide. Adherence to the TPGs by the OECD and UN Tax Committee limits both organizations' ability to develop guidance on the simplified approaches that could be more applicable to low-income countries – although the 'Amount B' proposal under consideration at the Inclusive Framework is an exception. We have discussed three types of simplification measure: safe harbors, fixed margins and deemed transaction dates. Practical implementations of these measures to date are not without their weaknesses, but they offer a starting point. The panel could play a role here by disseminating best practices in the area of simplification.

3.1.3 Promote examples of unilateral measures and second-best options for taxing the digital economy that are better suited to resource-constrained contexts.

Despite the OECD's best efforts, there is no global consensus on how to address the tax challenges of digitalization of the economy. As the experience with BEPS 1 suggests, even if a compromise is found in the Inclusive Framework, it is unlikely that all developing countries – not least those who have chosen not to join – will consider it worthwhile adopting. We are therefore at a critical juncture: while there is no dominant global standard, developing countries have the potential to shape the long-term development of international tax norms. The panel will no doubt want to offer its view on the Inclusive Framework discussions, but we recommend that the focus of its attention be directed towards what developing countries are – and should be – doing individually and through other mechanisms of cooperation. Regional coordination in this area could reduce the likelihood of competition between neighbours, or members of common institutions and minimize impacts on trade or investment obligations and protections. The panel could offer a critical perspective on the emerging menu of options, including DSTs, withholding taxes, Significant Economic Presence, fractional apportionment and VAT measures. This might inform the ongoing work at the UN Tax Committee to develop a new treaty article responding to the challenges of digitalization.

3.1.4 Promote local filing legislation for CBCR

Many countries, especially developing countries, do not have access to CBCR data, in spite of the progress made on this topic. It is open to the panel to throw its weight behind public CBCR, to advocate for a lowering of the reporting threshold, or to encourage developing countries to join the CBCR-MCAA. An option that we recommend for further consideration would be to encourage countries to develop among themselves a standardized approach to local filing of CBCR reports. The current review of CBCR within the IF could be an opportunity to advocate for a more flexible approach to local filing in the Minimum Standard as well.

3.1.5 Develop proposals for new 'minimum standards' from a developing country perspective

The notion of minimum standards is now tacitly accepted by 137 countries that have joined the Inclusive Framework, but the existing four standards were not developed with developing countries' participation. Could the Panel convene a process or recommend a UN-led initiative that assesses compliance with international tax norms that will help developing countries tackle IFFs? For developed countries, these might include:

- Inclusion of certain treaty provisions in tax treaties with developing countries (eg UN articles 5(3)(b) or 12A for taxation of services, UN/OECD article 13(4) for taxation of indirect transfers of assets, and an appropriate anti-treaty shopping article).
- Assistance in the collection of taxes relationships with developing countries, through multilateral or bilateral means.
- A minimum number of active CBCR exchange relationships with developing countries, or publication of CBCR for headquartered MNEs.

The MLI and Inclusive Framework peer reviews cover some of these areas already, and we have provided some critical analysis of these institutions in this paper. There is a case that the UN system or regional bodies may have more added value and acceptance in some or all of these areas.

3.1.6 Help elevate international tax norm considerations to political level in lower-income countries

One factor constraining many developing countries' negotiating strength, in multilateral and bilateral settings, is the absence of a strong political mandate for their negotiating position. As well as undermining their negotiators, this can also lead to poorly formulated policies underlying negotiations, insufficient civil service capacity being made available to participate effectively in negotiations to which a country has committed, and problems ratifying and implementing the eventual outcomes. There is therefore a considerable political awareness-raising task to which the panel could contribute.

3.2. Medium-term reforms that require some time to formulate

3.2.1 Re-examining the purpose of tax treaties to maximize the gains for developing countries while limiting the restrictions on source taxation

Tax treaties currently pose a difficult choice for developing countries: they need cooperation to fully eliminate double taxation and to tackle tax avoidance and evasion, yet to gain it through a tax treaty they must give up source taxing rights. A more radical approach to tax treaties might re-examine the bundling together of their component parts into a single agreement. The panel might reflect critically on tax treaties from this perspective, whereas UN Tax Committee and OECD deliberations take the basis of the Model Conventions for granted.

3.2.2 Developing new nexus and transfer pricing rules within the current paradigm

Because the adoption of unilateral tax measures can result in double taxation for MNEs, the unilateral adoption of simplification and redistribution measures should not be a long-term strategy. The Panel could initiate some work to explore the coordinated adoption of simplification measures, beyond those under consideration in the Inclusive Framework, on a bilateral basis, such as could be introduced to treaties, or preferably on a multilateral basis. This could take place through the UN system (for example, the model treaty and transfer pricing manual) and/or in collaboration with regional bodies.

3.2.3 Institutional reforms, including at the UN, to strengthen developing countries' participation in international tax cooperation and capacity building

Although the case that current institutions of international norm-setting are not fit for purpose is quite persuasive, there is much that can be done within those existing structures in the medium term. Developing and emerging economies form a majority at the Inclusive Framework, as do members nominated by developing countries on the UN Tax Committee. To strengthen developing countries' participation requires a series of interventions that the panel could support. This includes:

- Supporting the emergence of a stronger cohort of elite negotiators from lower-income countries, through funding and negotiation training.
- Improving the political engagement with international tax norm-setting at national and regional level among lower-income countries.
- Investigating changes that could be made to the institutional design of the UN Tax Committee and Inclusive Framework that would enhance developing country influence.

3.2.4 Develop alternative models of tax dispute resolution that are appropriate for developing countries

While the current MAP and arbitration models have limitations that are still being resolved, there is a compelling case that some form of dispute settlement procedure is needed in their place. The panel could consider what form this might take, with the cooperation of the UN Tax Committee. Capacity building on MAP and efforts to improve the process are underway and the panel may consider re-emphasizing this. However, two suggestions that deviate from the prevailing model are the pursuit of MAP mediation as opposed to arbitration and the creation of an international tax dispute settlement panel with panellists nominated by countries, under the auspices of the UN. In making this recommendation the Panel should remain aware of the position of developing countries and the potential constraints in establishing an independent dispute settlement panel.[124]

3.3. Long-term reforms

3.3.1 Evaluating new paradigms in place of the arm's length principle approach to transfer pricing

There is not enough breadth or depth in the development of simplified approaches to transfer pricing to judge conclusively the impact of their widespread adoption. While in the short and medium term this is where energies should be focused, there is also a need to consider more concretely the possibilities for a more comprehensive overhaul. The main alternative to which we direct the panel is unitary taxation with formulary apportionment. To fully evaluate this alternative paradigm would require considerably more technical work and political debate, of the kind that requires the convening power of an intergovernmental organization. A 'blue skies' approach to this matter would not be limited to unitary taxation, however, and the panel might consider the menu of options provided in a recent IMF board paper.[125]

3.3.2 Developing a new normative basis for tax base allocation grounded in global redistribution.

The BEPS 1&2 processes have opened up a debate about the normative basis on which the multinational tax base should be distributed. The first BEPS project introduced the notion that MNEs should be taxed "where value is created," though the definition of value creation is itself subjective and contestable. The current negotiations are premised on a redirection of taxing

[124] See for instance comments of the UNTC member – UNTC, *Tax Consequences of the digitalized economy – issues of relevance for developing countries*, June 2020, p.10, https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-06/CICTM%2020th_CRP.25%20_%20Digitalized%20Economy.pdf

[125] IMF, *Corporate Taxation in the Global Economy.* (Washington, DC: IMF, 2015).

rights to market jurisdictions, a change that may not be unambiguously positive for all developing countries. Certainly, the adoption of formulary methods, whether within or beyond the current paradigm, invites debate about the principled basis through which taxing rights are allocated.[126] This is an intellectual task in which the panel could take a leadership role.

3.3.3 Investigate new instruments for mutual accountability that meet the needs of developing countries, and reduce their compliance costs.

The current patchwork of blacklists, peer review mechanisms and trade investigations means that we are living in the most coercive era of tax cooperation ever. In the absence of an intergovernmental global tax body or binding convention, these sanctions inevitably reflect the preferences of those states powerful enough to be able to use them. They can have the effect of stifling unilateral measures by developing countries that merely reflect the inappropriateness of international norms to their contexts. Developing countries that pose no threat to powerful states are effectively the collateral damage from these mechanisms, while they have little recourse when they themselves need cooperation from other states. We suggest that the Panel could consider how an equitable international norm of mutual accountability could be developed and delivered, recognizing that the goal of global cooperation cannot be uniformity, respecting the differences in countries' priorities and capabilities, while also acknowledging that developing countries depend to some extent on cooperation from other states in the enforcement of their tax laws.

3.3.4 Consider seriously the call for a global tax body

Under the medium-term heading, we noted that the potential for developing countries to obtain reforms to international tax norms under current institutional arrangements is far from exhausted. Nonetheless, the panel will be aware of the call from the G77 and civil society for an intergovernmental tax body under the auspices of the UN. The Addis Ababa Action Agenda emphasized that international tax cooperation should be "universal in approach and scope and should fully take into account the different needs and capacities of all countries." The panel could provide some welcome precision to this call. What should be the mandate of any global tax body, and which existing model of intergovernmental cooperation would be most appropriate to the tax sphere? The starting point for such an investigation is our clear conclusion that current institutions have failed to develop international tax norms that meet developing countries' needs.

[126] On this, see Christians, Allison and van Apeldoorn, Laurens, Taxing Income Where Value Is Created (March 1, 2018). 22 Florida Tax Review 1, 2019. Available at SSRN: https://ssrn.com/abstract=3132538