Problematising Tax Treaties

- Taxation represents fiscal social contract
- Social contract- an agreement reached by a society in the state of nature about its fundamental characteristics- aspects of social justice, including the division of the societal pie and the assignment of civil rights and liberties
- Vertical fiscal social contract between the state and citizens
- Horizontal fiscal social contract between the states

Focus

- Distributive justice- how burdens and benefits should be distributed throughout society
- Political justice- examine conditions for the democratically legitimate exercise of political power
- Relevance in an interconnected and interdependent world order
- Is the current international tax regime based on politically just process to ensure distributive justice?

- Tax treaties are explicitly political- bilateral negotiation between two countries settling up the right to tax the cross-border economic activity between them
- Most Tax treaties are based on some Model Convenention that serves as a ‘cookie cutter’
- Therefore it is critical to question who shaped this ‘cookie cutter’? Whose opinion mattered in deciding its shape? Was that opinion informed? What was the procedure democratic?

Political Justice

- Was the participation of developing countries in the policymaking process on an equal footing?
- **Legitimacy deficits -** how power and influence over policy making is distributed among countries
- Treaties are not negotiated in a vacuum but within institutional frameworks
- These frameworks qualify the options states have for co-operation
- Questionable **Institutional legitimacy** and **structural legitimacy**

- OECD with the first movers advantage
- Hold central position:
- a) technical superiority of its Standards and b) their endorsement by the world’s most advanced economies
- Is it elitist?

The role of OECD

- The OECD’s ideational role into five categories:
- **an artist**, which formulates, tests, and diffuses policies;
- **an agent**, which transfers ideas from more prosperous to less prosperous states;
- **an agency**, which takes emerging ideas from states, develops them, and then sells them back in a more refined form;
- **an arbitrator**, through which civil servants are socialized; and
- **an authority**, used by states to back up their positions.

- The OECD has more recently sought to include the participation of non-member countries in some of its tax policy discussions
- It is closely looked at whether it entails actual participation in setting the rules or merely securing their engagement and fostering a public perception of inclusiveness, is it at the implementation stage and limited role in agenda-setting and decision making phases

- **Structural legitimacy**
- Formal equality may not resolve the issue
- structural inequities resulting from differences in power and influence in the global political economy
- Negotiation, interpretation, and administration of tax treaties is resource-intensive and requires highly skilled staff.
- power asymmetries and lack of negotiating experience both translate into greater restrictions on source taxing rights.

Distributive Justice

- Political injustice raises concerns in ensuring distributive justice
- Unresolved issues around institutional and structural legitimacy leads to the issues of allocation problems
- OECD seen as a regional group of affluent developed countries setting out self-serving rules with inherent bias towards capital exporting countries.
- Taxing rights under OECD more favourably assigned to the resident state than the source state

Nomenclature

OECD

- Model Tax Convention of Income and on Capital

UN

- Model Double Tax Convention between Developed and Developing Countries

Purpose of the Treaty

OECD Model

- **to clarify, standardise, and confirm the fiscal situation of taxpayers** who are engaged in commercial, industrial, financial, or any other activities in other countries through the application by all countries of common solutions to identical cases of double taxation

UN Model

- Broadly, the general objectives of bilateral tax treaties therefore include the protection of taxpayers against double taxation **with a view to improving the flow of international trade and investment** and the transfer of technology

Permanent Establishment

OECD

- Threshold of project site
- 12 months
- NO service PE

UN

- Threshold of project site
- 6 months
- Recognises service PE

Business profits

OECD Model

- No force of attraction rule

UN Model

- Limited force of attraction rule
- **Article7** The profits of the enterprise may be taxed in the other State but only so much of them as is attributable to
- (a)that permanent establishment;
- (b)sales in that other State of goods or merchandise **of the same or similar kind as those sold through that permanent establishment**; or
- (c)other business activities carried on in that other State **of the same or similar kind as those effected through that permanent establishment**

FTS

OECD Model

- The Model does not comprise an article on FTA.
- But DTAA with India does include FTS.

UN Model (Art. 12A)

- FTS arising in a Contracting State and paid to a resident of the other Contracting State **may be** taxed in that other State.
- Previously, FTS was taxable exclusively by the resident State unless the enterprise carried on business through a permanent establishment in the source State.

Royalty

OECD Model

- Royalties arising in a Contracting State and beneficially owned by a resident of the Other Contracting State shall be taxable **only** in that other State

UN Model

- Royalties arising in a Contracting State and paid to a resident of the other Contracting State **may be** taxed in that other State.
- Such royalties may also be taxed by Source State, but the tax is limited to ___ % percent of the gross amount of the royalties

Tax competition impacting distributive justice

- key challenge is the pervasiveness of tax competition
- tax competition undermines the ability of countries to set their tax regimes
- negatively affect tax equity- 1) allows the rich to reallocate 2) tax burden shifts from capital to labor 3) changes the income distribution not only within but also between countries

- Existing international taxation framework has failed to address
- Revenue problems- reduces overall tax revenues, more significantly affects developing countries
- allocation problems- allocating taxing rights in a way that favours more affluent countries
- Discussions on fairness and distributive justice in international taxation regime assumes criticality
- But these principles will still need to be translated into concrete and specific solutions for real-world problems.

IF Agreement and the 2 Pillar Approach

- How radical is theIF Agreement and its approach?
- The Independent Commission for the Reform of International Corporate Taxation (ICRICT) in Open Letter
- Proposals for a global effective minimum tax of 21%
- Developing countries have greater dependency on corporate tax income and suffer the highest losses from corporate tax abuse
- reallocate a small fraction of profits of only the 100 largest and most profitable global multinationals
- reinforces global inequities
- countries should not be restricted from continuing to pursue alternative measures, such as digital services taxes, which are already generating revenue today

Addressing the Fallacy

- Steps towards ensuring political justice and attaining global distributive justice
- **Inclusiveness, participation and alternative forms of power with developing countries**
- Refer Martin Hearson, Rasmus Corlin Christensen & Tovony Randriamanalina (2022): Developing influence: the power of 'the rest' in global tax governance, Review of International Political Economy, DOI: 10.1080/09692290.2022.2039264
- **Ensuring Transparency**
- **Open letter to G20: OECD failure to deliver on G20 mandates**
- https://taxjustice.net/2022/11/15/open-letter-to-g20-oecd-failure-to-deliver-on-g20-mandates/

- **Capacity building for negotiation and renegotiation**
- UN Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (UN 2019) and the Platform for Collaboration on Tax’s “Toolkit on Tax Treaty Negotiations” (PCT 2021)
- At the regional level, bodies such as the African Tax Administration Forum (ATAF) and the Inter American Centre of Tax Administrations (CIAT) have invested in tools and training for their members in treaty negotiation
- **Availability of information and data**
- **Tax Treaties Explorer https://www.treaties.tax/en/**

- **Creating parallel narrative**
- ICRICT, Tax Justice Network TJN, ATAF

Shift in the balance of power?

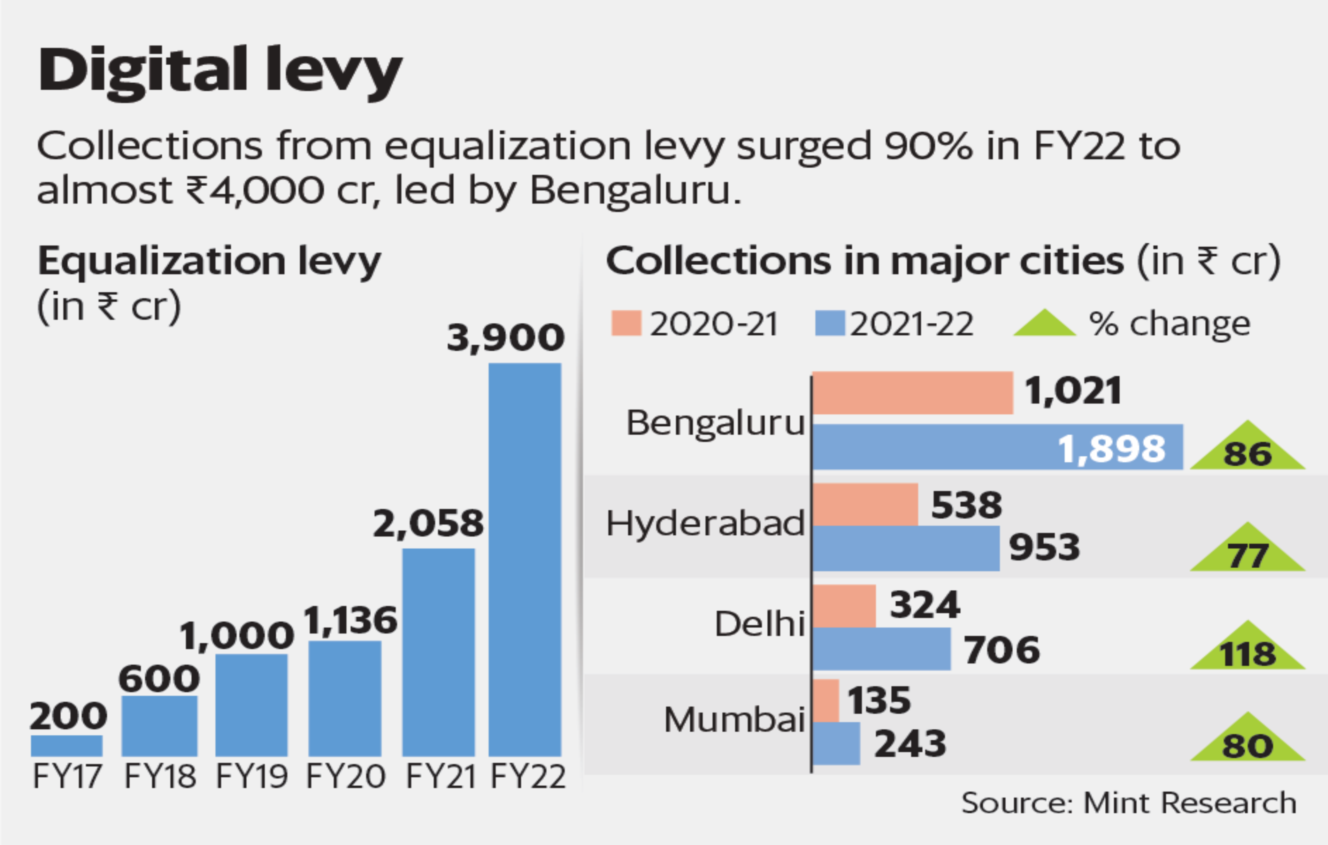
- 23rd Nov., 2022 UN General Assembly passed resolution that gives mandate to begin intergovernmental talks on tax.
- UN’s decision to take leadership on global tax affairs- creation of new global tax body – UN tax body
- Expectations – more inclusive and transparent
- Power struggle between new UN-backed Tax Organisation and OECD
- In the backdrop of 2 Pillar Approach stalled with increasing dissatisfaction about its content.

- Refining the question:
- Why developing countries are signing the treaties?
- What are they giving up ?

Unresolved Issues

- Empirical question - Do tax treaties increase investment in developing countries?
- In what circumstances might a tax treaty attract investment, and on what terms? Tax is not the only factor influencing investment decisions of companies such as labour costs, regulatory obligations, political stability
- Impact of FDI not necessarily unidimensional. That FDI brings economic development and economic infrastructure. Critical to question whether it is only the economic infrastructure that matters and not the social infrastructure- education, health, food security.
- Policy discourse should be qualifying the same
- Refer Hearson, Carreras and Custers 'Using New Data to Support Tax Treaty Negotiation' ICTD World Bank (2021)

Are Unilateral measures in form of DST yielding results?



- HM Revenue & Customs' (HMRC's) investigated implementation of the Digital Services Tax (DST) introduced in April 2020.
- Report dated 23rd Nov., 2022 was released.
- Most digital business groups who are paying the tax now pay more in DST than they do in Corporation Tax. Of the 18 groups paying DST, 13 paid more DST than Corporation Tax in 2020-21.
- HMRC collected 30% more revenue through DST than originally forecast for its first year, around 90% of which was paid by five business groups.

Tax Justice

- International Tax regime
- Not only about inclusion but also settling the norms
- fairness, justice and sustainablity
- The UN’s 2030 Agenda for Sustainable Development particularly its Goal 10 to “reduce inequality within and among countries

- India’s strategically positioned
- Can lead the way
- building capacity

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