William Morris
Chair, BIAC Tax Committee
13/15, Chaussée de la Muette, 75016 Paris
France

Submitted by email to: taxcollaborationplatform@worldbank.org

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BUSINESS AT OECD FEEDBACK ON PLATFORM FOR COLLABORATION ON TAX (PCT) DRAFT TOOLKIT ON TAX TREATY NEGOTIATIONS

Dear PCT Secretariat,

Business at OECD (BIAC) thanks the PCT for the opportunity to comment on the PCT's draft Toolkit on tax treaty negotiations, and specifically, the chance to consider whether the draft (i) effectively addresses relevant technical and practical considerations to build capacity for tax treaty negotiations in developing countries and (ii) provides all the resources and tools to enable that.

We believe work in this area is more necessary than ever, particularly given the growing importance of eliminating the risk of double taxation and ensuring the availability of bilateral dispute resolution in the context of the development of a global tax framework under the OECD's digital tax proposals, and increased international tax cooperation more generally.

Business at OECD looks forward to continuing to provide feedback into the PCT's draft Toolkits, as work continues on the Toolkit on tax treaty negotiations and on other policy issues of relevance to developing countries.

Sincerely,

Will Morris
Chair, BIAC Tax Committee

Comments

1. We welcome the PCT's work, at the request of the G20, to develop "Toolkits" to guide developing countries in their implementation of international taxation policy, including in the area of tax treaty negotiations that is the subject of the following comments.

2. The opening discussion in the document provides useful background on the role treaties play in encouraging cross-border trade, investment, and transfer of skills and technology; however, the discussion of these matters is quite short and may lead a reader to infer that there is more potential downside, and less upside, to negotiating a tax treaty.

3. We suggest that a more thorough background discussion regarding the total considerations involved in pursuing tax treaties may help countries approach treaty negotiations with a more balanced mindset. Indeed, perceived downsides or risks in the tax treaty negotiation process can be appropriately mitigated through a practical approach and increased resources, including by relying on the guidance in the Toolkit. It could also be noted that there is increasingly significant downside for countries that do not have a broad network of tax treaties, as this inhibits investor interest and dispute resolution. We think it would be useful to expand the opening discussion around these points, particularly given the vital role tax treaties play in preventing double taxation by providing for bilateral dispute resolution via mutual agreement clauses, especially those with binding arbitration.

4. For example, while credit or exemption systems might provide relief from double taxation, as is referenced on page 9 of the draft Toolkit, this only applies where the two tax authorities take an identical view on profit allocation. Where there is a mismatch and the tax authorities take a different view on profit allocation, tax treaties provide a mechanism to resolve the dispute through a bilateral process.

5. This need for bilateral dispute resolution will only increase as a result of the OECD's work to address the tax challenges arising from the digitalization of the economy, which the OECD itself has noted.[1] Likewise, the OECD has emphasized that rules designed in the context of this work will be implemented by changes to domestic law and tax treaties, which further highlights the importance of tax treaties to developing countries.[2]

6. In this respect, we note it would be helpful if the draft highlighted the potential need for tax administrations to develop internal resources skilled at understanding treaty provisions to ensure potential disputes with treaty partners are avoided in the first place. Likewise, it would be useful to include discussion of the administrative systems that might be required in response to increased investment resulting from executed tax treaties (e.g., cooperative compliance, MAP, international tax capacity building) and the assistance (e.g., ATAF/OECD/CIAT) that is available. Recognition also should be made that tax administrations

[1] https://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf (refer to paragraph 65, for example).
[2] http://www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf (refer to paragraph 6, for example).

will need to upskill in terms of understanding treaty provisions to make sure they are avoiding these potential disputes in the first place.

7. We also think it would be useful to frame the "revenue impact" of implementing tax treaties (page 8) also by reference to the positive impact from investment by having tax treaties in place. In this respect, it would be helpful to put discussion of certain treaty positions into context of their impact on investment. For example, investors often assess where to make investments based on whether countries have tax treaties in place that provide certain assurances, such mutual agreement provisions providing a mechanism to reach bilateral agreement through a pre-determined process. Likewise, while withholding tax is certainly important to the developing country tax base, high withholding tax rates often deter investment. It would be helpful if the draft framed discussion of withholding tax provisions (and whether to include provisions with a similar effect, such as offshore capital gains tax provisions) in tax treaties in the context of potential impact to investment. Discouraging investment could have negative secondary effects, such as on decreased corporate income tax revenues and local employment.[3]

8. In connection with this, we think it would be worthwhile to add to the discussion of treaty shopping on page 6 to clarify benefits associated with a wider network of tax treaties, such as ensuring a level playing field for investors regardless of their jurisdiction. As noted above, countries with tax treaties are often attractive to investors because of their preference to mitigate the risk of double taxation through access to dispute resolution procedures, including MAP, and to mitigate excessively high withholding tax rates. An expanded network of tax treaties reduces the systemic disadvantages facing investors from less developed countries or from countries that do not access a wide network of treaties. We think the draft could expand upon this, also highlighting that countries might prioritize jurisdictions with whom they wish to establish tax treaties based on level of trade and likely source of capital investment.

9. Further to this, on page 7 the Toolkit recommends that countries should focus on renegotiating problematic treaties rather than entering into new ones. This is somewhat simplistic, as there are a number of reasons why a country might prioritise new treaties with

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[3] See the following helpful research studies on these topics:
Effect of tax treaties on investment: "The Foreign Investments Effects of Tax Treaties," Oxford University Centre for Business Taxation (2014), https://www.eesc.europa.eu/resources/docs/2014-the-foreign-investment-effects-of-tax-treaties_oxford-univ-centre-for-business-taxation.pdf; Policy Framework for Investment User's Toolkit, Chapter 5: Tax Policy, OECD (2013), http://www.oecd.org/investment/toolkit/policyareas/41890309.pdf; "The impact of double taxation treaties on foreign direct investment: evidence from large dyadic panel data," Barthel, Fabian, Busse, Matthias and Neumayer, Eric (2010), Contemporary Economic Policy, 28 (3). pp. 366-377, available at http://eprints.lse.ac.uk/28823/.
Effect of withholding taxes on investment: Riedle, Michael, Withholding Tax Effects on the Investment Decision of Multinational Firms (March 1, 2016), available at https://ssrn.com/abstract=2759293.
Benefits of foreign direct investment: "The Impact of Investment Policy in a Changing Global Economy: A Review of the Literature," Roberto Echandi, Jana Krajcovicova, Christine Zhenwei Qiang, World Bank (2015), http://documents1.worldbank.org/curated/en/664491467994693599/pdf/WPS7437.pdf.

new or increasingly important trading partners. Adding new jurisdictions might offset the negative impact of existing treaties by providing more choice to investors.

10. We would also encourage having the Toolkit take a broader perspective on the risks of double taxation. In contrast to the draft language on page 6 of the Toolkit, investment can diminish in circumstances where there is even a perceived potential for double taxation, rather than only in cases where there is actual double taxation. Accordingly, this section would benefit from a more expansive acknowledgement that the threat of double taxation can be a hindrance to investment. It may in fact be the case that existing double taxation is low because investors elect not to invest at all because of anticipation of double taxation risks.

11. Another topic worth explaining in greater detail in the Toolkit is the Multilateral Instrument (MLI), which is specifically designed to allow jurisdictions to swiftly modify their bilateral tax treaties with other countries who have signed the MLI and also identified the relevant tax treaty as a Covered Tax Agreement (CTA). The MLI presents an attractive option to developing countries curious about potential downsides or time investment associated with tax treaty negotiations and could be discussed in this context.

12. Finally, and perhaps most fundamentally, we think it would be helpful if the Toolkit reiterated the importance of consulting with business and relevant industries when preparing for tax treaty negotiations with another country, as is appropriately reflected in the U.N. Manual for the Negotiation of Bilateral Tax Treaties (2019), para. 94.[4] The U.N. Manual highlights several benefits of consulting business, including obtaining business input on important issues in economic sectors or issues that should be taken into account in treaty negotiations, often based on real problems business has encountered or anticipates when engaging in cross-border activities. In this context, the Toolkit omits the U.N. Manual language that business may initiate the request for tax treaty negotiations between countries and also seems to remove certain references encouraging business involvement, replacing the term "business" with "relevant ministries and agencies."[5] In combination, these changes might leave an unintended impression that business input is not (or should not be) sought. We think it would be helpful, in this respect, to adhere more closely to the tone of the U.N. Manual, which highlights the important role business can serve in the context of tax treaty negotiation initiation and consultation. Indeed, active engagement of business before and during the treaty negotiation process can yield substantial insights and identify practical concerns that can be proactively addressed, benefitting all stakeholders (both private and public).

[4] https://www.un.org/esa/ffd/wp-content/uploads/2019/06/manual-bilateral-tax-treaties-update-2019.pdf.

[5] Compare U.N. Manual, para. 94 (stating that "[c]onsultation with business will, in most cases, provide the team with important information on economic sectors or issues that should be taken into account during the negotiations") with the draft Toolkit, page 13 (citing this same sentence buy replacing "business" with "relevant ministries and agencies").