IMF Revenue Mobilizations and Development Conference: Session on Business Taxation

Alan Carter (ITD)

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International Business Tax Issues

- Why are international tax issues important?
  - -Countries tax systems interconnected via treaty networks (directly and indirectly)
  - -Issues around who sets international tax norms and role of developing countries in developing these.
  - -Avoiding unintended consequences on investment.

Transfer pricing and the arm's length principle

- Multinational enterprises (MNEs) consisting of groups of associated companies or branches often conduct transactions with each other

- "Transfer pricing": prices in place for such transactions within MNEs

-Problems associated with transfer pricing:

- if MNEs conduct their intra-group transactions at prices that distort the allocation of income / expenses among associated enterprises (compared to normal market forces)
- not in accordance with the arm's length principle

- "Arm's length principle": conditions of commercial and financial transactions between associated enterprises should not differ from the conditions that would be made between independent enterprises

- Objectives:

- protecting countries against erosion of their tax base
- MNEs: certainty of treatment, reducing risk of double taxation

Treaties in international tax avoidance and evasion

- International standards on the arm's length principle:
  - OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("TP Guidelines")
  - UN Model Tax Conventions

- Also adopted by almost all countries in their Double Tax Conventions

- Supported by regional bodies and expert groups such as:
  - EU Joint Transfer Pricing Forum
  - Inter-American Centre of Tax Administrations (CIAT)
  - African Tax Administration Forum (ATAF)
  - Study Group on Asian Tax Administration and Research (SGATAR)

Alternative approaches in discussion, e.g. "global formulary apportionment"

Role of treaties and transfer pricing regulations

- It is important to note:

  - Transfer pricing regulations and their implementations directly affect the business environment in which cross-border trade and investment take place ;

  - A principled application of transfer pricing rules is in the mutual interest of business and countries;

  - Transfer pricing rules do not stand in the place of more general anti-avoidance rules, nor can they address issues of tax evasion of fraud;

  - Most countries back up their transfer pricing rules with other anti-abuse laws;

  - The effectiveness of transfer pricing rules in a country cannot be considered in isolation from other aspects of a country's tax administration, and standards of governance.

Practical difficulties in implementation

- Many developing countries report difficulties in effectively implementing transfer pricing rules:

  - In building tax administration expertise and experience in transfer pricing in order to carry out effective audits;

  - With applying rules that require taxpayer and tax administration discretion in application;

  - In obtaining information needed from taxpayers in order to select cases for audit or carry out an effective audit;

  - In obtaining public information on arm's length conditions (e.g. price and profit margins)

Initiatives to address these challenges

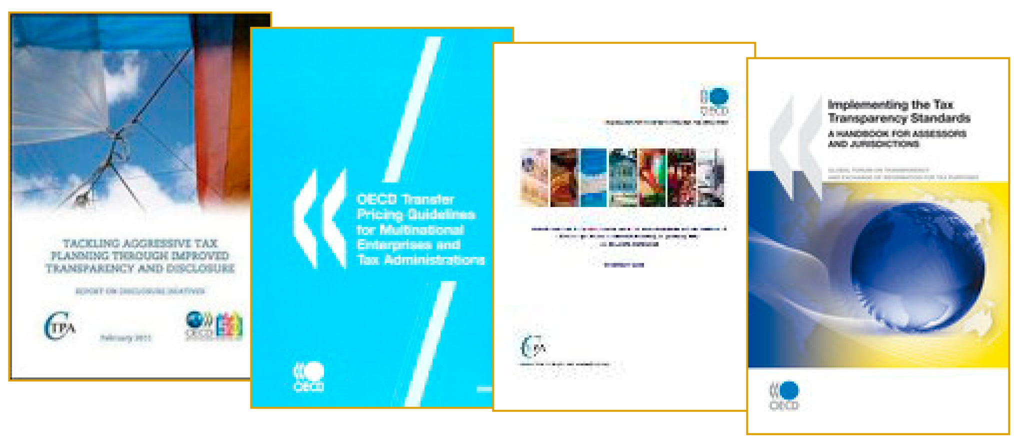
- There is very large demand from developing countries to adopt transfer pricing rules.

- Primary requirements relate to:
  - Domestic legislation (tax profit of MNEs operating in the country to be computed on arm's length terms)
  - Administrative structures
  - Supporting provisions (e.g. documentation requirements)
- Treaty network also important in the context of transfer pricing:
  - Provides access to exchange of information
  - Provides for mechanism for avoiding double taxation and gives business comfort that internationally accepted approach will be applied

Task Force on Transfer Pricing

- The Task Force is committed to improving the transfer pricing capability of developing countries:

- International panel of transfer pricing experts;
- Development of a transfer pricing diagnostic tool;
- Enhanced cooperation between IOs: focus on close and intensive work with a number of key countries;
- Development of guidance tailored to developing countries' needs.



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Concentration of tax avoidance/evasion

- Crisis-related losses in the financial sector are a source of risk
    - Report on "Addressing Tax Risks Involving Bank Losses" (September 2010)

- Large business and High net worth individuals pose particular challenges to tax administrations
    - "Compliance Management of Large Business Task Group"
    - "Study into the Role of Tax Intermediaries" (2008)

- Need for increased transparency and disclosure on the taxpayers' side
    - "Tackling Aggressive Tax Planning through Improved
    - "Transparency and Disclosure" (January 2010)

- There is an increased focus on tax avoidance overall not related to specific industries.

- Key issues:
    - Importance of timely, targeted and comprehensive information
    - Need to reach balance between good compliance and certainty

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Current Challenges

- Variety of challenges, technical and institutional:
  - How to deal with growth in importance of intangible assets which can be located anywhere?
  - Dispute settlement amongst RAs – businesses cannot themselves mediate such differences.
  - How to meet huge growth in demand for TA on international tax issues and relative priorities with domestic tax issues?
  - International institutional tax architecture and roles of IMF,WB,OECD,UN, ITD, regional development banks, regional tax organisations and other groupings (e.g. G20, FTA, Task Force on Tax and Development)