

# Tax Treaty Policy for Developing Countries



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Dialogue with Developing Countries on International Taxation

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For Asian Countries in Tokyo

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Views are author's alone and should not be attributed to the IMF, its Executive Boards, or its management

# Outline

- Overview of DTA network of Asian Countries
- Tax Policy Considerations when Developing Countries decide whether to enter tax treaty
- Tax Policy Consideration when Developing countries negotiate tax treaty
- Need for Regional Harmonization

# Context

- Best counter measure to treaty shopping is not concluding tax treaties
- Why Developing Countries need tax treaty policy ?
- The number of Double Taxation Agreements (DTAs) does not mean the MOF's capability
- How to strike a balance between protecting revenue and encouraging inbound investment.

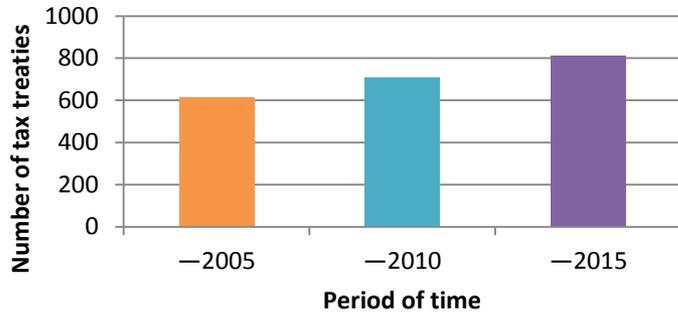
# Overview of Tax Treaty Network of Asian Countries

# Overview of Tax Treaty Network

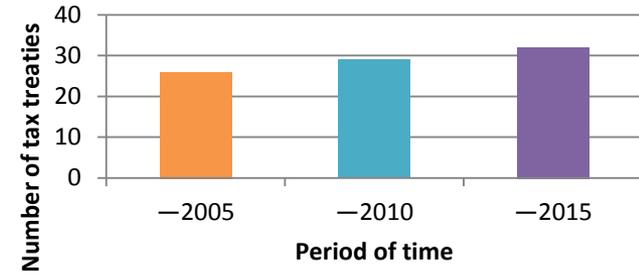
Tax Treaty Network of selected Asian countries as of March 2015						
	OECD members	Asian countries	Other regions	Total	TIES	Transport tax treaty
Bangladesh	17	12	3	32	0	1
Cambodia	0	0	0	0	0	0
China	33	35	35	103	10	20
Hong Kong	16	6	6	28	1	26
India	33	34	44	111	16	11
Indonesia	27	25	12	64	1	1
Lao	2	7	3	12	0	0
Malaysia	26	31	19	76	1	3
Mongolia	13	7	5	25	0	0
Myanmar	2	5	0	7	0	0
Nepal	2	7	1	10	0	0
Pakistan	22	27	13	62	0	4
Philippines	23	12	4	39	0	1
Singapore	30	17	29	76	1	9
Sri Lanka	18	18	6	42	0	4
Thailand	27	20	12	59	0	1
Vietnam	28	19	17	64	0	1

# Recent Trend (1)

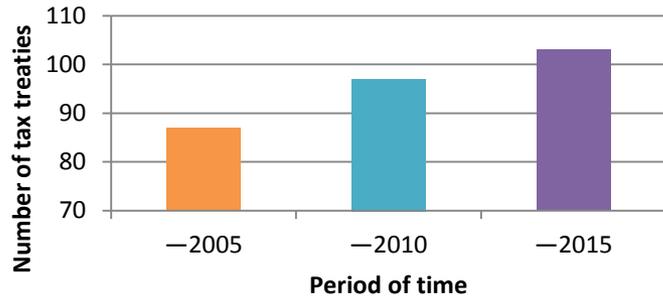
## Selected Asian countries



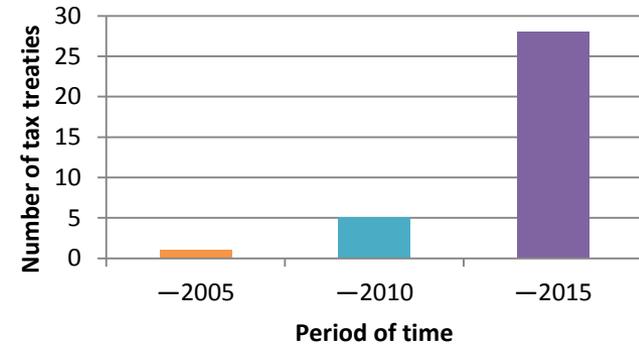
## Bangladesh



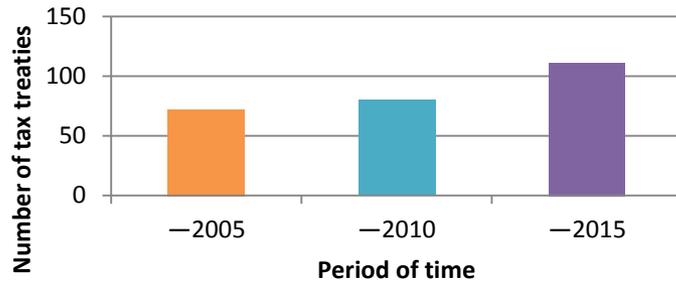
## China



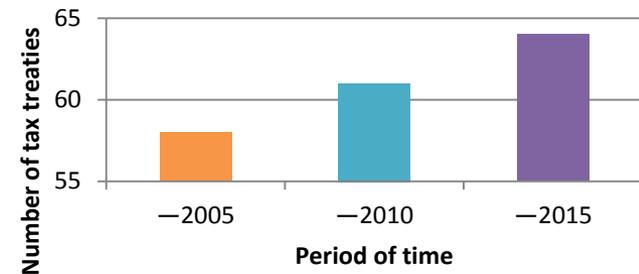
## Hong Kong



## India

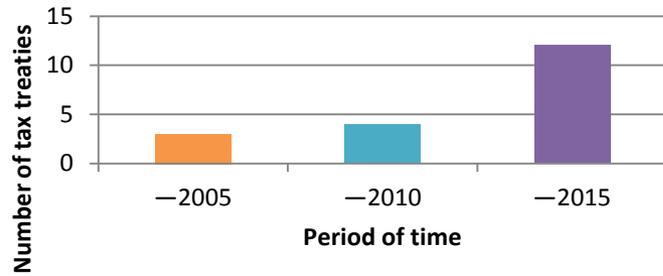


## Indonesia

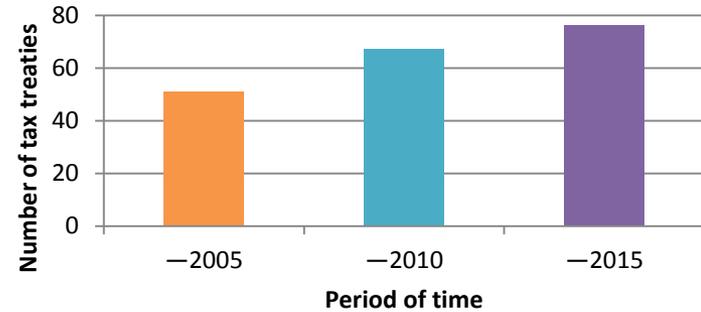


# Recent Trend (2)

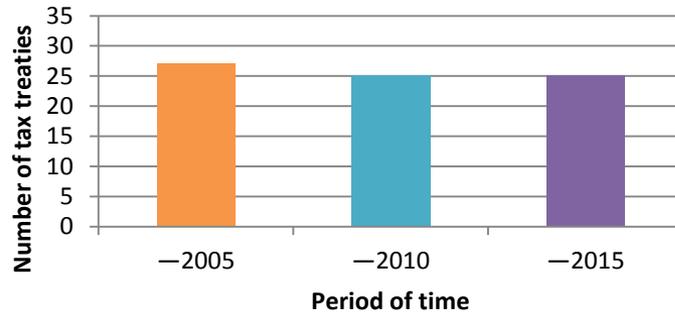
## Lao PDR



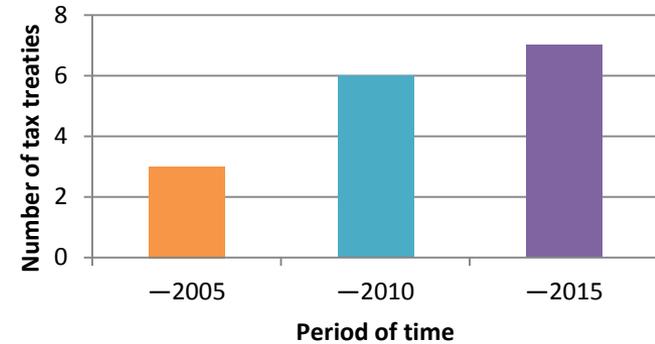
## Malaysia



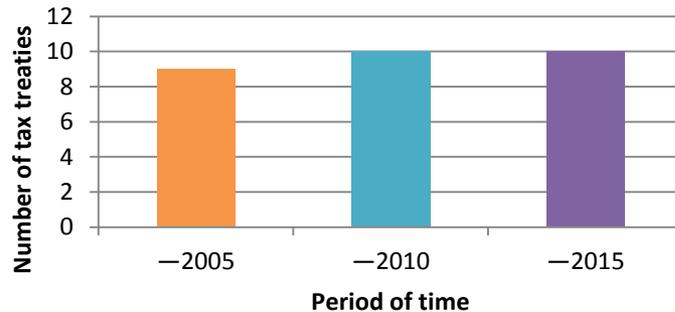
## Mongolia



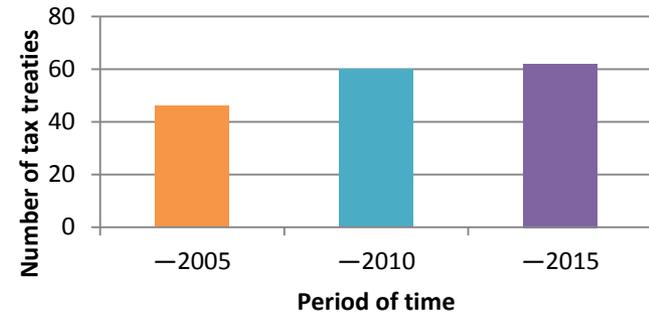
## Myanmar



## Nepal

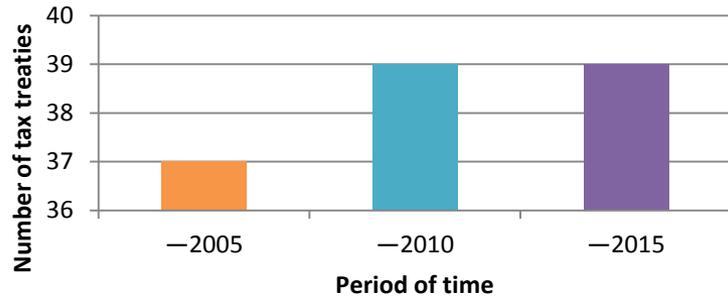


## Pakistan

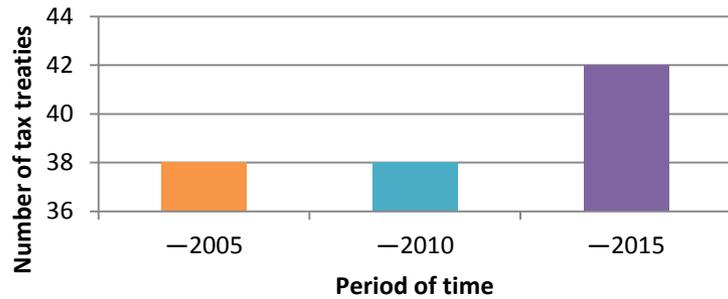


# Recent Trend (3)

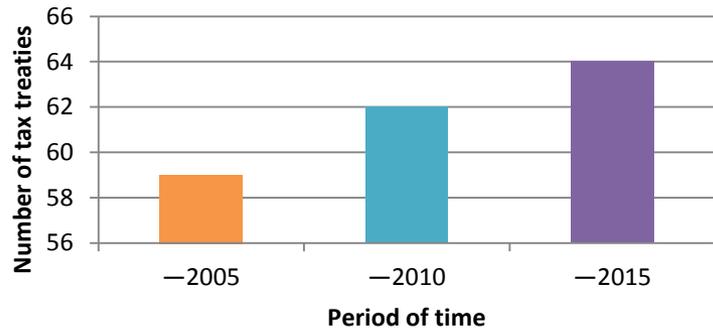
## Philippines



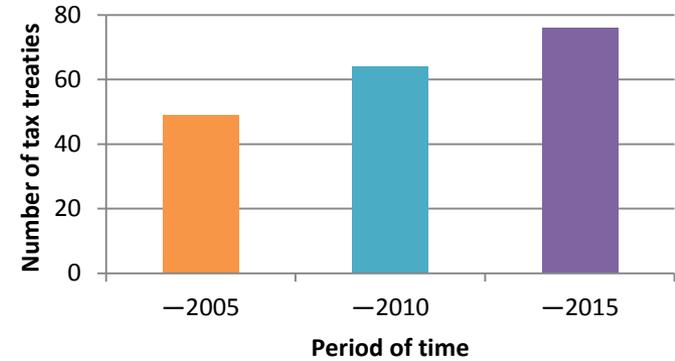
## Sri Lanka



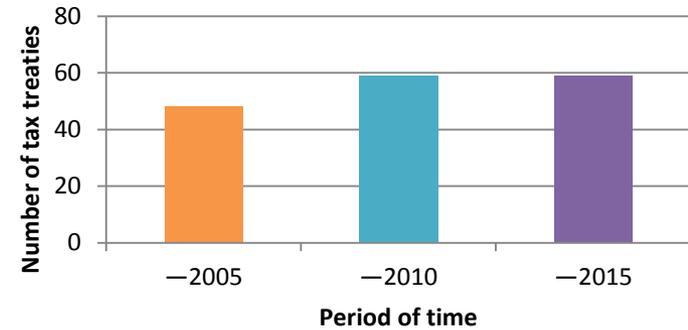
## Vietnam



## Singapore



## Thailand



**Tax Policy Considerations when Developing  
Countries decide whether to enter  
tax treaty negotiations**

# Risk of Double Taxation

- Main purpose of tax treaties = to avoid double taxation
- If no/ little double taxation => no/less need for tax treaties
- Rather, a DTA with tax haven/low tax jurisdictions is harmful => induce treaty abuse and tax avoidance
- A TIEA\*/MAC\*\* should be concluded

\*TIEA=Tax Information Exchange Agreement

\*\* MAC=Convention on Mutual Administrative Assistance in Tax Matters

# Treaty Shopping

- Development of anti-treaty shopping provisions/rules shows how innovative taxpayers/advisors have been.
- Many double non taxation cases could not be achieved without treaty shopping/abuse.
- BEPS Action Item 6 aims to address treaty shopping by: developing model treaty provisions and domestic rules to prevent the granting of treaty, clarifying that tax treaties are not intended to be used to generate double non-taxation, and identifying tax policy considerations that countries should consider before deciding to enter into a tax treaty with another country.
- UN paper, “Negotiation of Tax Treaties for Developing Countries” also addressed risk of treaty shopping.

# Unilateral Relief by Domestic Laws

- Double taxation can be alleviated by domestic laws, e.g., foreign tax credit, to some extent.
- For a capital importing country, little need for alleviating double taxation of its own residents.
- But, economic double taxation by transfer pricing adjustments can be most effectively solved by a DTA.
- With expansion of territorial system, a DTA is no longer necessary for tax sparing. The remaining worldwide country may not grant tax sparing.

# (Prospective) Economic Ties

- If economic ties are remote, an actual risk of double taxation is low.
- Will a DTA promote inbound investment?
  - Taxation is just one of many factors on which a MNE makes an investment decision
  - MAP and Non discrimination clause are important legal infrastructure, but not a decisive factor
- Need for administrative cooperation

# Do Tax Treaties encourage FDI ?

- Often seen as a principal reason to enter a DTA.
- But, much empirical evidence is mixed:
  - A key difficulty is causality: a country may enter a treaty only because significant investment expected.
  - A treaty includes provisions that encourage FDI and those that discourage FDI => may make predicted effect of treaty on FDI studies ambiguous.
- Overall, signs of strong investment effects are not overwhelming.

# Participants' Views on Primary Factors to consider when deciding whether to start negotiations

- Economic relationship
- Potential for growth in trade and investment.
- Scale of mutual investments
- Domestic tax laws of the other country
- Specific requests raised by own taxpayers
- Diplomatic relationship
- Need for exchange of information
- Incidence of double taxation
- Geographical proximity

# **Tax Policy Considerations when Developing Countries negotiate Tax Treaty**

# Domestic Laws

- Should a DC insist a taxation right under the treaty that cannot be exercised under domestic law or that cannot be collected in the ordinary course of tax administration?
- There would be case that a DC should preserve a taxing right in the treaty that cannot be exercised if the future law changes are anticipated.
- But, such a taxing right may be of little value to the DC and could be used as a bargaining chip.
- If a domestic law provides a final withholding tax as a mode of taxation for a certain type of investment income, net-based taxation in treaty will not work.

# Ability of Tax Administration

- It is unlikely for a DC to fully rely on detailed anti-treaty-shopping measures such as a detailed LOB provision. Deterrence effects of such measures would fade away soon unless a DC has capacity to apply the measures.
- Making a counterpart to accept LOB often requires efforts.
- For example, assistance in collection article requires legal and administrative ability to implement.
- It is often the case that field offices of revenue administration in DCs do not apply treaty benefits simply because officers do not know tax treaty or so not want to make a refund.

# Safeguard for securing cooperation from a treaty partner

- How to respond/counter if a treaty partner is uncooperative in implementing treaty obligation, e.g. EOI
- Terminating a DTA may not be an easy option
- Temporary reciprocal suspension of reduced source country taxation could be an option to make the treaty partner cooperative in administrative assistance and sit for a table for renegotiation.

# Need for Tax Treaty Policy

- Could be a combination of OECD Model, UN Model and own provisions. A deviation from the international models without legitimate reasons should be minimized to avoid difficult negotiations.
- Based on analysis of treaty's impacts on main source of revenue and areas of current or potential foreign investment areas, the tax treaty policy should include:
  - ✓ its preferred position (model treaty);
  - ✓ relative priority among preferred position;
  - ✓ fall-back positions and bottom lines.
- Most of participants' countries have tax treaty policy.

# **Need for Regional Harmonization**

# Common Model DTA

- A common model DTA for negotiations with a third-party country could underpin the harmonization of tax system in a regional economic community. Even if the community has a code of conduct on tax incentives/tax competition, a tax treaty could provide a preferential tax treatment.
- Intra-region Tax Treaty e.g. Intra-ASEAN Model Tax Convention (1987) should not exempt source country taxation if constituencies includes a low tax countries. Otherwise a low tax country may best enjoy benefits of the regional integration

# Joint Tax Treaty Negotiations

- Joint Tax Treaty Negotiations, which are negotiations of a bundle of bilateral tax treaties with a third-party country, by a joint negotiation team comprising members of a regional economic community.
- Merits:
  - ✓ Could encourage advanced countries to come to the negotiation table because they can expect to expand its tax treaty network in a more efficient way.
  - ✓ Could give members more bargaining power than they have in a one-to-one negotiation.
  - ✓ Could minimize a risk that differences in tax treaties and domestic taxation rules will be abused by multinational corporations.
- IMF is currently working with East African Community 23

# Reference

- OECD, “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances” (2014)
- Pickering, “Tax Treaty Policy Framework and Country Model”, Papers on Selected Topics in Negotiation of Tax Treaties for Developing Countries(2014), United Nations