# THE INTERESTS OF DEVELOPING COUNTRIES IN THE CONTEXT OF THE OECD/ G20 LED INTERNATIONAL INCOME TAX INITIATIVES

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**Abstract:** There has been growing concern about the erosion of sovereign country tax bases internationally.[1] This concern has been particularly prominent since the Global Financial Crisis (GFC). The below paper contextualises the OECD/ G20 tax initiatives and considers the issues that developing countries need to carefully consider in weighing up their commitment and support for these initiatives.[2]

**Key words:** International tax, tax and development, tax competition, legal complexity

## 1 FOCUS ON MULTINATIONALS AND THEIR STRUCTURES

The key area of concern that has attracted attention in respect of international taxation is the tax paid by corporate groups or multinational enterprises. It is thought that the use of complex structures and related transactions by these taxpayers allows them to avoid paying a fair amount of taxation in the countries in which they are actually carrying out their activities.[3] At the heart of this issue are problems in relation to transfer pricing on transactions between individual members of the corporate groups and their associates.

It has long been an issue that the different national tax laws of countries may allow opportunities for taxpayers to arbitrage and achieve beneficial outcomes. This issue actually has several dimensions. First, there are unintended gaps in the system created by the combination of the myriad substantive tax laws of sovereign nations together with the network of international treaties. These gaps can be exploited by taxpayers. Second, there can be a lack of information on what is happening in other countries that may allow taxpayers to mislead revenue authorities as to what has occurred overseas. Third, there are genuine differences in tax rates and tax treatment in different countries that are not unintended gaps but may still be arbitraged by taxpayers. Finally, there are genuine differences in tax treatment that have been specifically designed to attract business and investment to the specific country.

[1] US concern was originally shown in 2007 when a Report to the US Congress entitled "Earnings Stripping, Transfer Pricing and US Income Tax Treaties".

[2] An early version of this paper formed an unpublished private report to the United Nations.

[3] For a government response in Australia: https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Corporate_Tax_Avoidance.

## 2 IT IS NOT JUST ABOUT TAXPAYERS – STATES HAVE DIFFERENT INTERESTS

In addition to the above, it is not the case that transfer pricing and allocation of income issues are only about taxpayer arbitrage. Another issue of major significance is the allocation of income between countries even when the taxpayer has nothing to gain or lose in the allocation.[4]

For example, assume two countries have a comprehensive tax base and a rate of 30% and a subsidiary in one country is paying a royalty to its parent in the other country. In these circumstances, it makes no difference to the taxpayer group if the country where the subsidiary is based taxes the royalty as the parent country will tax any amount not taxed by the subsidiary country. The total tax between the two countries will be the same. However, it makes a difference to the countries as the subsidiary country gets the tax to the extent that it imposes it.[5] Therefore the two countries have an interest in the transfer price of the royalty. They also have an interest in whether the subsidiary country is able to tax the royalty under a Double Tax Agreement (DTA).

This later concern is reflected in the differences between the OECD Model Tax Convention and the UN Model Tax Convention.[6] The former seeks to prevent source country taxation of royalties paid while the latter allows such taxation. This issue is an example of the tensions between states that underpin international tax debates as states compete for tax revenue in relation to international transactions. This tension is not always acknowledged in the current debate.

## 3 FOCUS OF CURRENT DEBATE

Much of the focus in the current debate has been on the taxing rights of consumer countries as these have been seen to be reduced.[7] It is argued that technology allows the sale of products to consumers without triggering a tax liability in the consumer country.[8] This may be because the use of technology means that a permanent establishment can be avoidable. There is also the concern that artificial arrangements are avoiding a permanent establishment in consumer countries and thereby avoiding tax there.

### 3.1 OECD and G20 response and its origin

The OECD has reacted to the concern about international tax avoidance. Concern was originally heightened in 2007 when a Report to the US Congress entitled "Earnings Stripping, Transfer Pricing and US Income Tax Treaties". This report has been added to by further US initiatives and studies in

[4] Thus the double tax agreement between the United States and Australia was subject to lengthy negotiation despite both countries having high tax rates and comprehensive tax bases. This common situation shows that state to state economic interests are as much a part of Transfer pricing and Double Tax Agreements as the interests of taxpayers versus states.

[5] The less tax paid in the originating country, the more paid in the destination country.

[6] See introduction in: United Nations (2011) *United Nations Model Double Taxation Convention between Developed and Developing Countries* United Nations.

[7] An example of numerous media reports on Starbucks: LAUERMAN, J. Starbucks Paid 2.8% Effective U.K. Tax Last Year, FT Reports [online]. Available at <https://www.bloomberg.com/news/articles/2018-09-19/starbucks-paid-2-8-effective-u-k-tax-last-year-ft-reports>. [q. 2019-11-10].

[8] Google has attracted a lot of media attention in this respect: https://www.theguardian.com/technology/2019/jan/03/google-tax-haven-bermuda-netherlands.


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2010 and 2012 showing the tax incidence of multinationals and its relationship to transfer pricing and other strategies.

In 2014, the European Commission entered the debate by commencing investigations into the tax affairs of Apple, Starbucks, Fiat and Amazon. The Commission's work is ultimately limited to seeing whether the tax practices of certain countries constitute unjustifiable State Aid. However, the investigations themselves have added to the international concern. The publicised investigations and actions of the UK HMRC in relation to Amazon, Google and Starbucks since 2012 have also attracted significant international attention and concern. It has been strongly argued that they have not paid sufficient taxation in the UK.[9]

## 3.2 The OECD and worldwide tax generally

The OECD has had significant involvement in international tax co-ordination for decades. Most notably, it publishes a widely adopted model tax treaty with accompanying commentary which is being referred to more and more internationally.[10] There is no doubt that the OECD work has had worldwide influence in both developed and developing countries and it has increasingly been seen as a source of authority in international tax matters generally.[11]

At the same time, it is clear that OECD initiatives may place the interests of its developed member states first if these conflict with other states. The primary example of this is the preference given to residence state rights over source state rights in the OECD Model Tax Convention. Residence state rights will traditionally favour capital exporting countries.[12] The United Nation's Model Tax Convention explicitly counters this aspect of the OECD Model by increasing source state rights. Other than this, the UN Model is structurally very similar to the OECD Model.

## 3.3 The BEPS Project

In the context of the concerns about international taxation, the Los Cabos G20 Leaders' Summit tasked the OECD with working to tackle the problem in 2012. The problem was now named Base Erosion and Profit Shifting or BEPS. The 2013 OECD Ministerial Council Meeting adopted the Declaration on BEPS. Following this and a request of the G20 Finance Ministers, the BEPS action plan was launched and fully endorsed in September 2013.[13]

The action plan sets out to tackle a number of areas or actions as noted below:

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[9] Example of typical media attention: VERRENDER, I. Document reveals tax multinationals should pay [online]. Available at <http://www.abc.net.au/news/2015-05-04/verrender-document-reveals-tax-multinationals-should-pay/6441558>. [q. 2019-11-10], also BARFORD, V., HOLT, G. Google, Amazon, Starbucks: The rise of 'tax shaming' [online]. Available at <https://www.bbc.com/news/magazine-20560359>. [q. 2019-11-10].

[10] OECD (2017), *Model Tax Convention on Income and on Capital: Condensed Version 2017*. OECD Publishing, Paris, available at < https://doi.org/10.1787/mtc_cond-2017-en>. [q. 2019-11-10].

[11] COCKFIELD, A., J. The Rise of the OECD as Informal 'World Tax Organization' Through National Responses to E-Commerce Tax Challenges. In 8 Yale J.L. & Tech, 2006.

[12] For an early review of this issue see: IRISH, C., R. International Double Taxation Agreements and Income Taxation at Source. In The International and Comparative Law Quarterly, Vol. 23, No. 2 (Apr., 1974), pp. 292-316.

[13] OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.

- Addressing the challenges of the digital economy. This action is based upon the idea that the digital economy allows taxpayers to escape taxation in the countries in which they do business.[14]
- Neutralise the effect of hybrid mismatch.[15] The issue with this is that the different definitions of taxpayer and related issues can allow double non-taxation or multiple deductions for a single outlay due to the fact that different tax systems are not well reconciled with one another.
- Strengthen Controlled Foreign Company (CFC) rules.[16] CFC regimes return income to the parent company on an accruals basis prior to it being paid as a dividend. This allows it to be fully taxed in the home country.
- Limit base erosion via interest deductions and financial payments.[17] Payments of interest and related amounts can strip profits from a source country as the payments are usually fully deductible but only subject to a lower withholding tax in the hands of the recipient.
- Counter harmful tax practices taking into account transparency and substance.[18] This action point is premised on the idea that certain countries' tax regimes are harmful to others. The basis for this argument is that the incentive regimes in these countries are designed to facilitate the base erosion of other countries for the financial benefit of the first country. This action point looks at countering these practices, particularly when there is a lack of economic substance in what they encourage. The action point also seeks to generate information about the regimes to allow other countries to take counter measures.
- Prevent treaty abuse.[19] Treaty shopping is the idea that certain countries are used in international tax arrangements to simply take advantage of their treaties. Such treaty shopping is thought to be undesirable.
- Prevent artificial avoidance of permanent establishment status.[20] The PE rule is a well-established principle that does not allow a source country to tax business profits unless there is a PE in the country. The idea being that without a substantive presence in the country, taxation is undesirable. It is however thought that certain taxpayers who do effectively have a substantive presence have avoided having a PE in the country through particular practices.
- Assure transfer pricing outcomes are in line with value creation.[21] These three action points seek to tackle the use of intangibles to shift value to low tax jurisdictions. They plan to do this by assuring that the value associated with an intangible is located where it was created and not where the property is simply registered. The action points also deal with other aspects of the complex area of transfer pricing.
- Establish methodologies to collect and analyse data on BEPS and actions to address it.[22] This point is all about information gathering between countries and ways to analyse it.
- Require taxpayer disclosure of aggressive tax planning arrangements.[23] This point seeks to force disclosure of more information by taxpayers.

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[14] This is Action 1 see page 14, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.

[15] This is Action 2 see page 15, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.

[16] This is Action 3 see page 16, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.

[17] This is Action 4 see page 17, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.

[18] This is Action 5 see page 18, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.

[19] This is Action 6 see page 19, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.

[20] This is Action 7 see page 19, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.

[21] Transfer pricing is the subject of Actions 8, 9 and 10 see page 20, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.

[22] This is Action 11 see page 21, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.

[23] This is Action 12 see page 22, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.


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- Re-examine transfer pricing documentation.[24] This action will involve significantly more documentation including country by country reporting that will allow revenue authorities to see what has been done internationally.
- Make dispute resolution mechanisms more effective.[25] This is a reference to disputes that may arise between tax authorities in relation to a taxpayer as much as it is about a dispute between a taxpayer and a tax authority.
- Develop multilateral instrument to deal BEPS initiatives and modify bilateral treaties.[26] This initiative has already triggered a multilateral instruments that has been supported by many jurisdictions to some extent.

Since the 2013 there have been a number of other developments in the project. Most notably there has been very significant progress with the multilateral instrument that has not only been developed but signed and implemented by many states. In addition, the detailed actions reviewed above were finalised in 2015 and the OECD/G20 Inclusive Framework on BEPS was established in 2016. This Framework met in May 2019 in Paris and included 289 delegates from 99 member jurisdictions and 10 observer organisations.[27]

## 4 THE OECD MEMBERS, DEVELOPING COUNTRIES AND BEPS

OECD members and BEPS Associates have been heavily involved in working toward a consensus on the various action points of the OECD plan. The BEPS Associates are non-OECD members who are high growth economies. They include only two non-G20 countries being Columbia and Latvia. A further 18 countries have been involved in the detailed discussions since January 2015 according to the Australian government report.[28] The OECD reports a higher involvement.[29]

There has been a significant degree of consensus in relation to the desirability of the solutions to the problems highlighted in the action points. These cover a number of areas of tax law mismatch that create unintended tax opportunities such as multiple deductions for the same economic outlay as well as harmful tax practices and anti-treaty shopping. There is also a significant focus on transfer pricing to ensure that profits are genuinely allocated to the place of value creation. There is also a focus on mechanisms for gathering and sharing of information and the settlement of disputes.

The OECD has been careful to show that the work it is doing is being done with the involvement of developing countries and is also for their benefit. Their summary in the FAQ about 'Developing Countries' on their site is a good indication of this.[30]

The project was clearly initiated by wealthy developed countries in relation to concerns that they have. This has been outlined above. Most of the substantive input and practical work has also been done by these same countries. However, it is clear that the input of developing countries has also

[24] This is Action 13 see page 23, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.
[25] This is Action 14 see page 23, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.
[26] This is Action 15 see page 24, OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.
[27] OECD/G20 Inclusive Framework on BEPS Progress report July 2018 – May 2019.
[28] http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Corporate_Tax_Avoidance/Report%20part%201/c04.
[29] See: http://www.oecd.org/tax/developing-countries-and-beps.htm.
[30] See from paragraph 101: http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm.

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been sought and received. There has also been some attempt to articulate the particular concerns of developing countries.

The OECD has made it clear that BEPS is as much a problem for developing countries as it is for developed countries. This has been echoed by the contribution of developing countries to BEPS stating how they are impacted by BEPS. The OECD has also shown how its assistance with capacity building in developing countries has helped raise revenue and how it can assist revenue authorities in dealing with the challenges of the BEPS initiatives.[31]

## 5 ANALYSIS – WHAT'S AT STAKE FOR DEVELOPING COUNTRIES IN THE GREAT TAX DEBATE

### 5.1 The Common Ground

It is certainly true that developing countries can be significantly impacted in a negative manner by taxpayers who engage in BEPS. The concerns about the activities of multinational enterprises avoiding the payment of a reasonable amount of taxation in relation to their in substantive business activities in various countries is as real for developing as it is for OECD members.

Notably, countries in the Asia Pacific region that have attracted significant foreign investment in productive industries have long complained that they have been unable to ensure a sufficient taxation take in relation to the operations of foreign interests in their country.

This has been a notable concern in countries such as China and Vietnam where foreign operations continue to operate for extensive periods and yet have continued to report losses in relation to their operations in the country.[32]

Tax authorities in these countries have felt unable to ensure a reasonable amount of taxation is paid and have been unable to deal with the transfer pricing practices of foreign investors and foreign companies. Countries such as China have been investing significant efforts to help them deal with this form of base erosion with mixed results. Other countries may not have the resources even to make China's efforts.

It is for these reasons that transfer pricing has been highlighted as a major concern of developing countries in the context of BEPS.[33] At the same time it must be noted that these countries find that they are unable to deal with the administrative challenge of MNEs transfer pricing assertions. This is because they have limited resources.

### 5.2 Points of difference – the integrity of the base versus shifting the base

On the above basis, it is clear that the OECD assertion that developing countries are as much concerned about BEPS as developed countries is fair. However, there are some differences in the situation that are not necessarily clear on the face of this simple assertion.

[31] See: https://www.oecd.org/ctp/tax-global/developing-capacity-in-beps-and-transfer-pricing.pdf.

[32] LIN, B., LU, R., ZHANG, T. Tax-Induced Earnings Management in Emerging Markets: Evidence from China. In The Journal of the American Taxation Association, Vol. 34, No. 2, 2012), pp. 19 – 44.

[33] See: https://www.oecd.org/ctp/tax-global/developing-capacity-in-beps-and-transfer-pricing.pdf.


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The first point is that much of the concern in relation to the now notorious cases of Google, Amazon and Starbucks is concern from the perspective of the consumer nation. The public outrage has been largely based on the idea that these companies make large profits in developed consumer nations but pay very little tax in them.

This concern is actually different to the concern outlined above in relation to countries such as China and Vietnam where the activity being carried out in the country is more likely to be a physical productive process.

Noting this difference is critical as it highlights that while in broad terms the concerns are both labelled BEPS and transfer pricing, they are in fact different. The problem in the case of the developing countries is about administering effectively a tax base that is well established in international tax. The place of production has long been a place that is accorded the right to tax. While transfer pricing principles support this claim, these countries have found that they simply do not have the resources and capacity to enforce their tax claim or deal with the transfer pricing contentions of relatively powerful taxpayers.

In addition, if the relevant transfer pricing dispute involves two different countries' authorities, the lack of resources and capacity of the less developed country will also be a significant disadvantage in this same debate.

The concerns of the developed consumer nations in this area are actually quite different. The location of the customer has never been the basis for a significant income tax claim in international taxation. The conducting of a substantial sales effort in a country has allowed a tax claim on the basis that this sales effort means you are conducting part of your business in that country. This is, of course, linked to the location of the customer but it is not the same thing as the customer. Even when substantial sales activity has occurred in a country, this has only allowed part of the international profit to be taxed in that country.

Modern technology and communications have allowed more products and services to be provided to consumers without conducting sales activities in the country of the consumer. This has given rise to the phenomenon where it can be argued that a large amount of money is being made from the consumer country but very little tax is being collected in that country. However this conclusion is not as outrageous as it appears in the context of the above discussion.[34]

There may be some debate as to what constitutes conducting a sales activity in a country in view of modern technology. For example, is an online advertisement in the consumer country where it is viewed or not? However, notwithstanding this debate, it is clear that the providers of certain goods are simply not conducting business in the country where there consumers are.

In this light, at least some of the motivation behind the push for change in the BEPS process is to increase the income taxing rights of countries with large and valuable consumer populations.

## 5.3 Evaluating the push towards the consumer state

A push to change income taxation principles and increase the rights of the country that holds the consumer must be carefully evaluated from the perspective of the developing states.

As noted above there is always competition for taxation by the different states touched by international transactions. In international tax the source taxing right is generally allowed first before

[34] SHARKEY, N. Taxing at the source is fair in law, so why not in practice? [online]. Available at <https://theconversation.com/taxing-at-the-source-is-fair-in-law-so-why-not-in-practice-46597>. [q. 2019-11-10].

the residual claim. The latter is often residence but it might be a residual source component. Thus a company resident in country A may manufacture in Country B and the goods may be sold to consumers in Country C or back in Country A. Tax taken by a consumer state on the basis of 'source' will be tax that cannot be collected in country of production.

In this light, a change to enhance the taxing right in the consumer state may come at the cost of the revenue take in the production state. Given this, those states that are the 'factories of the world' should be conscious of the risks inherent in the current BEPS debate. As these countries are often developing, their voices may not be heard as well as they should be.

It should be noted that taxation in a consumer state is likely to impact the economic success of enterprises in the productive state when such states are not seeking to tax. This is because the consumer state taxation will increase the cost of their products to consumers or reduce profits margins.

Of course, not all developing countries are in this position and those with valuable consumer markets may share the concerns of the developed countries. China, for example, has a growing middle class consumer market.

## 6 COMPLEXITY AS A CORE PROBLEM FOR THOSE WITH FEW RESOURCES

Returning to the BEPS related concerns of developing countries, the issue of tax complexity needs serious consideration.[35] Above it was noted that developing countries do have concerns over BEPS even though they are not identical to those of developed countries.

In the case of developing countries, the concerns around transfer pricing are significantly based upon their ability to technically deal with complex transfer pricing rules. This is because they do not have the technical expertise and wider capacity to enforce transfer pricing rules correctly.

In addition, by their nature, transfer pricing positions are open to argument and contesting. Which broad method is most appropriate depends on a number of factors. Which comparables are available and which are appropriate creates difficulty. The typification of the nature of the local enterprise is arguable and subject to available information and arguments.

While the challenges exist for all revenue authorities and taxpayers, there is no doubt that in areas of high complexity and specialist knowledge, the contest is always in favour of those with more expertise, more data and more resources generally. A small company in a transfer pricing argument with the IRS of the United States is in a much weaker position in arguing its case successfully than a multinational is against the revenue authority of a developing country.

While there is merit in the position that transfer pricing is neutral, it is actually something that is significantly and inherently open to argument and dispute. Disputes favour the well-resourced and, as noted above, disputes in the area may be effectively between states as much as between states and taxpayers.

In this context, the BEPS project led by the OECD also needs to be carefully evaluated by the developing world.

The initiatives being pursued to gather more information and have country by country reporting etc., promise much to lesser resourced tax authorities of the region. If these initiatives provide

[35] See James, Simon, Sawyer, Adrian, Budak, Tamer (Eds.) (2016) *The Complexity of Tax Simplification* Palgrave.


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valuable information on the true nature of multinational enterprises' international activities, it may assist in determining proper transfer pricing allocations to these countries. Similarly, if foreign tax authorities are obliged by these initiatives to work with the developing countries tax authorities, it will also have positive results.

However, there are also significant risks in the process for developing countries. Most notably, it has already been shown that the inherent complexity of transfer pricing rules fuel disputes due to the contestable positions stakeholders can take. A number of the refinements to transfer pricing and wider international tax concepts that are being pursued through the BEPS project are highly complex and will simply make the problem faced by those with fewer resources worse.

Essentially a core problem faced by developing countries at present is their lack of capacity to deal with the complexity of the current rules. A number of the initiatives being pursued to 'improve' the current rules are actually adding to their complexity. When the problem is encapsulated as one of complexity, more complexity cannot be a solution.

The OECD has noted the issue that developing countries have with the complexity of the current rules and administrative capacity. They acknowledge the issue but suggest that the solution is raising capacity. This solution seems far less realistic than an alternative which would be to simplify the rules to allow ease of administration.

As a wider part of this issue, the developing world has to be cautious that the OECD project does not raise unreasonable expectations of what might be administratively feasible for the countries of the region.

The core problem is however that the system may ultimately benefit the better resourced taxpayers and countries in the international contest for tax revenue. It may also institutionalise a system of taxation that disadvantages the developing world and impugns on its sovereignty to depart from the prescribed methods of taxation.

## 7 TAX COMPETITION AND LOW RATES

A number of the actions of the OECD BEPS project seek to challenge the attraction of business, income and investment to particular states through their tax regimes. This may be through generally low tax rates such as those in Hong Kong or Singapore for example. It may also be through specially designed incentives that seek to attract particular investment or business. This is a complex issue with significant consequences that should be considered very carefully by developing countries.

The debate around tax havens, low tax jurisdictions and incentives has never been clear cut.[36] On the one hand, it can be argued that countries that seek to be tax havens are bad and that the world should work towards neutralising their impact. The argument is that these countries or regimes simply exploit a weakness in other countries' tax laws in order that they may make some revenue out of fees, minor taxes or the creation of some local work.

Ways that the impact of these regimes is neutralised include: through CFC rules, more sophisticated transfer pricing rules, general anti-avoidance rules, anti-treaty shopping rules and similar methods.

[36] John Douglas Wilson, Theories of Tax Competition *National Tax Journal* Vol. 52, No. 2 (June, 1999), pp. 269 – 304 (36 pages).

On the other hand is the argument that it is perfectly reasonable that countries may seek to competitively attract international capital and business by offering the most desirable location and one key factor is a good tax environment with low rates.

The argument is that if a state like Singapore can attract international business and capital through its excellent resources and low tax rates, then why should it not. In addition, if such a state seeks to give up higher amounts of taxation to make itself attractive, why should other states be allowed to take measures to neutralise the benefit of the competitive tax regime. Indeed, why should other states be allowed to pick up the tax foregone by a state such as Singapore in acting competitively, they would never have had this tax in the first place.

While certain practices of certain states may be more readily typified as negative or positive, the reality is that in most cases it is not clear and highly debatable. Regimes that rely upon deception and secrecy are readily typified in a negative manner. Those which allow the diversion of significant profits on next to no substance are also more easily typified in a negative sense. However, the vast majority of cases are hard to typify.

Ultimately, all countries operate tax systems that are designed to be competitive and attract desirable capital and investment. This is the case even with large developed states.

The nature of many new industries and financial factors means that it is significantly easier for many types of capital and investment to be moved to attractive tax locations. For example an online business may be able to be located anywhere in the world and have little need for a number of state infrastructure and other resource features. For this reason more and more business and capital may be located in states where it has been attracted by low tax features and special regimes. This factor has played a large part in the uproar that resulted in the BEPS initiative.

## 8 POTENTIAL IMPACTS DEVELOPING COUNTRIES SHOULD CONSIDER IN THE TAX COMPETITION CONTEXT

In the context of these debates and initiatives, developing countries should be careful of the risks and benefits possible. Clearly the OECD project has the potential to harm the economies of states that have an economic strategy that involves offering low tax rates and/ or incentives. If the BEPS project introduces wide ranging measures that neutralise these regimes or transfer the foregone tax to developed countries, they will be significantly impacted.

The discourse on the issue has tended to suggest that where there is economic substance to the activities etc. located in the low tax state, it will not be targeted by the measures. However, the extent that this is true and the manner in which it will be determined means that the project may never the less significantly impact these states.

This issue may impact not only countries such as Singapore that operate as financial centres but also other countries that offer notable incentives for particular capital and business.

The substance arguments may on the other hand favour certain low tax jurisdictions while damaging those that are less established. For example there may be a transfer of capital to Singapore from a state such as Mauritius. These outcomes will be difficult to determine and merit the utmost attention of developing countries.


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On the other hand it may be argued that many developing states have been disadvantaged by the regimes in place in low tax jurisdictions. For example, it may be asserted that China has suffered as much by low substance allocations of revenue to tax havens as the US has. In this respect this aspect of the BEPS project of the OECD should be seen as a positive development for these states.

Ultimately, it may be that few advantages result from this change in that income may still be allocated to low tax jurisdictions in a manner that complies with new norms such as the requirement for substance.

For example, the requirement that the income from intellectual property be allocated to where the value was developed rather than to where it is registered, may mean that the value creation business moves to a suitable low tax jurisdiction rather than the income reverts to a high tax jurisdiction.

In addition, low tax jurisdictions that do not comply may commence to comply and thus not lose business. It is already the case that professional advisers are developing strategies on how taxpayers can comply with BEPS. This does not involve the removal of low tax jurisdictions from their structures. Rather it involves using them in a manner that complies with anticipated BEPS requirements.

## 9 OTHER ASPECTS AND FINAL COMMENT

Other aspects of the OECD BEPS initiative involve states working more closely with one another and the reconciliation of unexpected 'gaps' in the international tax system. Such gaps being those associated with hybrids for example. The closing of these gaps is desirable for all states and should be supported. The working together of different states on tax matters is also something that is generally highly desirable and should be supported.

However, developing states need to be careful that working together does not involve the creation of international obligations that do not allow them to take care of their own specific interests in the competitive international tax environment.

These broad specific interests are:

The need to be able to tax in a simple manner that allows collection of tax revenue without significant contests over complying with international norms on issues such as transfer pricing.

The minimisation of administrative costs and capacity challenging expectations generally.

The allowance of sufficient value to be allocated to the productive processes that occur in the region rather than allowing it to be allocated to consumer states or residence states.

The ability to use low tax and incentive strategies to competitively attract investment and trade to the region as well as facilitate development and capacity building.

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