Improving international tax rules
Stop or try again?

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In recent decades, innovation, new technologies and globalisation have changed the way businesses are run. International trade has grown sharply. Many consider that international tax rules are not up to date with the realities of doing business in a globalised world. They are creating new challenges for national tax authorities all around the world.

As stated by Pascal Saint-Amans[1]: *"It is a watershed moment for international tax policy. The debate over tax evasion by the wealthy and tax avoidance by multinational corporations has never before grabbed so many headlines[2] or caused so much anger"[3].*

While the current hot tax topics emerged for governments over a decade ago[4], there has been political support for international tax coordination as from the end of 2000s.

Indeed, the financial and economic crisis has forced governments to struggle over the question of public and social spending, as well as to increase taxes and protect their tax base.

This article focuses on two main aspects of international tax coordination between governments: the increase in tax transparency and the update of international tax rules and consequences for taxpayers.

1 Director of the Centre for Tax Policy and Administration at the Organisation for Economic Co-operation and Development (OECD)
2 The media has scrutinised many 'tax affairs' all over the world. Recent tax events in many countries are one way or another in the spotlight of the international media
3 'Bringing International Tax Rules Into the 21st Century', Pascal Saint-Amans, article published on the website of the Huffington Post on 17 September 2013
4 For illustrative purposes, the OECD report 'Harmful Tax Competition: an Emerging Global Issue', 1998

Towards more tax transparency...

Since 2009, tax transparency has become widespread through the exchange of information. There are three different methods for exchanging information:

- **On demand:** a government may ask another government to provide information on a case-by-case basis
- **Automatic:** governments will automatically exchange the information agreed upon (e.g. income, frequency, format)
- **Spontaneous:** without prior request, a government must forward to another government information of which it has knowledge under a number of circumstances

In April 2009, the G20 declared that *"the era of bank secrecy was over"*[5]. Since then, the OECD standard of an exchange of information on demand has been implemented by many governments[6].

Currently more than 60 countries have signed the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, as amended in 2010 (over 20 countries signed during 2013)[7].

Furthermore, cooperation for the automatic exchange of information is expanding both at international and European levels[8] and is becoming the new norm when it comes to exchanging information between governments.

In this respect, the drafting of a new OECD standard on the automatic exchange of financial account information is under way. Under this OECD standard, governments will automatically exchange information obtained from their banks and financial institutions on an annual basis. The OECD is expected to deliver detailed commentaries on the new standard in September 2014.

5 'Tax is all about trust', Pascal Saint-Amans, release published on the OECD website
6 This is the case of Luxembourg, which negotiates double tax treaties including this OECD standard
7 On 29 May 2013, Luxembourg signed this multilateral tax convention
8 At the European level, the action being taken relates to the European Directives on Administrative Cooperation and Savings

As stated by Angel Gurría[9]: *"The commitment by so many countries and jurisdictions to implement the OECD's global standard on the basis of a specific and ambitious timetable is good news for everyone who wants to see a fair and transparent international tax system. The rapidity with which the new norms are being developed and agreed shows that the political momentum for reform is now overwhelming."* And he added: *"Adopting the new global standard is not just a question of establishing cooperation between states; it is also about restoring the trust of citizens in government[10]."*

On the basis of this trend toward global coordination among governments through the various forms of information exchange, national authorities will collect a huge amount of data on their taxpayers.

The exchange of information will generate significant reporting costs for financial institutions, taxpayers and governments. Nevertheless, the expectation is that governments will be able to assess taxes in a more straightforward manner and collect them with greater efficiency.

International agreements implementing the different methods of exchanging information always indicate that this international cooperation will respect the fundamental rights of taxpayers.

However, there is always the fear that this will not be necessarily the case in practice (e.g. fishing expedition issues, guarantees and information on taxpayers facing an exchange of information request).

Based on what has been accomplished so far, we are not sure that a proper balance between the need to exchange information between governments and the need to provide safeguards for taxpayers has been found.

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9 OECD Secretary-General
10 "Tax: OECD's Gurría welcomes international progress towards automatic exchange of information", release published on the OECD website, 24 March 2014

…and a revamp of international tax rules…

On an international level, the OECD has the political clout[11] to introduce measures in connection with base erosion and profit shifting (commonly known as BEPS).

But what is BEPS? It refers to aggressive *"tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low resulting in little or no overall corporate tax being paid"*[12].

For governments, the aim of the BEPS initiative is to redefine the boundaries of what is considered acceptable and legitimate for cross-border transactions.

As recently stated by Pascal Saint-Amans, *"What multinationals are doing is legal, and if it is legal but you do not like the outcome what you need to do is change the rules[13]."*

Indeed, *"the OECD has been providing solutions to tackle aggressive tax planning for years. The debate over BEPS has now reached the highest political levels in many OECD and non-OECD countries. The OECD does not see BEPS as a problem created by one or more specific companies. Apart from some cases of egregious abuses, the issue lies with the tax rules themselves. Business cannot be faulted for using the rules that governments have put in place. It is therefore governments' responsibility to revise the rules or introduce new rules"*[14].

The key issue is how to define 'aggressive tax planning'. To the best of our knowledge, there is no definition currently available. However, public opinion could agree with a kind of common public understanding of which situations would come under this notion. One could effectively have the feeling that something is wrong in certain situations, such as stateless income, double exemption, etc.

In July 2013, the OECD published its action plan on BEPS. This action plan sets forth the work that the OECD will do in 15 areas of international tax law and practice[15]. According to the OECD, these measures will result in *"fundamental changes to the international tax standards and are based on three core principles: coherence, substance and transparency"*[16].

The draft propositions currently on the table suggest that this is about more than simply combating *"aggressive tax planning"*.

One example relates to BEPS Action 6 *"The granting of treaty benefits in inappropriate circumstances"*. The OECD action plan identifies treaty abuse, in particular treaty shopping, which is viewed as one of the most important issues. The OECD released a discussion draft on 14 March 2014 on this subject, which is currently under discussion.

In a nutshell, the draft proposals on BEPS Action 6 are as follows:

- Limitation on benefits clause: a specific anti-abuse rule is proposed based on the limitation on benefit provision already included in many U.S. tax treaties. The rule is designed to limit treaty benefits to companies and individuals (not-for-profit organisations, pension funds and government bodies) with sufficient presence in the relevant country. The rule operates based on the legal nature, and general activities of residents of a treaty country
- General purpose rule: in addition to the limitation on benefits clause, the discussion draft proposes a broadly drafted general purpose rule aimed at removing treaty benefits from income where one of the main purposes of the arrangements or transaction was to obtain treaty benefits

One of the concerns with these wide-ranging proposals is the degree of uncertainty that will exist in applying them. Indeed, the general purpose rule will be very difficult to define and apply. This uncertainty will create practical issues for businesses seeking to understand whether the benefits of a treaty will apply to their transactions.

On a European level, the European Commission has pledged to support the BEPS initiative. The European Commission already provides recommendations to tackle aggressive tax planning. In this respect, it has proposed new provisions for the Parent-Subsidiaries Directive to limit double non-taxation situations in Europe. The European Commission's proposal would also oblige member states to adopt a more comprehensive, common anti-abuse rule adapted to the specifics of the Parent-Subsidiaries Directive. Nevertheless, the proposed amendment has a broader scope and creates uncertainty.

…but the proposals should not create uncertainty about tax rules

At the present time, although we do not know the outcome of the BEPS initiative (on which there have been many articles and discussions), we do know that the international tax rules will change.

Lawmakers should keep in mind that international tax rules are here to enhance international transactions and not to create unnecessary or disproportionate obstacles.

The rationale of international tax rules is to remove obstacles to the development of economic transactions and provide certainty to taxpayers in cross-border situations[17]. In order to achieve this, international tax rules should be clear, transparent and workable for taxpayers, as well as easy to administer for national tax authorities. Compliance costs to taxpayers should also be as low as possible.

The current proposals give the impression that the overloaded 'weapons' being prepared might prove to be an issue for international business and global transactions. To increase their respective tax revenues, governments could change the international tax rules in connection with the fight against tax evasion. However, such changes cannot restrict the exercise of fundamental freedoms of taxpayers, such as the freedom to conduct a business, unless the restrictions are justified, proportionate and well balanced.

The changes to international tax rules could be viewed as a creation of barriers and a return to state protectionism motivated purely by budget concerns (for which taxpayers are not necessarily responsible), as opposed to adequately fighting obvious abusive situations effectively on an international level.

The exchange of information will generate significant reporting costs for financial institutions, taxpayers and governments

11 The BEPS project is being driven by key OECD member countries (including France, Germany, the United Kingdom and United States) and is strongly endorsed by the G8 and G20
12 Frequently Asked Questions on BEPS published on the OECD website
13 Pascal Saint-Amans speech during the G20 finance ministers meeting in Sydney, 23 February 2014
14 Frequently Asked Questions on BEPS published on the OECD website: http://www.oecd.org/ctp/beps-frequentlyaskedquestions.html
15 The 15 areas include tax challenges of the digital economy; hybrid mismatch arrangements; controlled foreign corporation rules; deductibility of interest and other financial payments; harmful tax practices; treaty abuse; artificial avoidance of permanent establishment status; transfer pricing for intangibles; transfer pricing for risks and capital; transfer pricing for other high-risk transactions; analysis of data on BEPS and actions addressing it; disclosure of aggressive tax planning arrangements; transfer pricing documentation; effectiveness of treaty dispute mechanisms; and development of a multilateral instrument for amending bilateral tax treaties
16 According to the OECD, the expected outcomes could be:
- *Changes in double tax treaties and possible development of a multilateral tax instrument. The OECD has already developed a multilateral tax instrument through the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters (please refer below to developments in connection with exchanges of information).*
- *Recommendations on the design of domestic rules*
- *Changes in transfer pricing guidelines and recommendations*

17 'Model Tax Convention on Income and on Capital', *full version (as it read on 22 July 2010), page 12 (introduction section)*