INTERNATIONAL CO-OPERATION IN TAX MATTERS

Report of the Ad Hoc Group of Experts on International Co-operation in Tax Matters on the work of its First Meeting
INTERNATIONAL CO-OPERATION IN TAX MATTERS

Report of the *Ad Hoc* Group of Experts on International Co-operation in Tax Matters on the work of its First Meeting

UNITED NATIONS
New York, 1983
INTRODUCTION

A. Organization of the Ad Hoc Group of Experts

(1) Terms of reference

1. The object of the United Nations Model Double Taxation Convention between Developed and Developing Countries, 1/ prepared by the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries, is to encourage the conclusion of an increasing number of bilateral treaties for the avoidance of double taxation, with a view to promoting greater flows of foreign investment into developing countries in accordance with their national laws and regulations and in conformity with their national objectives and priorities. These treaties also normally contain provisions (notably for the exchange of information) for combating tax evasion and avoidance which may, if those provisions are absent or ineffective, reduce the beneficial effects of the treaties and have adverse budgetary consequences for the parties to such treaties, violate the principles of fiscal justice and distort international capital movements.

2. It was in the light of these considerations that the Economic and Social Council adopted resolution 1980/13, in which it recognized the importance of international co-operation to combat tax evasion and avoidance and urged the Ad Hoc Group of Experts to expedite its work with a view to working out, as soon as possible, proposals for such co-operation. In the same resolution, the Council approved the suggestion made in paragraph 52 of the Secretary-General's report on international taxation issues (E/1980/11 and Corr.1) that since the Ad Hoc Group of Experts had completed its work on the Model Convention, it should be given a broader title. In the resolution, the Ad Hoc Group of Experts was accordingly referred to by its new name, the Ad Hoc Group of Experts on International Co-operation in Tax Matters. Furthermore, in order to ensure a more equitable geographical representation within the Group, the Council in its decision 1980/155 decided to increase the membership of the renamed Ad Hoc Group of Experts from twenty to twenty-five. As in the case of the former Ad Hoc Group of Experts, the members of the renamed Ad Hoc Group of Experts were to be appointed by the Secretary-General on the nomination of Governments of selected States, but were to act in a personal capacity.

(2) Composition of the Ad Hoc Group of Experts

3. Pursuant to Council decision 1980/155 of 18 July 1980, the Secretary-General appointed twenty-four members of the Ad Hoc Group of Experts on the nomination of the Governments of the following States: Argentina, Austria, Brazil, Chile, Egypt, Finland, France, Germany, Federal Republic of, India, Indonesia, Israel, Jamaica, Japan, Mexico, Morocco, Netherlands, Nigeria, Pakistan, Spain, Switzerland, Syrian Arab Republic, United Kingdom of Great Britain and Northern Ireland, United Republic of Cameroon and United States of America.

4. The following members attended the first meeting of the Ad Hoc Group of Experts at the Palais des Nations at Geneva from 7 to 18 December 1981:
Antonio H. Figuero (Argentina), accompanied by Juan Sola; Alfred Philipp (Austria); Francisco O. N. Dornelles (Brazil), accompanied by José Otávio Dos Santos Pinto and Orvilo Edvino Pieto; André Titty (United Republic of Cameroon); Thomas Menck
(Federal Republic of Germany); Rainer Söderholm (Finland); Jean-François Court (France); R. R. Khosla (India); Sutadi Sukarya (Indonesia); Mayer Gabay (Israel), accompanied by Dov Neiger; Yasuyuki Kawahara (Japan); Alberto Navarro Rodriguez (Mexico); T. Dekker (Netherlands); I. O. Oni (Nigeria); Abdul Waheed (Pakistan), accompanied by Alvi Abdul Rahim; José Ramón Fernandez Perez (Spain); Daniel Luthi (Switzerland); Marwan Koudsi (Syrian Arab Republic); M. H. Collins (United Kingdom of Great Britain and Northern Ireland), accompanied by Margaret Hill; and Mordecai S. Feinberg (United States of America). The appointed members from Chile, Egypt, Jamaica and Morocco did not attend the meeting.

5. The meeting was attended by observers for two States Members of the United Nations: Savas Toprak (Turkey) and Francisco García Arjona (Venezuela); and for one non-Member State: Seung Man Yang and Kyung Soo Choi (Republic of Korea).

6. The meeting was also attended by observers for international and regional organizations and other institutions: Olav Snelligen (International Monetary Fund); J. C. L. Huiskamp and Maisto Guglielmo (International Fiscal Association); P. Crescenzi (Commission of the European Communities); Jean-Louis Lienard (Organisation for Economic Co-operation and Development); Alun Davies (International Chamber of Commerce); and Stanley S. Surrey (Harvard University).

7. The meeting was also attended by the following special guests: W. H. van den Berge (Netherlands), former member of the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries; and Gordon Nicholson and Francis J. Walsh, international tax specialists, partners of Arthur Anderson and Company, New York.

(3) Documentation

8. To facilitate the work of the Ad Hoc Group of Experts, a number of working papers were submitted to the Group.

B. Meeting of the Ad Hoc Group of Experts

1. Opening of the meeting

9. The meeting was opened on Monday, 7 December 1981, by P. N. Dhar, Assistant Secretary-General for Development, Research and Policy Analysis, Department of International Economic and Social Affairs, United Nations, who welcomed the members of the Group on behalf of the Secretary-General and who acted as temporary Chairman.

10. The Assistant Secretary-General observed that the ease and rapidity of communication, the progressive elimination of obstacles to the movement of persons and property and the growing internationalization of business relations, combined with differences between national tax systems and hence in the tax burden from country to country, and also with the growing sophistication of the techniques used to exploit loopholes in the tax laws, had led to an increase in tax evasion and tax avoidance which extended beyond national borders. Tax evasion and tax avoidance, whether at the national or the international level, violated the principle of fiscal equity which lay at the root of a democratic system of government, since those who could not evade or avoid taxation had to be taxed more to offset the revenue losses caused by those who managed to escape the tax net. Furthermore,
international tax evasion and tax avoidance distorted capital movements and conditions of competition and, more seriously, caused persistent budgetary losses. Few estimates concerning the extent of such losses were published, but impressionistic evidence suggested they were quite substantial in both developing and developed countries. The conclusion of an increasing number of bilateral agreements for the avoidance of double taxation, which had provided foreign investors with considerable tax relief, did not seem to have been accompanied by any significant decline in international tax evasion and tax avoidance.

11. After outlining briefly the history of international co-operation aimed at combating international tax evasion and tax avoidance, with particular emphasis on the work done under the auspices of the League of Nations, he said that such co-operation as currently existed was based largely on the exchange-of-information provision contained in the bilateral double taxation agreements concluded on the basis of the OECD Model Double Taxation Convention on Income and on Capital. That co-operation was, however, limited in scope and further work was being done under the auspices of the OECD Committee on Fiscal Affairs, relating in particular to the preparation of a model bilateral agreement on reciprocal administrative assistance for the collection of taxes, the tax problems in connection with transfer pricing policies, and tax evasion and tax avoidance techniques and the measures taken to combat them.

12. He noted that the work of the Ad Hoc Group of Experts would form part of the international efforts to combat tax evasion and tax avoidance, but stressed that it was important to avoid duplicating those efforts. He suggested, therefore, that, as in the case of the United Nations work on avoidance of double taxation, the Ad Hoc Group should take into account and build on the results already achieved in other forums, adapting them to the realities and requirements of developing as well as developed countries.

2. Election of officers

13. The meeting elected M. H. Collins (United Kingdom of Great Britain and Northern Ireland) as Chairman, Francisco O. N. Dornelles (Brazil) and R. R. Khosla (India) as Vice-Chairmen, and I. O. Oni (Nigeria) as Rapporteur. J. Pierre V. Benoit and Mark A. Roy of the United Nations Secretariat served as Secretary and Deputy Secretary of the Group.

3. Adoption of the Agenda

14. The Ad Hoc Group of Experts adopted the following substantive agenda for the first meeting:

(a) Question of an international forum for the discussion of issues and problems relating to direct taxation;

(b) Preliminary stages in the preparation of guidelines for international co-operation to combat international tax evasion and tax avoidance.
Chapter I

QUESTION OF AN INTERNATIONAL FORUM FOR THE DISCUSSION
OF ISSUES AND PROBLEMS RELATING TO DIRECT TAXATION

15. At its seventh meeting, held from 24 October to 4 November 1977, the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing countries reached a consensus on the usefulness of creating an international forum for the sharing of technical experience in the tax field and asked the Secretariat, in close co-operation with the competent intergovernmental organizations and the tax administrations in both developed and developing countries, to consider the possibility of undertaking the preparatory work for such a project. At its eighth meeting, held in December 1979, the Ad Hoc Group of Experts considered further the idea of creating such a forum, in the form of a proposal (ST/SG/AC.8/L.30) concerning the preparatory work for the establishment of a direct tax co-operation council, and asked the Secretariat to study the feasibility of establishing such a body. In submitting the proposal for consideration by the Economic and Social Council at its first regular session of 1980, the Secretary-General, in his report on international taxation issues (E/1980/11, para. 51), expressed the view that the proposal concerning the establishment of a direct tax co-operation council would be consistent with the current trend towards increased and closer international co-operation in the tax field. The Secretary-General stated that, taking into account the comments on the proposal made by the members of the Ad Hoc Group of Experts at the Eighth meeting, he would like to consult Governments and interested international organizations in order to ascertain their views on the possible functions to be performed by the proposed tax body and the possible institutional arrangements for such a body. In paragraph 3 of its resolution 1980/13, the Economic and Social Council approved, inter alia, paragraph 51 of the report of the Secretary-General on international taxation issues and, in paragraph 4 of the same resolution, the Council requested the Secretary-General to report to it at its second regular session of 1981 on his consultations with Governments and international organizations concerned regarding the desirability and feasibility of establishing a direct tax co-operation council.

16. In the report submitted pursuant to that request (E/1981/74), the Secretary-General stated that the replies received from Governments, from concerned organizations in the United Nations system and from intergovernmental and non-governmental organizations indicated that, while there was a consensus concerning the need for a forum in which selected international taxation issues could be discussed by both developed and developing countries, there were varying views about the specific functions and institutional framework of such a forum. Taking into account the replies received and in the light of budgetary and technical considerations, the Secretary-General suggested that the functions to be performed by the envisaged tax body should be entrusted to the Ad Hoc Group of Experts on International Co-operation in Tax Matters. In that context, he observed that many respondents had praised the performance of the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries; he expressed the belief that any additional functions assigned to the Ad Hoc Group of Experts on International Co-operation in Tax Matters would, as in the past, be performed with thoroughness, expertise and objectivity. After noting that the latter Group was scheduled to hold its first meeting in December 1981, he proposed that, if the Council agreed in principle with the suggestion that the Ad Hoc Group might be entrusted with additional functions related to direct tax-co-operation, the
Ad Hoc Group could be asked to consider the matter at that meeting and to make specific recommendations on the additional functions to be performed and the priorities to be accorded to them, the frequency of its meetings and other related matters.

17. At its second regular session of 1981, the Economic and Social Council, by its decision 1981/183, took note of the Secretary-General's report (E/1981/74), transmitted the suggestions contained in chapter III thereof to the Ad Hoc Group for its consideration and requested it to make specific proposals in that respect. The Council also requested the Secretary-General to report to it on the recommendations of the Ad Hoc Group at its first regular session of 1982.

18. The Ad Hoc Group considered the two basic questions raised in the suggestions of the Secretary-General, namely

(a) The question of the feasibility of entrusting to the Ad Hoc Group the functions that would have been performed by a direct tax co-operation body, had such a body been established;

(b) The additional functions to be performed by the Ad Hoc Group if it were to serve also as a direct tax co-operation body.

A. Views of the Ad Hoc Group concerning the feasibility of entrusting to it the functions that would have been performed by a direct tax co-operation body, had such a body been established

19. The Ad Hoc Group first considered whether in principle it wished to be entrusted with the functions of a direct tax co-operation body. There was a consensus that the Ad Hoc Group could usefully serve as a forum where issues related to direct tax co-operation could be discussed by developed and developing countries and appropriate policy suggestions formulated for possible application by Governments. The Ad Hoc Group would thus perform for both developed and developing countries a function analogous to that performed for a limited group of countries by the OECD Committee on Fiscal Affairs. Among other useful functions, the work of the Ad Hoc Group would supplement that of the OECD Committee, since it could inter alia, study the implications for developing countries of OECD findings and decisions and consider how they might be adapted to conditions in those countries.

B. Views of the Ad Hoc Group concerning the functions to be performed by it if it were to serve as a direct tax co-operation body

20. The Ad Hoc Group noted that Governments and international organizations had been invited to indicate, in order of decreasing priority, the functions which they considered might usefully be performed by a direct tax co-operation body. It also noted that in order to facilitate the preparation of their replies, the Governments and international organizations had been provided with the following list of functions, which was indicative but not exhaustive and had been formulated on the basis of proposals made and the views expressed at the seventh and eighth meetings of the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries:
(a) **Functions relating to the drawing up and implementation of tax treaties**

These functions might include, *inter alia*:

(i) Periodic review and updating of the United Nations Model Double Taxation Convention between Developed and Developing Countries;

(ii) Efforts to resolve issues left temporarily to bilateral negotiations in the United Nations Model Convention;

(iii) Periodic review of the problems arising in connection with the interpretation and implementation of bilateral tax treaties and provision of advice on means of solving such problems;

(iv) Facilitating the implementation of bilateral tax treaties by fostering exchanges of information and the uniform interpretation of bilateral tax treaties;

(v) Acting in a conciliatory capacity in disputes concerning the interpretation and implementation of bilateral tax treaties;

(b) **Functions relating to the harmonization of direct taxation procedures in the various countries with a view to enhancing the efficiency of tax administrations as regards the implementation of bilateral tax treaties**

These functions might include, *inter alia*:

(i) Continuous updating of taxation norms, definitions, classifications, rules, recommendations and guidelines;

(ii) Formulation of a common agreed classification and definition of taxes and similar levies and their base;

(iii) Formulation of a model tax code to regulate the substantive and procedural aspects of the relationship between taxpayers and tax authorities;

(iv) Study of the variations in tax policies and establishment of a basis for their eventual harmonization;

(v) Examination of the technical aspects of direct taxation systems with a view to proposing practical means of attaining the highest possible degree of harmonization;

(vi) Dissemination of information regarding direct tax procedures and provision of information and technical advice to member tax administrations;
(c) Functions relating to training and formal exchanges of experience

These functions might include inter alia:

(i) Drawing up training programmes and making arrangements for their implementation;

(ii) Setting up effective systems for the registration and identification of taxpayers for tax purposes;

(iii) Sharing of experiences regarding the efficient use of computers for tax purposes;

(iv) Facilitating the organization of meeting of tax administrators to enable them to exchange views and experience on the technical and other problems they encounter in detecting tax offences and abuses or making correct tax assessments.

21. The Ad Hoc Group noted further that the Secretary-General's analysis of the replies received from Governments and international organizations (E/1981/74) indicated that by and large they appeared to favour three different patterns of functions, namely, a comprehensive pattern, a gradually expanding pattern and a limited pattern. There was a consensus within the Ad Hoc Group that it should be entrusted with a specified limited pattern of functions, including many of the functions of the suggested direct tax co-operation body. That pattern of functions might subsequently be expanded in the light of changing needs and circumstances. There was also a consensus within the Group that, in defining that pattern of functions, some modifications and rearrangements would be necessary in the list of items set out in the Secretary-General's report.

22. The Ad Hoc Group had very much in mind that it was a continuation of the former Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries set up with a view to facilitating the conclusion of bilateral treaties for the relief of double taxation. It therefore regarded as an important part of its functions the continuation of the work of the predecessor Ad Hoc Group of Experts, and in particular the review of issues arising in connection with the United Nations Model Double Taxation Convention between Developed and Developing Countries. In the longer term, bearing in mind the need for stability in the Model Convention and for avoiding excessively frequent changes in its terms, the Ad Hoc Group also regarded the updating of the Model Convention as a proper part of its functions (subitem a (i)).

23. The Ad Hoc Group considered that a suitable opportunity it should be ready to make efforts to resolve issues which in the preparation of the United Nations Model Convention had been temporarily left to be settled in bilateral negotiations. The Ad Hoc Group nevertheless recognized that, since it had been impossible to settle those issues within the former Ad Hoc Group of Experts, even after several years of discussions, the possibility of settling them in the foreseeable future seemed to be remote (subitem a (ii)).

24. The Ad Hoc Group considered that it might appropriately undertake the task of considering issues which might arise concerning the interpretation of the articles of the United Nations Model Convention, although it would not advise on the interpretation and implementation of bilateral tax treaties (subitem a (iii)).
25. The Ad Hoc Group considered that an important part of its functions should be to facilitate the application of bilateral tax treaties and international co-operation in the prevention of tax evasion and tax avoidance by fostering exchanges of information, but it would not advise on the uniform interpretation of bilateral tax treaties (subitem a (iv)).

26. The Ad Hoc Group considered that disputes arising out of the interpretation and operation of bilateral tax treaties were essentially matters for the parties concerned and that, consequently, it should not act in a conciliatory capacity in such disputes (subitem a (v)).

27. The Ad Hoc Group considered that it might usefully deal with such questions as the classification of taxes and interpretation of tax terms, although it felt that such work should not be given great priority (subitem b (i) and b (ii)).

28. Similarly, the Ad Hoc Group considered that it might usefully examine the different ways in which national administrations deal with questions arising in relations between the tax administration and taxpayers, but felt that this topic should not receive high priority (subitem b (iii)).

29. The Ad Hoc Group considered that it might perform a useful function by serving as a forum in which information could be gathered and disseminated about the way in which fiscal matters were dealt with in other international organizations, the technical advice available in the fiscal field, such as that provided by various international organizations, and other related matters (subitem b (vi)).

30. The Ad Hoc Group did not consider that it could usefully attempt to harmonize tax policies or systems, since it regarded the possibility of achieving any such harmonization to be too remote for the foreseeable future.

31. The Ad Hoc Group considered that it could usefully serve as a forum for exchanges of experience concerning such matters as: the effectiveness of different kinds of training programmes for tax officials in different circumstances; (subitem c (i)); the effective use of different systems for the registration and identification of individuals for tax purposes (including, where appropriate, the use of computers) (subitems c (ii) and c (iii); the ways in which particular fiscal problems (including both administrative and technical problems) are approached in different countries and, in particular, ways of approaching the problems encountered in detecting and preventing tax abuses and offences against fiscal laws and, more generally, in making correct tax assessments (subitem c(iv)).

C. Views of the Ad Hoc Group concerning its possible future consolidated functions and methods of operation

1. Possible consolidated functions

32. If the Economic and Social Council should decide to entrust to the Ad Hoc Group certain functions initially proposed for a direct tax co-operation body, and agreed that the functions in question should be those selected by the Ad Hoc Group, which would be merged with its existing responsibilities, the Ad Hoc Group would be entrusted with the following consolidated functions:
(a) Functions related to tax evasion and tax avoidance

33. These functions might include facilitating international co-operation in the prevention of tax evasion and tax avoidance, and in dealing with transfer pricing and the allocation of income and expenses, inter alia, by the production of guidelines fostering exchanges of information.

(b) Functions related to tax treaties

34. Since among their general objectives, tax treaties include the full protection of taxpayers against double taxation, the promotion of investment, the removal of fiscal disincentives for the free flow of international trade and investment and the transfer of technology, the prevention of discrimination between taxpayers in the international field, and the provision of a reasonable measure of legal and fiscal certainty favouring the conduct of international transactions, the Ad Hoc Group's functions in relation to tax treaties would include:

(a) A continuing review and, when appropriate, updating of the United Nations Model Double Taxation Convention, covering for example:

(i) Matters that may arise which are not covered by the Model Convention or the commentary thereon;

(ii) Any changes which may be considered appropriate;

(iii) The resumption at an appropriate time of discussion of any issue which was left in the construction of the Model Convention to be settled in bilateral negotiations;

(iv) A continuing examination of the articles of the Model Convention and their operation and application. That would include a continuing examination of the operation of the articles in the Model Convention concerned with exchange of information and mutual agreement procedure (including the competent authority's activity) with a view to considering either improvements in their operation or the dissemination of general information about their operation.

(b) An examination, when appropriate, of the impact of the conclusion and operation of tax treaties with a view to assessing their effectiveness in improving the flow of investments, specially to developing countries, their efficacy in achieving their other objectives, and the extent to which they incorporated the exemption method and provisions concerning tax sparing.

(c) Continuing efforts to develop an understanding and knowledge of tax treaties.

(d) A continuing exchange of experience concerning, in general, the ways in which fiscal problems (including both administrative and technical) are approached in different countries and, in particular, those encountered in detecting and preventing tax abuses and offences against fiscal laws and others encountered in seeking to ensure the making of correct tax assessments. This exchange of experience might also cover experience in dealing with:
(i) The use of computers in tax administration;

(ii) Problems arising in achieving a satisfactory relationship between taxpayers and tax authorities;

(iii) The provision, effectiveness and results of, training programmes for tax officials in varying circumstances;

(iv) Problems encountered in devising and making effective use of different systems of registration and identification of individuals and enterprises for tax purposes. The Ad Hoc Group might also foster the exchange of experience by encouraging the organization of seminars and similar meetings, training programmes and so on.

(e) Acting as a forum for the dissemination of information about the work, and in particular the results of the work done, in the fiscal field by the United Nations and other international organizations, Governments and private institutions, and the technical assistance available to countries needing it in the fiscal field and other related and similar matters.

(c) Additional functions

35. These would include such additional functions as the Group might wish to assume from time to time in the area of tax relationships between countries and in particular between developed and developing countries, and in the area of assisting tax authorities in improving the effectiveness of their operations.

2. Possible methods of operation

36. The Ad Hoc Group of Experts would discharge these functions by acting:

(a) Through meetings of the Group as a whole, which should take place at least every two years, for a period of not more than one week on each occasion (the limitation to one week of the meetings of the Group as a whole is contingent on the use of a Steering Committee as noted below);

(b) Through meetings of a Steering Committee (held normally between the meetings of the full Group);

(c) Through meetings of Standing or Ad Hoc Working Parties of the Group selected for particular purposes;

(d) In such other ways as the Group may determine.

37. As part of its functions the Steering Committee would:

(a) Make a survey of the issues to be considered by the Ad Hoc Group and to indicate the priority to be given to those issues;

(b) Prepare the agenda for meetings of the Ad Hoc Group and submit the necessary material for consideration at the meetings;
(c) Request the Standing or Ad Hoc Working Parties of the Ad Hoc Group, if necessary, to prepare working papers on specific issues or to undertake other tasks, and to monitor the activities of the Standing or Ad Hoc Working Parties;

(d) Perform any other functions entrusted to it by the Ad Hoc Group.

38. The Ad Hoc Group or the Steering Committee may make suggestions as to the work which the Secretariat might do in support of the Group's activities, including the circulation of questionnaires.
Chapter II
PRELIMINARY STAGES IN THE PREPARATION OF GUIDELINES FOR
INTERNATIONAL CO-OPERATION TO COMBAT INTERNATIONAL TAX
EVASION AND AVOIDANCE

39. The Ad Hoc Group began its consideration of the preparation of guidelines for international co-operation to combat international tax evasion and avoidance by:

(a) Considering whether it would be possible or necessary to formulate an internationally acceptable definition of tax evasion and avoidance;

(b) Surveying briefly a range of methods used to evade and avoid taxes at the international level;

(c) Surveying briefly also the unilateral, bilateral and multilateral measures which are currently, or could be, used by Governments to combat international tax evasion and avoidance.

The discussions provided an opportunity for a general sharing of the experiences of a number of countries in identifying and dealing with cases of international tax evasion and tax avoidance and for informing the members of the Group and observers about the frequency of such cases and the degrees of concern felt about them in different countries. While these phenomena affect to some extent all countries which charge taxes on income, profits, capital transfers and capital gains, it is often tackled in different ways with different considerations in mind and the discussions showed that further work would be required before guidelines could be produced that would be widely accepted internationally. The discussions provided a very useful basis for mapping out, for the future discussions of the Group, the broad lines of a deeper exploration of tax evasion and avoidance and the ways in which international co-operation might be used for curbing such undesirable practices.

A. Consideration of an internationally acceptable definition of tax evasion and avoidance

40. The Group took note of certain other international discussions of this question and of the definition of tax evasion given in the United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries, which reads as follows:

"Tax evasion proper is considered to occur when non-compliance with the laws of the taxing jurisdiction is the result of a wilful and conscious failure to do so. In a broader sense tax evasion also normally encompasses the case of persons who as a result of carelessness of negligence fail to pay taxes which are legally due although they do not have resource to deliberate concealment for that purpose." 4/
41. The Group noted, in addition, the comment of the OECD Committee on Fiscal Affairs that "within tax evasion proper a distinction is sometimes made between the less serious offence of omission, e.g. failure to submit complete returns of income, and more serious offences, such as false declarations, fake invoices etc." 5/ The Group also noted the same Committee's further comment that "in most countries, 'tax evasion' is usually quite unequivocal, even though in a few countries, where the courts are prepared to take the view that the law is already broken if it can be shown that its spirit or the intention of the legislator is infringed, the distinction [between evasion and avoidance] may not be altogether meaningful". 6/

42. In the discussions the definition of tax evasion cited above from the United Nations Manual was considered useful, although the question whether failure to pay tax because of negligence would be regarded as evasion was thought by some members to be debatable. The point was made, however, that the difficulty consisted not so much in drawing the dividing line between tax evasion and tax avoidance, as in delimiting the scope of what is considered tax avoidance, since the treatment of tax avoidance tends to vary from country to country, depending not only on the forms of avoidance, but also on the attitudes of governments, parliaments, public opinion and the courts. In that connexion, the Group noted that the OECD Committee on Fiscal Affairs had commented that "a tax avoidance scheme would typically have the following characteristics:

(a) "Almost invariably there is present an element of artificiality or, to put this another way, the various arrangements involved in a scheme do not have business or economic aims as their primary purpose. However, it must be borne in mind that the growth of tax incentives to achieve economic and social policy aims (e.g. tax concessions for savings, home ownership, productive investment, research and development), itself leads to taxpayers arranging their affairs in ways that are different from those they would have adopted, if these tax incentives had not been available.

(b) "Secrecy may also be a feature of modern avoidance. In some cases tax advisers sell ready-made avoidance devices, one term of the contract of sale being that the taxpayer keeps the facts secret for as long as possible. It is in the interest of the avoiders to keep the administration from learning about new schemes because official and public knowledge may be followed by legislation to counter that kind of avoidance.

(c) "Tax avoidance often takes the form of taking advantage of loopholes in the law or of applying legal provisions for purposes for which they were not intended (e.g. provisions designed to encourage manufacturing of equipment being used for leasing of motor vehicles)." 7/

43. It was suggested in the course of the discussions that a very rough distinction between avoidance and evasion could be drawn on the lines that evasion was the use of illegal methods of reducing tax liability (for example, by the deliberate non-disclosure of information about taxable income or by claims of fictitious expenses) and that avoidance, on the other hand, was the use of methods to reduce tax liability which, although in themselves lawful, nevertheless would achieve their objective in circumstances where it would be the underlying intention of the tax law to charge tax (for example, arrangements which result in turning taxable income into non-taxable capital and which would not have been entered into for any purpose other than that of minimizing tax liability).
44. The Group did not, however, pursue the discussion to the point of agreement on any precise way of formulating the distinction between tax evasion and tax avoidance and came to the conclusion that although it would be useful to bear the broad distinction between the two in mind in the course of its further work, it was not necessary for its present purpose to formulate the distinction in precise terms. Nevertheless, there was a certain amount of agreement on the following diagnosis of the situation.

1. **Administrative aspect**

45. It was pointed out in the discussion that tax administrations concerned operationally with ascertaining and collecting the taxes due to the State under the national law of that State (subject possibly to the provisions of tax treaties). The main question for them is therefore whether or not tax is due under the law as it stands and whether the processes necessary to establish the liability can be carried out. Consequently, the first concern of a tax administration is with the line of demarcation between compliance and non-compliance, and as regards non-compliance it may be considered irrelevant whether a specific pattern of action by the taxpayer is classified as evasion or avoidance. This would still be true even where a State used very general provisions to draw the line between compliance and non-compliance (for example, by provisions in its law against abuses whose scope is defined in general terms). Where compliance with the letter of the law nevertheless produces results which conflict seriously with the spirit of that law, then the tax administration is confronted with the problem which is discussed in the next paragraph. But in either case it is clear that an appropriate international exchange of information designed to establish the facts may not only be very helpful, but may also be quite proper, some members thought, even in borderline cases where it seems probable that the taxpayer has in fact complied with the tax law. Moreover, it was observed that international co-operation could also greatly help taxpayers who, in their own view, have from the outset complied fully with the tax laws, but have sometimes had difficulty in producing evidence to rebut suspicions that may have arisen about their activities on the part of one or other of the tax administrations concerned.

2. **Policy aspect**

46. A tax administration may well find, however, that its country's tax law as it stands contains deficiencies which can be exploited by the creation of artificial arrangements or by the use, for purposes not intended by the draftsman, of reliefs and exemptions specifically provided in the law. By such means the taxpayer may obtain tax reliefs or advantages which conflict with the basic principles of the tax law or which give unjustified or inequitable tax privileges to a taxpayer who is able to exploit the situation. In addition, there may be serious losses of tax revenue. In such situations the law may have to be changed in order to restore justice and equity to the tax system and prevent the loss of revenue. This remedy can clearly take only a national form, but it was suggested during the discussion that the international exchange of experience and information might be of great help in enabling tax administrations to recognise the circumstances which produce such situations and to take timely measures to deal with them. It may also help to create an international consensus as to what sorts of situations are properly regarded as giving unjustified or inequitable tax advantages. The exchange of information may be of help to the makers of national tax policy.
3. Economic aspect

47. International economic activity requires for various reasons differing and often very complex arrangements. Enterprises may need to adopt particular patterns of commercial behaviour primarily for straightforward commercial reasons, but tax considerations, especially in these days of widespread high taxation, may also be of considerable importance. Tax reasons may therefore influence, as a matter of commercial prudence, the choice between particular patterns of commercial behaviour if the tax law either explicitly or implicitly offers a choice of methods producing different tax results. It was underlined in the discussions that tax administrations would therefore, quite properly, examine international transactions with a view to determining whether existing measures against abuse apply to them or whether new rules are necessary to deal with what is regarded as a new abuse. The approach will vary from country to country to some extent, and it was pointed out that this diversity creates an element of uncertainty for commercial enterprises in the international field. The comment was made that the danger that a specific pattern of international trade or investment may be regarded as unacceptable and as either within the application of existing rules against abuse or as properly the subject of new rules may possibly deter the parties from undertaking that trade or investment. Hence, it was argued, the achievement of a broad international consensus about what patterns of behaviour could be regarded as acceptable and what patterns would clearly be regarded as unacceptable might give some legitimate protection to enterprise operating internationally and tend to promote international trade and investment.

B. Devices used at the international level to evade or avoid taxes

48. The Group took a broad preliminary look at the techniques used at the international level to evade or avoid taxes. They surveyed them under a number of headings:

(a) Evasion and avoidance devices used by residents;
(b) Evasion and avoidance devices used by non-residents;
(c) Evasion and avoidance devices used by expatriate residents;
(d) Evasion and avoidance devices involving transfer pricing;
(e) Evasion and avoidance devices involving tax havens;
(f) Evasion and avoidance devices involving tax treaties.

It was recognizable, however, that there was often some overlap between these various categories.

1. Evasion and avoidance devices used by residents

49. The Group reviewed some of the more obvious tactics, techniques and devices used internationally by residents to evade or avoid taxes. (Some of these may also, of course be used in a purely domestic context.)
(a) **Evasion devices**

50. Among the evasion devices considered were the following:

(a) Failure to report items or sources of taxable income, gains or assets situated or derived from abroad (such as interest, dividends, commissions and kickbacks) or failure to report the full amount. (The discussion underlined the fact that it may be made easier to conceal these items where secret bank accounts, bearer securities, etc. can be used);

(b) Claims of deductions from income or gains for fictitious expenses supposedly incurred abroad, such as expenses which have not been incurred at all, or expenses, in computing business income, which have been incurred but not for the purposes of the trade (for example, for private purposes), or expenses which though incurred were incurred for smaller amounts - all of which claims might be supported by false vouchers, receipts, invoices, accounts or other fraudulent evidence;

(c) Claims of relief for foreign tax to which the taxpayer was not liable or other reliefs to which the taxpayer was not entitled;

(d) Failure to pay over to the tax authorities tax properly due, including tax deducted from payments to persons abroad;

(e) Flight to another country leaving tax unpaid, with no intention of returning to pay it, and leaving no assets against which payment of the tax debt can be enforced;

(f) **Over-invoicing** of imports;

(g) **Under-invoicing** of exports;

(h) Smuggling items of value out of the country so as to transfer income abroad before its existence can be detected;

(i) Falsification of accounts and other documents;

(j) Concealment of information about income and assets held abroad.

(b) **Avoidance devices**

51. It was recognized that avoidance techniques could take many and various forms, depending on national laws. Among the examples which the Group considered of activities which might, in appropriate circumstances be undertaken to avoid tax were:

(a) Transformation of income into capital or capital gains;

(b) Transformation of capital or capital gains into income;

(c) Transformation of receipts into interest-free or indefinite loans;
(d) Transfer of legal ownership of assets to non-taxable persons or to persons taxable at lower rates, while still retaining effective control of the assets or the power to enjoy the income from those assets (e.g. by using controlled or "base" companies established in a low tax country);

(The list is by no means exhaustive.)

(c) Remedies against evasion and avoidance devices used by residents

(i) Remedies at the domestic level

52. It was recognized that at the domestic level a major weapon against evasion was an efficient and effective tax administration capable of enforcing the tax laws strictly. It was suggested, however, that some additional assistance might be afforded by the adoption of measures aimed at improving the attitude of the taxpayer to his tax obligations and at making it easier for him to comply with the law (these would include, for example, the enactment of tax laws that are, as far as possible, clear and precise).

(ii) Remedies at the international level

53. It was generally felt that there was a crucial need for tax administrations, in dealing with both evasion and avoidance in the international field, to have access to relevant information about what was happening outside their domestic jurisdictions. Types of relevant information could include:

(a) Details of interest, dividends, commissions and kickbacks;

(b) Information about the other end of any relevant transaction (e.g. the price paid for goods sold and whether it was a market price);

(c) Details of bank accounts held outside the domestic jurisdiction (especially interest paid);

(d) Details of property owned outside the domestic jurisdiction;

(e) Details of relevant property transactions;

(f) Details of payments made abroad by foreign payers to residents of the country. (Again, the list is not exhaustive but contains what seemed, prima facie, to be the most important items).

54. Consequently, it was concluded, the exchange of information between tax authorities could be expected to be one of the most useful forms of international co-operation in ensuring the proper taxation of resident taxpayers (see paragraphs 106 to 114 on exchange of information).
2. Evasion and avoidance devices used by non-residents

55. The methods used by non-residents to reduce their taxes did not seem to the Group, in this preliminary examination, to fall easily into distinguishable categories of evasion and avoidance. Either or both may be involved, but it may not be easy to arrive at the correct tax liability of a non-resident even in cases where there is neither evasion nor avoidance. The Group did not, therefore, attempt at this stage to analyse the possible devices by using these categorisations.

(a) List of devices

56. The main forms of evasion and avoidance by non-residents seemed to the Group to be as follows:

(i) Allocation of head office expenses to branches and of parent company expenses to subsidiaries

57. The head office expenses allocated by non-resident entities to branches in another country might be arbitrary, or inflated, or not related to the activities of the branch. A similar case would be that where a non-resident parent company charges a resident subsidiary for expenditures incurred by the parent company.

(ii) Charges for technical assistance and services

58. For the purpose of apportioning expenses incurred by the head office or parent company in respect of technical assistance and services provided to a resident subsidiary, it is necessary to have some knowledge of the technology involved so as to be able to assess the nature and quantum of the assistance or services provided.

(iii) Misdescription of trading activities or income

59. Cases may occur where non-residents carrying on a trade through a permanent resident establishment seek to disguise or conceal the fact or to conceal the connexion between the income and the permanent establishment in question or to disguise the nature of the income so that it is not taxed as profits attributable to the permanent establishment. It may also happen that payments are made to non-residents for the right to use technology which, under the applicable domestic law should, as royalties, be paid subject to the deduction of withholding tax from the gross amount, and that these payments are disguised as general trading or business disbursements of a permanent establishment with the object of reducing the effective rate of tax borne on the net income by the non-resident recipient.

(iv) Turn-key projects

60. In package deals involving, for example, the provision of a complete factory by a non-resident in which the contract provides for the supply of plant and machinery, and the construction of the factory, together with the transfer of technology and know-how, it may be difficult to determine the proportion of the price to be allocated to trading activities carried on in the country of construction, and to determine the proportions to be allocated to the sale of tangible items and to the transfer of technology.
(v) Abuse of tax incentive reliefs

61. Where tax reliefs are provided to encourage industrial and other investment from abroad there may be scope for abuse by the failure on the part of a non-resident parent company to charge royalties and other fees to a resident entity benefiting from the incentive relief, with the possible consequence that the extent of profits world-wide is distorted.

(vi) Abuse of tax treaties - treaty shopping

62. Tax may be lost if enterprises route the profits arising from their activities and investment through affiliated enterprises in countries having a double taxation treaty simply in order to take advantage of favourable provisions in that treaty.

(vii) Failure to file returns etc.

63. Tax may be lost if a non-resident carrying on a taxable activity in a country does not comply with an obligation under its law to file a return or otherwise notify the tax authorities of his activities in that country.

(b) Remedies against evasion and avoidance devices used by non-residents

64. Among the remedies against avoidance and evasion by non-residents the Group discussed the following (tax treaty abuse is discussed in paragraphs 86-88 below).

(i) Exchange of information with other tax authorities

65. It was recognized that in this context, too, the exchange of information with other tax authorities could be of considerable assistance in ascertaining the facts, and some emphasis was laid on this in the discussion in relation, in particular, to the allocation of head office expenses.

(ii) The deemed expenses and deemed profit concept

66. It was pointed out that the tax authorities of some countries, particularly developing countries, might find it very difficult to investigate the accounts of non-residents in full detail or to assess adequately the results of such investigations or the information which might be provided in relation to them by other countries. Some countries therefore either totally disallow the deduction of certain kinds of expense or limit the amounts of allowable deductions to certain fixed ceilings or have deemed a fixed percentage of receipts to be the profit for tax purposes. Some members of the Group emphasized the practicability of this approach, but others pointed out that, while it provided simplicity and certainty, it could not be relied upon to provide the foundation for an internationally acceptable result and could therefore, they thought, hinder the flow of investment. Other members suggested that, with further experience and through increased exchanges of information between tax authorities dealing with such matters, it might be possible for this approach to give way gradually to a more accurate allocation of expenses and determination of profits, with a consequential favourable influence on the flow of international investment.
(iii) Extra-territorial audits

67. There was some discussion within the Group of various ways in which an audit might be carried out of head office of parent company expenditure and charges by or on behalf of the tax authorities of the country in which the relevant branch or subsidiary was situated. The methods considered included:

(a) Audit by the tax authorities of the country of residence of the head office or parent company, on behalf of the tax authorities of the country of the branch or subsidiary but without the participation of those authorities;

(b) Audit by the tax authorities of the country of residence of the head office or parent company with the participation of the tax authorities of the country of the branch or subsidiary; or audit by independent auditors employed by the latter tax authorities (or employed by the taxpayer with the agreement of those authorities);

(c) Audit by the tax authorities of the country of the branch or subsidiary carried out in the other country.

68. It was established that these techniques had been employed satisfactorily to a certain extent by some country, but a number of problems were mentioned. For example, if the tax authority of the country of the branch or subsidiary did not take part in the audit, it would still have to ensure that whoever undertook the audit on its behalf asked the right questions, and it would have to make its own judgment of the answers. Similarly, the tax authorities of the other country might face difficulties if they were called upon to undertake activities which would not be required for their own purposes, and in some countries an audit by or on behalf of a foreign tax authority would be regarded as an infringement of sovereignty.

69. Some members suggested, however, that most of the information needed to establish the proper allocation of head office or parent company expenses could be obtained by using the normal exchange-of-information provisions in a double taxation agreement.

(iv) Withholding of tax at source

70. By withholding tax at source from payments such as interest, royalties and salaries, it would be possible to ensure that at least some tax on these items was collected without undue difficulty. Some members pointed out, however, that broader economic or political considerations, such as the need to attract capital, might override the need to collect tax in this way in some circumstances.

3. Evasion or avoidance devices used by expatriate residents

71. The Group considered the use of these devices from two angles: first, the tax position in the home country of an individual normally resident therein who takes up residence in another country and works there for an enterprise resident in the home country; second, the tax position in the host country of an individual from another country employed in the host country by a non-resident enterprise.
(a) Position in the home country

72. Some members considered it necessary to ensure that an individual whose ordinary residence or normal residence or domicile is in the home country should not, unless the domestic laws or a convention for the relief of double taxation so provide, pay less tax when working for a domestic enterprise in a foreign country than he would pay on the same remuneration if working for the enterprise in the home country.

73. One means of achieving this result, it was suggested, might be to subject the employee to home country taxation and require the employing enterprise to deduct tax from remuneration at source as it would if the employee was working in the home country. Some members pointed out, however, that this method would give rise to double taxation if the other country also taxed the employee, and the resulting situation might thus need to be dealt with by a tax treaty between the two countries.

(b) Position in the host country

74. A number of members of the Group drew attention to the device of splitting remuneration. For example, an employee of a non-resident enterprise (or of the resident affiliate of the non-resident enterprise) may be in a position to split his remuneration for work done in the host country, receiving some of it outside that country and either perhaps claiming that the part so received was paid for work done outside the host country where this, if true, would exempt it from tax in that country, or simply failing to disclose that part of the remuneration to the host country's tax authorities. These splitting techniques may be used both by employees who are resident in the host country and by employees who are not resident there (short-term visiting employees, for example). Although in theory the device might come to light through a discrepancy between the amount of remuneration declared by the employee and the amount claimed as a expense by the employer, it would not be difficult for the expenditure to be disguised or the connexion between it and the employee's remuneration otherwise obscured. The result may be a serious reduction not only of the income tax payable in respect of the remuneration but also of the social security contributions payable by the employee or the employer if these are proportionate to the remuneration.

75. Some members pointed out that in dealing with such a case it would be necessary to consider how far the host country's right to tax the remuneration should extend, in which context it might be relevant to consider to what extent the work for which the remuneration was paid was carried out in the host country or for an entity in the host country. One participant suggested that some guidance for estimating the amount of remuneration appropriate to such work might be found by a comparison with remuneration paid for similar work by other similar enterprises.

76. It was suggested that an improvement in exchange of information between the tax authorities of the home country and host country could be of assistance in at least clarifying the relevant facts in particular cases.
4. Evasion and avoidance devices involving transfer pricing

(a) General considerations

77. The Group next considered ways in which tax authorities might seek to deal with the case of transfer pricing and the tax evasion or avoidance that might (but would not necessarily) result. As background the Group had before it not only the general papers prepared by its own present or past members, but also a more specific paper entitled "A corporate view of the United States experience with regard to transnational corporations" (ST/SG/AC.8/L.36), which had been contributed by an independent firm of accountants. Representatives of the firm of accountants also contributed to the Group's discussions on this as well as on other issues.

78. The Group noted that artificial transfer pricing might occur in relations between any enterprises which are subject to some degree of common control. In a multinational or transnational enterprise many transactions normally take place between members of the group or parts of the entity — sale of goods, the provision of services, licensing of patents and know-how, lending of funds etc. The prices charges for such transfers may not necessarily reflect the free play of market forces but may, for a variety of reasons and because the enterprise can, for its own internal purposes, adopt whatever pricing principles are convenient to it, diverge considerably from the prices which would have been agreed upon between unrelated parties engaged in the same or similar transactions in the open market. That is, they may diverge from what is generally described as the "arms's length price". Where this happens, most countries will seek to base their tax charge on some amount other than the profits as shown in the accounts. Many countries do this by adjusting to the arm's length price for tax purposes the actual transfer prices charged.

79. It was pointed out in the discussion, however, that a discrepancy between the "arm's length" price and the actual transfer price charged was not necessarily evidence of tax evasion or avoidance. Very often transfers took place in circumstances — e.g. where there were no comparable open market transactions — in which there could properly be some scope for argument about the approach that was necessary in arriving at the "arm's length" price. Moreover, it was observed, taxes on income or profits would not necessarily be the most important influence on pricing policy. Other factors also might well tend towards pricing policies based on arm's length prices.

80. Some participants in the discussion urged, therefore, that the Group should not start from the assumption that multinational enterprises would prima facie be engaged in artificial transfer pricing with the object of tax minimization.

81. The Group was, however, very conscious of the fact that there are circumstances in which transfer price that are not arm's length prices are deliberately used to evade, or at least to avoid, taxes. Because multinational or transnational enterprises operate in more than one country such artificial transfer prices can be used to exploit differences in tax rates and systems from one country to another. The various possibilities include:

(a) Setting up a subsidiary company in a tax haven to which transactions are booked at a low price from the country of manufacture and from which they are booked at a high price (or even an open market price) to the country of sale;
(b) Funding operations in a high tax country by way of loans so as to reduce profits in the high tax country by charging interest at higher than market rates;

(c) Paying management and service fees to an affiliate for activities which have not taken place or services which have not been provided, or for which the fees are above a fair market price;

(b) Situations creating a presumption of artificial transfer pricing

82. A number of situations were mentioned in which it would often be useful or necessary to investigate the transfer prices being used in order to establish whether or not artificial transfer pricing is taking place. One member observed that the existence of such situations did not necessarily mean that artificial transfer pricing was actually taking place. The situations mentioned included the following:

(a) Where the transfer prices adopted by a multinational enterprise in a country differ from those charged for comparable goods and services in transactions between unrelated parties in that country or elsewhere;

(b) Where the transfer prices adopted do not correspond with the amounts declared for customs purposes;

(c) Where the information provided by an entity to its home country’s tax authorities about the profits of foreign affiliates does not correspond with the particulars reported to the tax authorities of the countries in which they operate. (This difference may not always be easy to establish but it may be possible in some instances by using exchange-of-information provisions in tax treaties. It was pointed out in the discussion that, for example, all United States multinationals are required by law to file each year the income statements and balance sheets of all their foreign affiliates and a note of transactions with them);

(d) Where a parent company establishes a subsidiary or affiliate in a tax haven, or where a multinational group which is operating domestically has a subsidiary resident in a tax haven. (The concept of "tax haven" is discussed in paragraph 89 below.)

(e) Where a company transacts business with other companies in tax havens or in countries which operate tax shelter arrangements, such as exemptions or reliefs for export industries, exemptions or reliefs for holding companies etc.

(f) Where goods sold abroad are shipped to one destination but invoiced to another;

(g) Where royalties, discounts or commissions are paid to a foreign affiliate in a tax haven or where payments are made to such an affiliate for trademarks or for partly-finished goods.

This list is by no means exhaustive.
83. In order to bring the membership of the Group up to date on ways of dealing with artificial transfer pricing, it was considered useful to have some discussion of the basic techniques used by tax authorities to deal with such cases. It seemed that the most common approach was to seek to assess the profits arising from international transactions between affiliated enterprises on the basis of prices adjusted for tax purposes to the "arm's length" price. The Group was reminded that this principle, which is incorporated in articles 7 and 9 of the United Nations Model Double Taxation Convention, and elaborated in the Guidelines produced by the Expert Group and contained in the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries, is also incorporated in the OECD Model Double Taxation Convention, has been endorsed by a recent OECD report, and has been accepted in many double taxation treaties throughout the world.

84. The Group was also reminded of the three main methods used in calculating the arm's length price. Ideally, tax authorities would refer directly to prices charged in comparable transactions between independent enterprises or between the multinational concerned and unrelated parties. This method is usually known as the "comparable uncontrolled price" method. Even where comparable uncontrolled prices are available, adjustments may be necessary to account for such factors as shipping costs and differences in quantity or quality. In many cases, evidence of uncontrolled transactions which are genuinely comparable is not available or is difficult to interpret and other methods have to be used. In these circumstances the "cost plus" or "resale minus" methods may be relevant. The "cost plus" method takes the actual cost of providing the goods or services etc. and then adds whatever cost and profit mark-up are appropriate. The "resale minus" method starts from the final selling price and subtracts the cost and any appropriate profit mark-up. It was acknowledged in the discussions that the complexities of real-life business situations would often make it very difficult to apply any of these three theoretical approaches in their pure form, and that in practice it might be necessary to use a mixture of the methods, or other methods.

85. The discussion indicated that the problems arising in connexion with this approach, particularly for developing countries, are very closely related to the difficulties, noted earlier, of arriving at a satisfactory allocation of expenses incurred by a head office or parent company for services provided for the other constituent parts of the enterprise (and particularly for technological services such as research and development). Another important difficulty which was noted lies in the assessment of an appropriate royalty rate for the use of patents and know-how, and the relative ease with which such charges could be duplicated by inclusion in the price of goods (especially partly-finished goods) supplied to a subsidiary, or otherwise used to transfer profits artificially from one country to another. It was suggested that there was some artificiality in the assumption that a subsidiary company and its parent could be treated as acting independently and that it was therefore arguable that some broad division of the parent company's expenses might not be inappropriate for the purpose of allocating these expenses notwithstanding the well appreciated possible distortions of profit allocation which might result. The burden on the taxpayer of providing the necessary information for a sizeable number of tax authorities was emphasized by one member and the other difficulties inherent in adopting an essentially rough and ready method were commented on by other members. These questions, and the question whether it might be possible to accept for tax purposes cost-sharing arrangements made by the multinational enterprises themselves, and if so under what conditions, were left for further exploration.
86. Several members of the Group expressed the view that an important preliminary task in this context was to make some arrangements which would ensure that all members (and tax administrations generally) were given access to the national and international studies already made and the practical experience already gained, in the field of transfer pricing including, where possible without breach of confidentiality, examples of transfer price determination in actual cases. This information would cover, inter alia, details of the laws and methods adopted by countries with comprehensive experience in establishing arm’s length prices, and the studies prepared by international organizations – including the United Nations itself and OECD. It could then be considered whether at some later stage it would be appropriate for the Group to conduct its own more detailed study of this important subject in the light of individual members' experience of transfer pricing.

87. The Group noted that a range of detailed information might need to be exchanged in any specific transfer pricing case. The extent of the information needed would vary with the circumstances, but it might include, in relation to any particular multinational enterprise, information about the ownership and function of subsidiaries, the extent of the control exercisable over affiliates, the nature of that control, the nature of the trade relationships between affiliates, the prices of comparable goods and services, the cost of producing goods or services, the relevance of particular services to specific entities within the group and the effective use made of them by that entity, the ultimate selling price of goods, the extent of benefits derived by particular entities from central research and development activity and the general pricing policy of the enterprise. But the Group noted that, in order to ensure that tax authorities had sufficient know-how to deal with any transfer pricing adjustments necessary, the first need might be for background information rather than for specific details of transactions. Members of the Group mentioned in this context the possibility of making arrangements for assistance by one country's tax officials in the training of those of others in dealing with transfer pricing generally, exchanges of experience on the modes of operation of particular industries, discussions (possibly on a multilateral basis) of the structure and general background to the operation of individual multinational enterprises etc. Some members considered that all these exchanges and others, including exchanges in the course of simultaneous examinations, would be possible under provisions in double taxation conventions modelled on article 26 of the United Nations Model Convention.

88. The Group was also very much aware that it was of the essence of transfer pricing that adjustments of prices for tax purposes made by one country might have a direct effect on the tax chargeable by the other country (or countries) where the multinational enterprise operated, and that very sizeable sums could be involved. Some members suggested that, in order to smooth any potential difficulties, countries should be prepared to make good use of the facility provided for by the competent authorities, by virtue of provisions in their tax treaties on the lines of article 25, paragraph 4, of the United Nations Model, for communications with each other directly either, in relation to individual transfer pricing cases, on the initiative of the taxpayer, or more generally in cases where the need for a corresponding adjustment might arise (whether under the relevant equivalent of article 9, paragraph 2 of the Model or in some other way). It was noted also that, under provisions patterned on article 26 of the Model Convention, consultations could take place between tax authorities about the treatment of individual cases involving exchange of taxpayer information.
5. Evasion and avoidance devices involving tax havens

89. The Group explored the meaning of the term "tax haven" and the method by which tax haven countries could be used by taxpayers to evade or avoid the tax of other countries, and the remedies which might be available to those other countries to minimize such losses of revenue. The Group observed that "tax haven" was a relative term. It was pointed out that in general, in relation to any particular country, a tax haven might be defined as another country in which the tax burden on all income or on particular categories of income was substantially lower than in the first country. Thus, in relation to income taxes, the term could comprise countries with low tax rates on all income, or countries with low tax rates on income from foreign sources, or countries with low tax rates on income from specific types of business such as holding companies.

90. Commonly, however, the Group noted, the term "tax haven" was loosely used to describe countries which have a low or zero rate of tax on all or certain categories of income. But even so, it was not usually applied to all such countries. Applied literally, that definition would include many industrialized countries not generally considered to be tax havens, for example those which did not tax interest on the bank deposits of foreigners or of non-residents, and developing countries which granted specific tax incentives to promote the inflow of investment. It was recognized that although the general picture of a "tax haven" was clear, a totally satisfactory exclusive definition of the meaning of the term would be hard to formulate. Members commented that the low-tax or no-tax countries most commonly used as tax havens often combined their favourable tax régimes with strict protection of bank secrets, a good system of communication with the rest of the world and in many cases a sophisticated legal and financial infrastructure. Those countries tended also not to have tax treaties with other countries and thus had few, if any, channels for the exchange of information about taxpayers with other countries, and some of them forcefully advertised the facilities which they could offer to enable those who should be the taxpayers of other countries to minimize their liabilities to tax in those countries in one way or another.

91. It was observed, however, that the use of tax havens for evasion and avoidance arose in direct response to the high rates of tax charged elsewhere in the world. It was noted that such use was facilitated by the fact that the legal systems of most countries recognized a distinction between the individual and various kinds of corporate body, possessing a separate legal personality, in which the individual might have an interest. Many countries also recognized institutions of the "trust" type which might hold property under an obligation to apply it, or the income arising from it, to a particular purpose - although in many cases the trustees might be entitled to exercise a wide discretion in the matter. Those legal concepts, which enabled an individual, or indeed a corporation or trust, to be dissociated from the legal ownership of assets or income, while nevertheless maintaining in fact a degree of control over them which amounted to very much the same control as if they had retained the legal ownership, were often used as instruments of tax avoidance and even of evasion. But institutions such as subsidiary companies and discretionary trusts did, a member pointed out, serve important commercial and social needs as well as facilitating tax evasion and avoidance, and this factor, it was recognized, would have to be taken into account in reviewing possible remedies against abuse.
92. The Group's attention was also drawn to another important factor which often facilitated the use of tax havens for avoidance and evasion, that of the legal protection of the secrecy of bank accounts. It was pointed out that strict protection of bank secrecy is often a notable feature of the laws of countries generally regarded as tax havens. It was forcefully suggested that bank secrecy rules should be relaxed for tax authorities. It was also pointed out, however, that it was not improper that the secrecy of bank accounts and business activities etc. should be protected in general; while strictly maintained rules of bank secrecy might protect those who committed international tax or other offences, it was perfectly proper for the citizens of a country to take the view that their Government should be entitled to know about their affairs only the minimum necessary to operate the country's laws fairly and efficiently, and that their parliamentary representatives should reflect that view in their domestic law in a manner which, for example, limited the capacity of the Government to require information about taxpayers from third parties who held their assets or advised them in their transactions. Countries might have different views as to what constituted the minimum necessary to operate the tax laws, and some variation was unavoidable. On the other hand the point was made that it was also proper to permit inquiry by domestic tax authorities investigating evasion and avoidance; the problem was to decide in what circumstances such inquiry was legitimate, and it was compounded when the tax authorities involved were those of another country.

93. It was recalled that the evader typically concealed relevant information from tax authorities. If he or his assets or his activities were not within the borders of the taxing country, his statements or omissions were the less easily checked and his tax liability the less easily enforced. It was not necessary for the evader to use a tax haven for those types of operation, but, if he did, he saved himself the trouble of multiplying his evasions. Avoiders also profited from concealment and found tax havens useful for this purpose. The first and possibly the most important need of the tax authorities in these situations was the need for information.

94. It was pointed out that, other things being equal, it could be an advantage to a taxpayer to arrange for his income from non-domestic sources to go to a controlled company or trust under his dominion outside the tax jurisdiction of the country in which he was resident, so that this income featured in the computation of his tax liability only when it was distributed to him or his dependants in income form. Obviously, for arrangements of that sort to be of any considerable advantage to such a taxpayer he needed to set up his trust or controlled company in a tax haven. Companies or trusts of that sort might hold shares, bonds, patents, copyrights and other rights, leases, licences and other assets. In the case of companies, it would be usual for arrangements of this kind to involve the use of a controlled subsidiary resident in the tax haven country.

95. Where an individual derived his income from the exercise of a profession or the performance of personal services in a variety of different countries, he might seek to minimize his tax liability in his country of residence by ostensibly becoming the employee of a company resident in a tax haven which would pay him a small proportion of the income derived from his activities and would accumulate the rest for his ultimate benefit. Film actors, popular musicians, professional athletes and others have frequently adopted expedients of this kind, but engineers, lawyers, accountants, architects and others have had the same opportunities. Tax treaties based on the OECD and United Nations Models, however, often contain provisions designed to enable the competent tax authorities to counter this kind of abuse.
96. It was indicated, that problems could also arise in the case of lower-paid individuals whose labour in one country - for example, manual labour in the construction industry - was ostensibly hired out by employment agencies in another. The arrangement might be perfectly legal and above board, although the use of tax havens by the agencies might enable them to avoid tax on their commission other than tax withheld by the country of its source, and in certain circumstances the arrangements might enable double taxation agreements to be abused by the employees to avoid tax on their remuneration.

97. It was emphasized that one important way in which tax havens could be exploited for tax minimization was their use in combination with artificial transfer pricing by multinational or transnational enterprises, operating through controlled subsidiaries or base companies.

98. The discussions indicated that, while developed and developing countries alike viewed the phenomenon of tax haven abuse with concern, the abuse most troubling the developing countries at the current stage was probably the use of tax havens by their residents to conceal income and capital so as to evade tax, while the developed countries were greatly concerned in addition with their use by residents to defer and avoid tax liability on profits, income, capital gains and capital.

99. The Group noted that a number of developed countries had introduced domestic legislation to deal with the problem of the deferral of liability on corporate profits, by in effect making resident shareholders liable to tax on the undistributed profits of companies in which they had sizeable shareholdings and which were resident in tax havens. In general these rules did not go so far as to tax income from a trade genuinely carried on in another country, whether that country was a tax haven or not.

100. It seemed to some members of the Group that at the present stage such domestic remedies presented the main possibility of countering the use of tax havens for avoidance, but it was recognized that there was scope for mutual assistance internationally in the matter through the exchange of information. This exchange would probably, it was suggested, have to take place mainly between the countries affected by the avoidance rather than with the tax havens themselves, but the latter could be useful in helping to measure, for example, the amount of income passing through or retained in a tax haven.

101. A member from a developed country expressed the view that it might be useful to explore the possibility that some countries commonly thought of as tax havens might be willing to co-operate in minimizing the ways in which their freedom or relative freedom from tax could be abused by those seeking to avoid or evade the taxes of other countries. It was suggested that the majority of States would seek to refrain from introducing tax privileges which could be abused to evade the tax revenues of other States, and where their laws produced this effect unintentionally would be prepared to counteract it by exchanging information with the other States concerned under a double taxation agreement. It was suggested, therefore that it might be useful to seek to establish a generally observed principle of this sort.

102. In this context the Group noted that the Parliament of the Council of Europe had, in its 1978 Recommendation (No. 833) on co-operation among its member States against international tax avoidance and evasion, urged member States, inter alia, to refrain from creating special tax laws which tend in practice to give undue tax favours to certain categories of companies in respect of foreign-earned income; to
abolish unduly strict rules on bank secrecy, whenever necessary, with a view to facilitating investigations in cases of tax evasion or concealing income arising from other criminal activities, while paying due regard to the protection of individual privacy, and to take other appropriate action with a view to making it more difficult for international firms to use tax haven countries for tax avoidance purposes.

6. Evasion and avoidance devices involving tax treaties

103. The Group observed that the facilities provided by double taxation agreements could sometimes be used to reduce taxation in a way which had not been intended by those negotiating the agreements. This phenomenon appeared in a particularly acute form as "treaty shopping", that is to say, the situation where a person who was not a resident of either country set up a resident entity in one of them in order to take advantage of benefits provided to residents of the country concerned under the income tax treaty between the two countries. It was pointed out that it was possible in certain circumstances for the residents of a third country to repatriate funds to that third country through the entity under more favourable conditions than if they had been repatriated directly (that is, it might be possible to reduce or eliminate taxes on the repatriation). This could be done if the treaty relaxed tax provisions in the country of origin of the income and there was a similar provision in a treaty between its partner country and the third country.

104. It was considered likely that in some countries cases of treaty abuse gave cause for concern. However, several members urged the need for great caution and emphasized the necessity to avoid damaging the legitimate activities which the treaties were designed to encourage, such as the investment of capital. However, the fear was also expressed that a bilateral treaty negotiated with the needs of the two treaty partner countries in mind might be used to extend the treaty's advantages much more widely, and a number of members from developed countries suggested that the country negotiating bilateral tax treaties might consider the feasibility of including in the proposed tax treaty an additional article to prevent the benefits of the treaty from being transferred to persons in third countries in a manner contrary to the intentions of the negotiating parties.

105. It was clear that treaty abuse was a subject for the Group to bear in mind for future discussion in the light of growing experience in the operation and formulation of tax treaties.

Exchange of information

106. A common feature of the discussions within the Group on all the various aspects of international tax avoidance and evasion was the frequently repeated comment that one of the most useful forms of international co-operation in dealing with those problems could be the development of more frequent and more effective exchanges of information.

107. It was recognized that the exchange of information about the affairs of taxpayers raised delicate issues. Individuals and companies are required for the purposes of taxation to disclose to their tax authorities particulars of their business and often even of their personal affairs, which they properly regard as private. The point was made that while this is necessary in order that tax
liabilities may be correctly calculated, it was widely regarded as wrong, in all but the most exceptional circumstances, for the authorities to take advantage of this requirement to allow the information to be used for other than tax purposes. The Group noted that it was generally, although not universally, recognized that disclosure to the tax authorities of other countries for their tax purposes was legitimate in certain circumstances. But it was also pointed out that it was also widely recognized that the taxpayer must in such cases be provided with adequate safeguards. It was likewise emphasized in the discussions that such exchanges of information had to be based on a firm foundation in law, such as could be provided by an article in a double taxation treaty on the lines of article 26 of the United Nations Model Convention.

108. It was suggested that comparatively little use had hitherto been made of exchange-of-information articles in bilateral tax treaties and that the use of such provisions might be usefully extended. The suggestion was also made that since many countries had not concluded double taxation treaties and it would take time to negotiate a complete network, there might be something to be said for attempting to negotiate (if this could be done more rapidly) treaties dealing with the limited topics of exchange of information and the mutual agreement procedure.

109. The Group noted that some multilateral instruments providing for international exchanges of information about taxpayers were already in existence and that others were in the process of being formulated.

110. It was observed that the use of exchange-of-information articles in bilateral treaties might be made more effective if tax authorities consulted each other with a view to conducting more frequent and useful exchanges, not only on request, but also as a matter of course (in relation to routine information). Furthermore, it was suggested that it would be especially valuable if tax authorities were to develop the practice of providing information spontaneously to each other when information came to their notice that seemed likely to be of value to the other country. Similarly, frequent contacts between the tax officials concerned to enable them to provide each other with the kinds of information required and available would be useful. It would also be helpful for them to confer in order to study the general background to the activities of multinational entities (they might, for example, engage in industry-wide exchanges of information, i.e. exchanges of information obtained when studying the general background of particular industries which, to the extent that they did not involve the exchange of confidential information about the affairs of taxpayers, need not be founded on the existence of a double taxation treaty or similar formal arrangement). It was also suggested that it might be useful to provide for simultaneous examinations, that is, the exchange of information between two tax authorities, each acting independently but in accordance with a co-ordinated plan, examining or auditing the tax affairs of the same or related taxpayers for the same tax year and thus creating a situation in which their exchanges of information could be more relevant and fruitful than they might otherwise be.

111. It was pointed out, on the other hand, that there were a number of limitations to the possibilities of exchanges of information (for example, it might be difficult to obtain the information in some cases, particularly where bank secrecy was strictly protected).
112. Another point raised in this connection was that the information would have to be provided in a form in which it could be effectively used, for example as evidence in a court of law. The problem of proof was underlined in the discussions.

113. It was also observed that the provision of information could be a burdensome activity and that there would have to be a satisfactory relationship between the requirement to provide information and the resources which could be spared for its provision and that there might be questions to resolve about the proper balance of the exchanges.

114. Nevertheless, the discussions indicated that, despite those provisos, international exchanges of information could be a fruitful means of international co-operation in countering international tax evasion and avoidance and that it would be important for the Group to study further how exchanges might be developed and improved.

Notes

1/ United Nations publication, Sales No. E.80.XVI.3.

2/ See Tax Treaties between Developed and Developing Countries, Seventh Report (United Nations publication, Sales No. E.78.XVI.1), p. 59.


6/ Ibid., para. 4.

7/ Ibid., p. 7, para. 7.
HOW TO OBTAIN UNITED NATIONS PUBLICATIONS

United Nations publications may be obtained from bookstores and distributors throughout the world. Consult your bookstore or write to: United Nations, Sales Section, New York or Geneva.

COMMENT SE PROCURER LES PUBLICATIONS DES NATIONS UNIES


КАК ПОЛУЧИТЬ ИЗДАНИЯ ОРГАНИЗАЦИИ ОБЪЕДИНЕННЫХ НАЦИЙ

Издания Организации Объединенных Наций можно купить в книжных магазинах и агентствах во всех районах мира. Найдите справки об изданиях в нашем книжном магазине или пишите по адресу: Организация Объединенных Наций, Секция по продаже изданий, Нью-Йорк или Женева.

COMO CONSEGUIR PUBLICACIONES DE LAS NACIONES UNIDAS

Las publicaciones de las Naciones Unidas están en venta en librerías y casas distribuidoras en todas partes del mundo. Consulte a su librero o diríjase a: Naciones Unidas, Sección de Ventas, Nueva York o Ginebra.