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Report of the Expert Group Meeting on “Tax Aspects of Domestic

Background

Although the United Nations (UN) tax work is deeply grounded in the early work of the League of Nations, this year marks the 40th anniversary of Economic and Social Council Resolution No. 1273 (XLIII) adopted on 4 August 1967, leading to the setting up of the Ad Hoc Group of Experts on Tax Matters, which was renamed the Committee of Experts on International Cooperation in Tax Matters (“the Tax Committee”) in 2004. In 2002, the Financing for Development Conference at Monterrey highlighted in its Monterrey Consensus¹ the role of domestic resource mobilisation for development and specifically called for increased cooperation in tax matters under the category of “systemic issues”.

In a spirit of drawing upon the lessons of the last 40 years, but (most importantly) looking to enduring and emerging tax issues and the role of international cooperation in helping address such issues over the coming years, the United Nations Financing for Development office, in conjunction with the International Fund for Agricultural Development (IFAD)², and with the assistance of the Italian Ministry of Finance, sponsored an Expert Group Meeting of a small number of eminent tax policy makers, administrators, academics and other experts³ to consider, in a very practical sense, areas where greater international cooperation might realistically make the greatest impact at a reasonable level of cost.

The discussions were wide ranging but focused on tax as a means of development, especially in developing economies and economies in transition, and with a special consideration for where the United Nations could add extra value in such areas by furthering international cooperation. As the meeting was essentially designed to freely generate ideas and share diverse perspectives on tax and development issues, this report does not attribute comments to particular speakers or seek to deal with every suggestion or idea generated. The views and conclusions in any case do not necessarily reflect views of the United Nations or the United Nations Committee of Experts on International Cooperation in Tax Matters.

While this report therefore only gives a relatively short summary of the main discussion points, and includes the Recommendations of the Group, specific presentations made at the Meeting can be found at the Financing for Development Office’s Tax Matters website⁴.

¹ Available at <http://www.un.org/esa/ffd/indexOverview.htm>

² <http://www.ifad.org/>

³ The participants, each participating in their personal capacity, were Mr. Bernell L. Arrindell of Barbados, Mr. Tizhong Liao of China, Mr. Noureddine Bensouda and Mr. Mustapha Kharbouch of Morocco, Mr. Stig Sollund of Norway, Mrs. Liselott Kana of Chile, Mr. Martin Grote of South Africa, Mr. Erwin Silitonga of Indonesia, Dr. Indira Rajaraman of India, Professor Yash Tandon of the South Centre, Mr. David Spencer of the Tax Justice Network, Mr. Claudino Pita of the Inter-American Center of Tax Administrations (CIAT), Mr. Paolo Ciocca of Italy and IFAD and Mrs. A. Luisa Perrotti and Mr. Enrico Martino of Italy. The UN Secretariat also participated.

⁴ <http://www.un.org/esa/ffd/ffdtaxation.htm> under the heading “Meetings”.

A Central Theme – addressing development issues means addressing tax issues

A key theme in discussions was the centrality of tax issues, and international tax cooperation, towards allowing for sustained development in developing countries (a term which is used in this report to also include economies in transition) most notably in the domestic and international mobilisation of resources.

It was recognised that tax issues played a key role in encouraging investment, but that this by itself was not enough to sustain and further such development. A workable tax system, effectively administered, could assist in expanding a jurisdiction's fiscal space. By enhancing the mobilisation of its own domestic resources - supplemented by official development assistance - the necessary fiscal framework conditions can be established for financing public infrastructure and for providing necessary health, education and other services that all play an important part in ensuring development is not merely sustained but is in fact broadened and deepened over time.

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The governance issues, including transparency of relations between business and government, were noted, and the Extractive Industries Transparency Initiative (EITI) was particularly referred to⁵. The EITI supports improved governance in resource-rich countries through the verification and full publication of company payments and government revenues from oil, gas, and mining. The Initiative works to build multi-stakeholder partnerships in developing countries in order to increase the accountability of governments regarding resource tax collections, and utilisation of these funds.

The issues of transfer pricing that may arise in resource sectors were also noted, and there were specific issues discussed, such as the need to value, despite the practical difficulty of valuing, diamonds on an arm's length basis, especially in an industry characterised by complex and close international networks and relationships.

It was noted that there was no single tax model suitable for every developing country and every situation, but that a model incorporating self-adjusting tax increases in times of high commodity prices will guarantee stability of the fiscal benefits while ensuring the resource-rich country remains an attractive place for investment.

It was also noted that there were creditability issues for many international taxes on resource exploitation – was the relevant imposition an income tax creditable under tax treaties or was it some other form of non-income related tax, such as a turnover tax. It was indicated that the UN Tax Committee may have a role in greater international cooperation to give guidance to countries and to increase the predictability and certainty of tax treatment in the resource sector, which could increase foreign direct investment into those sectors.

Taxation of Fishing

Discussion of the taxation of fishing noted the link to sustainability of the harvesting of fish stocks, itself linked to broader issues of sustainability of development. The difficulties of addressing intensive fishing activities under current Model Tax Conventions, and bilateral treaties based upon them, were also noted. It was recognised that there were issues of enforcement that would be served by better international and intranational cooperation and coordination, and that the UN would have a role in any such developments.

It was noted that adopted tax measures should not create incentives for overexploitation, which would run counter to the quest for sustainable development, and that care must be taken in creating such incentives in any case, as they may, for example, result in low grade timber being used to replenish overexploited high grade timber. In general, the tax treatment of exploited resources must be designed to take into account the dynamics of the resource renewal process.

The hope was expressed that better international cooperation to fight international tax avoidance and evasion could lead to an improved internal position also for some countries. Some participants noted that often the key information necessary to combat tax avoidance and evasion was not available internally because tax crimes were not always treated as strongly as other crimes, even though they were serious inhibitors of country development and impeded the alleviation of poverty. It was noted that there needed to be greater international recognition of this, including the importance of not in practice encouraging crimes against *other* jurisdictions, while simultaneously deterring such activities against a country's *own* taxation system.

Land Tax

On land tax, it was noted that land taxation was an important way of ensuring water sanitation, law and order and education, including for the benefit of both landowners and those not sharing in that ownership of land. It was recognised that there were problems in having accurate ownership information readily available, and that sharing

⁵ See <http://www.eitransparency.org/>

of best practice and technical assistance would be helpful in this regard. There were also great difficulties in achieving high levels of land tax compliance, and it was suggested that one way of achieving this might be to link ownership rights to having paid tax. It was also acknowledged, however, that land tax set at too high a level could unfairly deprive landowners of their land, especially if they were no longer in the workforce. It was debated how many of the issues in this area could be regarded as tax issues, but it was noted that the International Fund for Agricultural Development was doing useful work in this area.

Environment Taxes

There was a general discussion on developments in the area of environment taxes and the part such taxes would in future play in alleviating environmental damage and helping to restore the environment. It was noted that nearly all of the initiatives and activities regarding environmental taxes had hitherto come from environmenvire wo /BDC /

There was a discussion of tax issues relating to the growth in “private equity” funds, used in this sense to mean investments that mobilise large amounts of capital, essentially for the purpose of facilitating leveraged buyouts of companies, which are then restructured and parts of which are usually on-sold. A participant noted that not only do some private equity undertakings make use of tax avoidance schemes, but that the tax laws of some countries favoured such activities by taxing profits as a capital gain (with a lower rate) rather than as income (with a higher rate), potentially disfavouring more obviously productive investment.

Transfer Pricing

The term “transfer pricing” refers to pricing arrangements between separate units - companies, business units, or divisions - that are part of the same corporate group. It can apply, for example, to intra-group transfers of goods, services and intangibles, as well as to financing and cost-sharing arrangements.

Such arrangements are ever-increasing, and they present an opportunity for “mis-pricing” and misallocation of revenue and expenses across the corporate group to reduce its total tax bill (such as by having the profits appear to be generated in a low tax or no tax country, with the deductions available in a higher tax country). Transfer pricing presents great challenges for tax administrations, especially in developing countries, and also for international tax cooperation – the ideal is often seen in terms of a system that is clear and encourages investment yet allows for countries to achieve their fair share of taxation of such economic activity.

It was noted that in the tax aspects of transfer pricing there was a certain consensus at the doctrinal level and there was also a certain degree of convergence in tax legislation on transfer pricing. The focus in both these areas was generally on recognising that the “arm’s length” principle should prevail (though not always, as other approaches such as “formulary apportionment” had their advocates). In other words, such prices should be equivalent to those corresponding to similar transactions carried out between independent businesses under similar circumstances. However there was not the same level of coincidence in the methods for applying that principle to particular factual scenarios.

Over-invoicing, under-invoicing, invoicing of fictitious transactions, the use of inadequate figures or forms of transaction (under-capitalisation, for example) were identified as some of the mechanisms used for unduly reallocating revenues and expenses between related companies, with a view to minimising the taxes paid on the earnings of the group.

digests and the like. Some projects were already in place to help in this regard, but the UN could play an important role in the area also, assisting developing countries in closing the skills gap that separates them from most of the developed countries in this area and allowing them to undertake a more effective defence of their legitimate viewpoints and interests.

Transfer pricing was identified as one of many areas where greater cooperation between developing countries, sharing practices that had been successful for them and might assist other developing countries, should be encouraged. It was noted that the UN Secretariat dealing with tax matters had begun discussions with the UN Special Unit on South-South Cooperation with a view to facilitating such a project, in the context of the Special Unit's "Sharing Innovative Experiences" programme, and that this could cover many of the topics dealt with at this meeting, not merely transfer pricing.

The special issues involved in transfer pricing involving intangibles such as use of "brands" was discussed, especially the issues involved for developing countries, such as attempting to judge the authenticity of the intangible properties concerned, identifying the real ownership of the intangible property in both legal and economic senses, analysing how the intangible is used and deciding, against this background, whether the transfer price is within the range of what is reasonable, bearing in mind whether it is commensurate with the extent of transferred rights and corresponding obligations.

Recommendations

Following these presentations and discussions, the Group of Experts on Tax Aspects of Domestic Resource Mobilisation decided that it should make a series of recommendations to the United Nations Committee of Experts on International Cooperation in Tax Matters ("th

Recommendation 2 – Resource Taxes and Land Taxes

Recommendation 5 – Trade and Investment

The Group noted that tax and trade reforms were so closely related that they needed to be considered together (or “hyphenated” as “tax-trade reform” issues, as one participant expressed it). In particular they noted the impact on developing countries of reduced tariff revenues as a result of trade liberalisation.

The Group therefore recommended that the United Nations should cooperate with others active in this field to assist countries in dealing with the disruptions caused by trade liberalisation to public finances, and that the Committee should consider what methods of technical cooperation and assistance could most readily assist in this area, without duplicating other relevant work, and as far

Recommendation 8 – Meeting the Committee Mandate

The Group recognised that the very limited resourcing of the United Nations tax work, including of Committee