THE EUROPEAN UNION'S TAX TREATIES WITH DEVELOPING COUNTRIES

Leading by example?

by Martin Hearson

GUE/NGL
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Report for the European United Left/Nordic Green Left (GUE/NGL) in the European Parliament

Martin Hearson is Fellow in International Political Economy in the International Relations department of the London School of Economics and Political Science.
m.hearson@lse.ac.uk

GUE/NGL
European United Left • Nordic Green Left

EUROPEAN PARLIAMENTARY GROUP

European Parliament,
B-1047 Brussels, Belgium

+32 (0)2 283 23 01

guengl-communications@europarl.europa.eu

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EXECUTIVE SUMMARY

Developing countries need tax revenue, not least from the profits of multinational companies, to achieve their development goals. Yet the taxation of most of those profits is regulated by a global network of bilateral tax treaties. More than half of these treaties, and 40 percent of those with developing countries, have an EU member state as signatory. The European Parliament has resolved that the "global network of tax treaties…often impedes developing countries from taxing profits generated in their territory" and that "when negotiating tax treaties, the European Union and its Member States should comply with the principle of policy coherence for development." The Economic and Social Council has also recommended that "when negotiating DTAs with developing countries, EU Member States take more account of the needs of developing countries." While much of the attention devoted to tax treaties has focused on their role in international tax avoidance, the core distribution of 'taxing rights' between developed and developing countries in the tax treaty regime is also at issue. In the language used by international tax policymakers, tax treaties place too much emphasis on the taxing rights of the countries of residence of multinational companies, imposing too many restrictions on the countries that are the source of those companies' income, often developing countries.

The paper uses an analysis of 172 tax treaties in force between EU members and developing countries, part of a sample of 519 tax treaties signed by developing countries. It shows that, on average, the treaties developing countries have concluded with EU members impose more restrictions on their source taxing rights than their treaties with other countries, even other OECD members. Put another way, EU members' treaties with developing countries more closely resemble the OECD model convention, which is not designed with developing countries in mind, than the UN model, which is. While much attention rightly focuses on the limits tax treaties impose on withholding tax rates in developing countries, it is in other parts of the treaty that we find the biggest gap between EU members' treaties and those of other states. This is particularly the case for the Permanent Establishment threshold, above which developing countries can tax foreign companies' profits generated in their borders. On average, this threshold is getting much lower in tax treaties signed among developing countries, and a gap is opening up between these treaties and those signed with EU countries. Nonetheless, there is a huge diversity between EU members in this regard, as well as within the treaties that individual countries have signed with developing countries. This suggests that there is much room for 'levelling up'. Focusing on two specific areas - the taxation of services and of capital gains - further underlines the room for improvement.

Recent developments, including the OECD and G20's Base Erosion and Profit-Shifting Project and Member States' renegotiations of their tax treaties with developing countries have not gone far enough to address this problem. Drawing on recommendations from the Parliament, Commission and the European Economic and Social Committee, the paper concludes that EU members should:

1. Conduct spillover analyses incorporating reviews of their double taxation treaties, based on the principle of policy coherence for development and taking into account guidance from the European Commission and other bodies.

2. Undertake a rolling plan of renegotiations with a focus on progressively increasing the source taxation rights permitted by EU members' treaties.

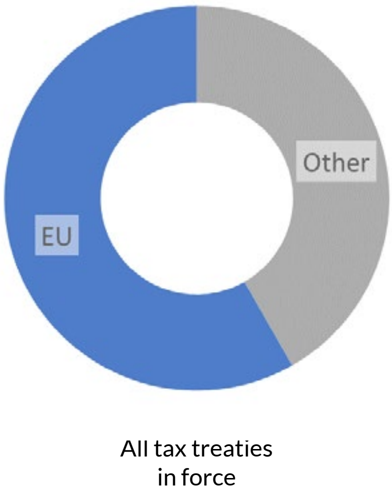
3. Reconsider their opposition to a stronger UN tax committee, as the Parliament has previously requested.

4. Formulate and publish an EU Model Tax Convention for Development Policy Coherence, setting out source-based provisions that EU Member States are willing to offer to developing countries as a starting point for negotiations, not in return for sacrifices on their part.

INTRODUCTION

"Effective mobilisation of domestic resources and a strengthening of tax systems will be an indispensable factor in achieving the post-2015 framework that will replace the Millennium Development Goals (MDGs)," concluded the European Parliament in 2015, adding that taxation "represents a viable strategy to overcome foreign aid dependency in the long term, and that efficient and fair tax systems are crucial for poverty eradication, fighting inequalities, good governance and state-building."[1] Yet most developing countries still lag behind the commonly cited, but arbitrary, benchmark of tax revenues equivalent to 15 percent of GDP, which is itself less than half the figure raised by OECD states.[2] Developing countries depend disproportionately on corporate taxation within their tax mix, and in particular on the taxation of foreign direct investment (FDI).[3] According to the Economic and Social Council, "corporation tax plays a more important role in developing countries' tax revenue structures than it does in developed countries."[4]

An international tax regime, based on a web of bilateral treaties, regulates the taxation of multinational companies, covering 96 percent of foreign direct investment.[5] Such treaties tie their signatories into restrictions on if, how, and how much they can tax multinational companies and other cross-border economic activity, ostensibly to eliminate the barriers to such activity caused when countries' tax systems overlap. Tax treaties have, however, become a controversial topic in development debates in recent years, the subject of campaigns by civil society groups and increasing



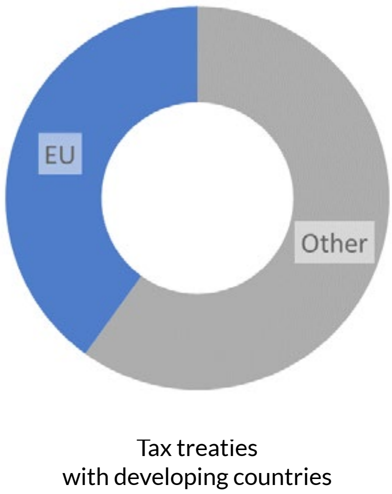


Figure 1: EU share in the total number of tax treaties

1 Tax avoidance and tax evasion as challenges in developing countries http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P8-TA-2015-0265&language=EN&ring=A8-2015-0184

2 Wilson Prichard, "Reassessing Tax and Development Research: A New Dataset, New Findings, and Lessons for Research," *World Development* 80 (April 1, 2016): 48–60, https://doi.org/10.1016/j.worlddev.2015.11.017.

3 UNCTAD, *World Investment Report 2015* (New York: United Nations, 2015).

4 European Economic and Social Committee. EU development partnerships and the challenge posed by international tax agreements. REX/487. https://www.eesc.europa.eu/en/our-work/opinions-information-reports/opinions/eu-development-partnerships-and-challenge-posed-international-tax-agreements

5 Author's own estimate, based on IBFD online database of tax treaties, and IMF Coordinated Direct Investment Survey.

within international tax organisations. As an IMF report argues, "tax treaties usually reallocate taxing rights over foreign investment income from the host country to the home country [of the investor or corporation] (…) Since developing countries are usually net capital importers with little if any outbound investment, they stand to lose significant revenue from the lower [withholding tax rates] negotiated in tax treaties."[6] A European coalition of civil society organisations, Eurodad, has therefore called on European Union member states to "ensure that harmful treaties are not signed with developing countries in the first place, and that harmful treaties that already exist are renegotiated or revoked."[7]

As recent debates over tax avoidance, tax information exchange and digital taxation all show, the EU plays a dominant role in setting the global agenda for international taxation, as well as in negotiating the bilateral treaties that form its basis. More than half of the world's tax treaties, and 40 percent of those with developing countries, have an EU member state as signatory (figure 1).

The EU is therefore a pivotal actor in the debate over tax treaties and developing countries. European Union institutions, including the Parliament, have recognised that member states' tax treaties frequently conflict with their commitment to policy coherence for development. The Parliament has resolved that the "global network of tax treaties… often impedes developing countries from taxing profits generated in their territory"[8] and that "when negotiating tax treaties, the European Union and its Member States should comply with the principle of policy coherence for development established in Article 208 TFEU."[9] The Economic and Social Council has also recommended that "when negotiating DTAs with developing countries, EU Member States take more account of the needs of developing countries."[10] The Commission, too, has stated that "Member States should apply a balanced approach to negotiating bilateral tax treaties with low-income countries, taking into account their particular situation. This includes the fact that developing countries are highly dependent on source-based taxation and therefore withholding taxes on outbound payments are an essential component of their tax income."[11]

A common recommendation from all the organisations cited above is that countries should undertake 'spillover analyses' that assess the impact of their tax treaties, in combination with their tax laws, on developing countries. The governments of the Netherlands and Ireland have commissioned such analyses, both of which were conducted by the International Bureau of Fiscal Documentation (IBFD).[12] These reports concluded that in most cases the individual provisions of these countries' treaties with developing countries were not so different to those that the developing countries had signed with other countries. Civil society groups ActionAid and Christian Aid have each made detailed proposals for more comprehensive methodologies. Suggestions include taking into account how treaties and

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6 IMF, *Spillovers in International Corporate Taxation* (Washington, DC, 2014).

7 Eurodad, Tax Games: the Race to the Bottom - Europe's role in supporting an unjust global tax system, 2017.

8 Tax rulings and other measures similar in nature or effect (TAXE 2) http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2016-0310+0+DOC+XML+V0//EN&language=EN

9 Tax avoidance and tax evasion as challenges in developing countries http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P8-TA-2015-0265&language=EN&ring=A8-2015-0184

10 European Economic and Social Committee. EU development partnerships and the challenge posed by international tax agreements. REX/487. https://www.eesc.europa.eu/en/our-work/opinions-information-reports/opinions/eu-development-partnerships-and-challenge-posed-international-tax-agreements

11 COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL on an External Strategy for Effective Taxation COM/2016/024 final https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2016%3A24%3AFIN

12 IBFD 2015, Onderzoek belastingverdragen met ontwikkelingslanden https://zoek.officielebekendmakingen.nl/blg-247787.pdf ; IBFD 2015, Possible Effects of the Irish Tax System on Developing Economies http://www.budget.gov.ie/Budgets/2016/Documents/IBFD_Irish_Spillover_Analysis_Report_pub.pdf

BOX 1: DEFINITIONS

Source taxation. Taxation levied on a company or person's income in the place where it is generated (its source). Typically, this means in the country in which a multinational company has its operations (referred to as the source country), rather than where it is headquartered.

Residence taxation. Taxation levied on a company or person's income in the place where they reside. Typically, this means in the country in which a multinational company has its headquarters (referred to as the residence country), rather than where its operations take place.

Model convention. Bilateral treaties are usually negotiated on the basis of a multilateral model. Most commonly this may be the OECD model, which is the agreed position of OECD Member States, or the UN model, which is written by a committee of experts and designed to represent a compromise between the interests of developed and developing countries. There are also regional models, such as that of the African Tax Administration Forum, and some countries have their own national models. While the models are only templates for negotiations with no legal status, they have commentaries stating how they should be interpreted. In disputes over the application of bilateral treaties – which are legally enforceable – national courts may refer to the commentary of the model on which the particular bilateral treaty is based.

Withholding tax (WHT). A tax imposed on the recipient of a payment, but which must be withheld from that payment and remitted to the tax authority of the country in which the payer is a resident. Tax treaties place restrictions on the circumstances in which WHTs can be levied, and the rates, typically in the areas of dividends, interest, royalties and service fees.

Permanent establishment (PE). A concept in treaty law that defines the minimum threshold of economic presence a company from the treaty partner must have in the source country before it can be taxed there. This may include the nature of the activity and the length of time for which it takes place. If the PE threshold is not met, the source country cannot tax the profits made.

other features of countries' tax systems are used in practice, and using peer comparisons to assess policy coherence, rather than for comparison as an end in itself.[13] The Commission has also compiled a toolkit for the Platform for Tax Good Governance, incorporating recommendations and examples from various organisations.[14] Nonetheless, the uptake by member states has been minimal.

This paper uses the most comprehensive publicly available dataset of bilateral tax treaties to analyse the content of EU member states' tax treaties with developing countries in sub-Saharan Africa and Asia. It takes a comparative approach, both in terms of the EU's treaties in global context, and between EU member states. It departs from the following text in the European Parliament's recent recommendation to the Council and the Commission:

> *Calls on the Member States to properly ensure the fair treatment of developing countries when negotiating tax treaties, taking into account their particular situation and ensuring a fair distribution of taxation rights between source and residence countries; calls, in this regard, for adherence to the UN model tax convention and for transparency around treaty negotiations to be ensured.*[15]

The dataset measures the amount of source taxation that tax treaties permit, assessing how much they follow the UN model convention recommended by the Parliament resolution, as opposed to the OECD model that allows developing countries fewer taxing rights. It also considers variations in the application of the model conventions. The overall message is that, while EU Member States have signed some tax treaties that live up to the Parliament's aspirations, many more do not.

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13 ActionAid, 2018, Stemming the Spills: Guiding framework for undertaking national tax spillover analyses. http://www.actionaid.org/sites/files/actionaid/stemming_the_spills_online.pdf; Christian Aid Ireland, 2017, Global Linkages: re-examining the empirical basis of the 2015 tax spillover analysis https://www.christianaid.ie/sites/default/files/2018-02/global-linkages-tax-report.pdf and 'Impossible' Structures: Tax Outcomes Overlooked By The 2015 Tax Spillover Analysis https://www.christianaid.ie/resources/campaigns/impossible-structures-2017-tax-report

14 Toolbox spill-over effects of EU tax policies on developing countries. Platform/32/2017/EN https://ec.europa.eu/taxation_customs/sites/taxation/files/toolbox_dtas_spill_overs_en.pdf

15 European Parliament recommendation of 13 December 2017. Recommendation following the inquiry on money laundering, tax avoidance and tax evasion. P8_TA-PROV(2017)0491

TAX TREATIES:
WHAT ARE THEY AND WHY DO THEY MATTER FOR DEVELOPMENT?

The main role played by tax treaties is to stipulate which of two principles should prevail when their signatories' tax systems come into conflict: the principle of source, by which a country is entitled to tax income because it is earned within its borders, and the principle of residence, by which a country is entitled to tax income because it is earned by one of its residents. Imagine a French multinational with a mine in Senegal: France could claim to tax the mine's profits under the principle of residence, while Senegal could make the same claim under the principle of source. Where the investment flows in either direction between two countries are of similar size, the balance between source and residence taxation is of less importance. But where the flows are predominantly one way, as they are between France and Senegal, it has consequences. Tax treaties by their nature have the effect of restricting source taxation, which means that it is predominantly on developing countries that they impose fiscal costs (box 2).

Of course, the fiscal costs of a treaty might be a price worth paying for its investment promotion benefits. Competition for inward investment is thought to have played a significant role in the diffusion of tax treaties into developing countries.[1] They offer investors a geographically-specific tax incentive, a lower effective tax rate applicable only to firms from the treaty partner. They also provide investors with stability, which may be at least as valuable to them as a lower tax rate: as many as 60 percent of businesses surveyed for an IMF and OECD report suggested that uncertainty over future changes in corporate taxation affected their location decisions.[1] The evidence that tax treaties attract investment into developing countries is, however, contested and unclear.[2] Few studies combine good coverage of developing countries in their data with methodologies that isolate the investment-promoting effects of tax treaties. Of those that do, the results have implied a positive, neutral or even negative impact.[3] Tax treaty shopping, by which firms use shell companies in conduit countries to obtain the benefits of tax treaties, is another major drawback.[4]

The asymmetrical costs imposed by tax treaties lie behind recent criticism of their development impact. Critical academic commentators suggest that the burden on developing countries is too high, and often unnecessary.[5] There is also evidence that

1 IMF and OECD, "Tax Certainty: OECD/IMF Report to the G20 Finance Ministers," 2017; European Commission, "Tax Certainty: Working Paper for the Platform for Tax Good Governance," 2017.

2 For reviews, see IMF, *Spillovers in International Corporate Taxation*; Martin Hearson, "Do Tax Treaties Affect Foreign Investment? The Plot Thickens," 2014, http://martinhearson.wordpress.com/2014/06/19/do-tax-treaties-affect-foreign-investment-the-plot-thickens/.

3 Karl P Sauvant and Lisa E Sachs, eds., *The Effect of Treaties on Foreign Direct Investment* (Oxford: Oxford University Press, 2009).

4 Francis Weyzig, "Tax Treaty Shopping: Structural Determinants of Foreign Direct Investment Routed through the Netherlands," *International Tax and Public Finance* 20, no. 6 (December 11, 2013): 910–37, https://doi.org/10.1007/s10797-012-9250-z.

5 Tsilly Dagan, "The Tax Treaties Myth," *New York University Journal of International Law and Politics* 32 (2000): 939–939; Victor Thuronyi, "Tax Treaties and Developing Countries," in *Tax Treaties: Building Bridges between Law and Economics*, ed.

developing country negotiators have not always been fully aware of the extent to which the treaties they were signing would constrain their future tax policymaking autonomy.[6] Several studies have found significant tax costs for developing countries from just two of the clauses found consistently in tax treaties, those on the taxation of dividends and interest payments. In two of these studies, the estimated revenue foregone in one year through treaties with the Netherlands was €770m, and with the United States $1.6bn.[7] Viewed from the developing country's perspective, the annual costs estimated to Bangladesh and Zambia are $85 million and Zambia $42 million respectively. Uganda's tax treaty with the Netherlands may have cost it as much as $85 million in one single capital gains tax case. While these are not transformative amounts, they are nonetheless significant, and they may only be the tip of the iceberg for tax treaties, the full costs of which cannot easily be estimated.

Consequently, there is a political movement to question the costs and benefits of tax treaties. Indonesia, South Africa, Rwanda, Argentina, Mongolia, Zambia, and Malawi are among those countries that have cancelled or renegotiated tax treaties in recent years, while others, such as Uganda, have undertaken reviews.[8] Perhaps in response to the international debate and the threat of further cancellations, the Netherlands and Ireland have also reviewed the impact of their treaty networks on developing countries, and offered partial renegotiations.[9] Civil society groups have begun to mount campaigns against particular tax treaties, culminating in an ongoing law suit in Kenya that has prevented its treaty with Mauritius from coming into force.[10]

Much of this growing politicisation concerns 'treaty shopping', a form of tax avoidance through which international investors from third countries exploit tax treaties to obtain benefits to which the signatories did not intend them to be eligible.[11] In such cases, firms reduce their tax liabilities in developing countries by structuring their investments through intermediate jurisdictions such as the Netherlands and Mauritius, whose treaties impose greater restrictions on the source country's taxing rights. Recent progress in international tax negotiations will make such structuring harder: the Netherlands has offered renegotiations with developing countries aimed at including anti-treaty shopping clause; a multilateral instrument created at the OECD also offers countries the opportunity

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Michael Lang et al. (Amsterdam: IBFD, 2010), 441–58; Dimitri Paolini et al., "Tax Treaties with Developing Countries and the Allocation of Taxing Rights," *European Journal of Law and Economics* 42, no. 3 (December 2016): 383–404, https://doi.org/10.1007/s10657-014-9465-9; Kim Brooks and Richard Krever, "The Troubling Role of Tax Treaties," in *Tax Design Issues Worldwide*, ed. Geerten M. M. Michielse and Victor Thuronyi (Kluwer Law International, 2015), 159–178.

6 Jalia Kangave, "The Dominant Voices in Double Taxation Agreements: A Critical Analysis of the 'Dividend' Article in the Agreement between Uganda and the Netherlands," *International Community Law Review* 11, no. 4 (November 2009): 387–407, https://doi.org/10.1163/187197409X12525781476123; Charles R Irish, "International Double Taxation Agreements and Income Taxation At Source:," *International and Comparative Law Quarterly* 23, no. 2 (1974): 292–316, https://doi.org/10.1093/iclqaj/23.2.292; Martin Hearson, *Tax Treaties in Sub-Saharan Africa: A Critical Review* (Nairobi: Tax Justice Network Africa, 2015).

7 Katrin McGauran, *Should the Netherlands Sign Tax Treaties with Developing Countries?* (Amsterdam: SOMO, 2013); IMF, *Spillovers in International Corporate Taxation*.

8 Martin Hearson, *Tax Treaties in Sub-Saharan Africa: A Critical Review* (Nairobi: Tax Justice Network Africa, 2015).

9 IBFD, *Possible Effects of the Irish Tax System on Developing Economies* (Dublin: Irish Ministry of Finance, 2015); Netherlands Ministry of Finance, *Government's Response to the Report from SEO Economics Amsterdam on Other Financial Institutions and the IBFD Report on Developing Countries* (Amsterdam: Netherlands Ministry of Finance, 2013).

10 For example ActionAid, *Mistreated: The Tax Treaties That Are Depriving the World's Poorest Countries of Vital Revenue* (London: ActionAid UK, 2016); McGauran, *Should the Netherlands Sign Tax Treaties with Developing Countries?*; Mike Lewis, *Sweet Nothings: The Human Cost of a British Sugar Giant Avoiding Taxes in Southern Africa* (London: ActionAid UK, 2013).

11 ActionAid, *Mistreated: The Tax Treaties That Are Depriving the World's Poorest Countries of Vital Revenue*; McGauran, *Should the Netherlands Sign Tax Treaties with Developing Countries?*

BOX 2: UNDERSTANDING THE COSTS OF TAX TREATIES

There are three significant ways that tax treaties reduce the amount of tax a source state may impose on income earned by a taxpayer who is resident in another state:

First, tax treaties limit the rate at which the source state can impose certain taxes. Most countries, especially developing countries, impose withholding taxes on payments of dividends, interest, royalties and fees for management, technical and consultancy services. Although technically imposed on the overseas recipient of the payment, they must be 'withheld' by the local company that makes the payment, and given directly to the revenue authority. This is the same principle by which an employer withholds income tax from their employees' salary payments. Tax treaties set maximum rates of tax that can be imposed on residents of the treaty partners, which are usually lower than the rates in the source country's domestic law, and may be as low as zero. These rates are usually the most visible part of the treaty to policymakers, and have formed the basis of most studies that examine the costs and benefits of tax treaties.

Second, tax treaties may define the scope of tax (what can be subject to tax) in a more limited way than would otherwise be permitted under domestic law. For example, the concept of 'permanent establishment' (PE) sets a minimum threshold of activity that must take place in a country before its government can levy tax on the profits generated there by the taxpayer concerned. Some aspects of this threshold are qualitative criteria, for example a warehouse for the delivery of products may either be included or excluded from the definition. Others are quantitative criteria, such as the number of days after which work by foreign contractors on a construction site becomes a PE.

Third, tax treaties may simply exempt some types of income earned in the source state from taxation in that state altogether. For example, many treaties prohibit the source country from imposing taxes on capital gains in particular circumstances. Often exempted in addition are pension and social security payments, and profits made by international shipping companies from operating in the source country's waters.

Tax treaties also impose limits on the residence state's right to tax. This is because they oblige the residence country to make allowance for any tax its residents have paid in the source country when calculating their tax liability at home, either through a credit for tax paid abroad, or by exempting it altogether. They may also be obliged to treat profits that are subject to tax incentives in the same way, as if they had been taxed in the source country, a practice known as 'tax sparing'. These sacrifices are rarely significant, however, because most countries already offer credits or, increasingly, exemptions even in the absence of a treaty.

Aside from assigning taxing rights in this way, tax treaties also impose other obligations on their signatories. These include: exchange of information to help tax authorities identify and challenge tax evasion; assistance in the collection of taxes clauses, by which countries commit to collecting tax on each other's behalf in circumstances where one state is unable to do so; mutual agreement procedures, through which tax authorities must try to eliminate outstanding double taxation that the treaty does not automatically prevent.

‘Several studies have found significant tax costs for developing countries from just two of the clauses found consistently in tax treaties, those on the taxation of dividends and interest payments’

to include such provisions across many of their treaties in one go, although there is some debate about their suitability for developing countries.

Beyond treaty shopping, however, the core distribution of ‘taxing rights’ between developed and developing countries in the tax treaty regime is also at issue.[12] According to a press release by a group of finance ministers from francophone developing countries, “the global tax system is stacked in favour of paying taxes in the headquarters countries of transnational companies, rather than in the countries where raw materials are produced. International tax and investment treaties need to be revised to give preference to paying tax in ‘source’ countries.”[13] Eric Mensah, Ghana’s head treaty negotiator, argues that “for developing countries the balance between source and residence taxation very crucial. International tax rules with [their] preferences for residence-based taxation [are] not in [the] interest of developing countries.”[14] Recent developments at the OECD and G20 have explicitly avoided this debate, leaving the balance of taxing rights a matter for bilateral negotiations on the basis of model treaties that developed countries played the primary role in drafting. As noted earlier, however, the European Parliament, Commission and Economic and Social Council have all recognised that the balance of taxing rights between source and residence countries is a matter of policy coherence for development. It is this balance that is the main subject of this study.

12 Martin Hearson, “The Challenges for Developing Countries in International Tax Justice,” *The Journal of Development Studies*, May 24, 2017, 1–7, https://doi.org/10.1080/00220388.2017.1309040.

13 Organisation Internationale de la Francophonie, “LIC Ministers Demand Their Fair Share of Global Tax Revenues,” Press note, 2014, https://www.francophonie.org/IMG/pdf/minmeet_washington_oct2014_press_note_en.pdf.

14 Eric Mensah, “Mobilizing Domestic Resources for Development & International Cooperation: Ghana’s Perspective,” in *Presentation at G24 Technical Group Meeting* (Addis Ababa: Intergovernmental Group of 24, 2017).

ABOUT THE DATA AND ANALYSIS IN THIS PAPER

The extent of the balance of taxing rights within a given treaty depends on the outcome of bilateral negotiations. The parameters for these negotiations are set by model conventions maintained by committees at the OECD and UN, and the vast majority of tax treaties follow these models closely. In some areas, the model treaties differ such that a given clause in the UN model leaves more developing country taxing rights intact than its OECD equivalent. In others, the UN model leaves open the precise extent of the limits placed on the developing country, and they are resolved through bilateral negotiations. In both cases, this standardised variation allows us to compare the extents to which different treaties impose restrictions on developing countries' ability to tax.

The most extensive comparative dataset that is publicly available is the ActionAid Tax Treaties Dataset, published in 2016 by ActionAid and the International Centre for Tax and Development.[15] It covers 519 tax treaties signed by developing countries, coding each of them for 26 points of variation based on the model conventions. It includes all treaties concluded between 1970 and 2014 by a sample of low and lower-middle income countries, all those in sub-Saharan Africa and Asia, excluding G-20 members. The dataset has already been used in peer-reviewed academic research to show that power asymmetries between countries translate into more restrictive treaties, and developing countries learn to protect more of their taxing rights over the course of their negotiating history.[16] As well as coding each individual provision, the dataset includes composite indices that show the overall balance of taxing rights within the treaty. In the charts that follow, based on these indices, a score towards 1 indicates a "source-based" treaty that safeguards the maximum amount of source taxing rights for its developing country signatory, while a score towards 0 indicates a "residence-based" treaty that takes the maximum amount of source taxing rights away from the developing country.

Following the Parliament's call for stronger sourced-based tax treaties, the analysis in this paper takes as read that more source-based treaties are more in keeping with Member States' commitments to policy coherence for development. An alternative point of view is that more residence-based treaties act more effectively as tools to attract inward investment into developing countries, since they reduce multinational investors' effective tax rates more. There is not currently an evidence base to support this view, and academic studies have tended to model negotiations on the basis that developing countries see double taxation relief as a means to attract investment, while at the same time seeking to minimise the restrictions on their ability to tax that investment created by a treaty.[17]

The comparative analysis made possible by this dataset is unique, but it does have a number of limitations. Some of these are discussed in the working paper accompanying the dataset. For our purposes, the limits to geographical focus and time

15 Martin Hearson, "Measuring Tax Treaty Negotiation Outcomes : The ActionAid Tax Treaties Dataset" (2016).

16 Martin Hearson, "When Do Developing Countries Negotiate Away Their Corporate Tax Base?," *Journal of International Development* 30, no. 2 (2018).

17 Thomas Rixen, "Bilateralism or Multilateralism? The Political Economy of Avoiding International Double Taxation," *European Journal of International Relations* 16, no. 4 (December 7, 2010): 589–614, https://doi.org/10.1177/1354066109346891; Thomas Rixen and Peter Schwarz, "Bargaining over the Avoidance of Double Taxation: Evidence from German Tax Treaties," *FinanzArchiv: Public Finance Analysis* 65, no. 4 (December 1, 2009): 442–71, https://doi.org/10.1628/001522109X486589; Richard Chisik and Ronald B Davies, "Asymmetric FDI and Tax-Treaty Bargaining: Theory and Evidence," *Journal of Public Economics* 88, no. 6 (June 2004): 1119–48, https://doi.org/10.1016/s0047-2727(03)00059-8.

scale are particularly important. The dataset covers around one sixth of all tax treaties, and around a half of those signed by developing countries. The EU has 1947 tax treaties and protocols in force, of which 468 are with developing countries. Of these, 172 are included within the dataset. To supplement this, therefore, the subsequent analysis also discusses a few of the 29 negotiations and renegotiations that have taken place between EU members and developing countries since the start of 2015.

The analysis that follows compares the EU with the rest of the world in its negotiations with developing countries, as well as comparing among EU countries. It takes into account both the aggregate balance of taxing rights and certain individual clauses, selected for their relevance to contemporary debates. When comparing the EU with the rest of the world, the analysis splits into three groups: EU members, other OECD members (a proxy for developed countries), and non-OECD members (an imperfect proxy for developing countries).[18] Among non-EU OECD members, Norway, Canada and Korea have the most treaties, and constitute more than half of the 64 treaties in the dataset. Among non-members, the list is naturally more diverse, but the countries with most treaties are India, Mauritius, South Africa, China and Malaysia.

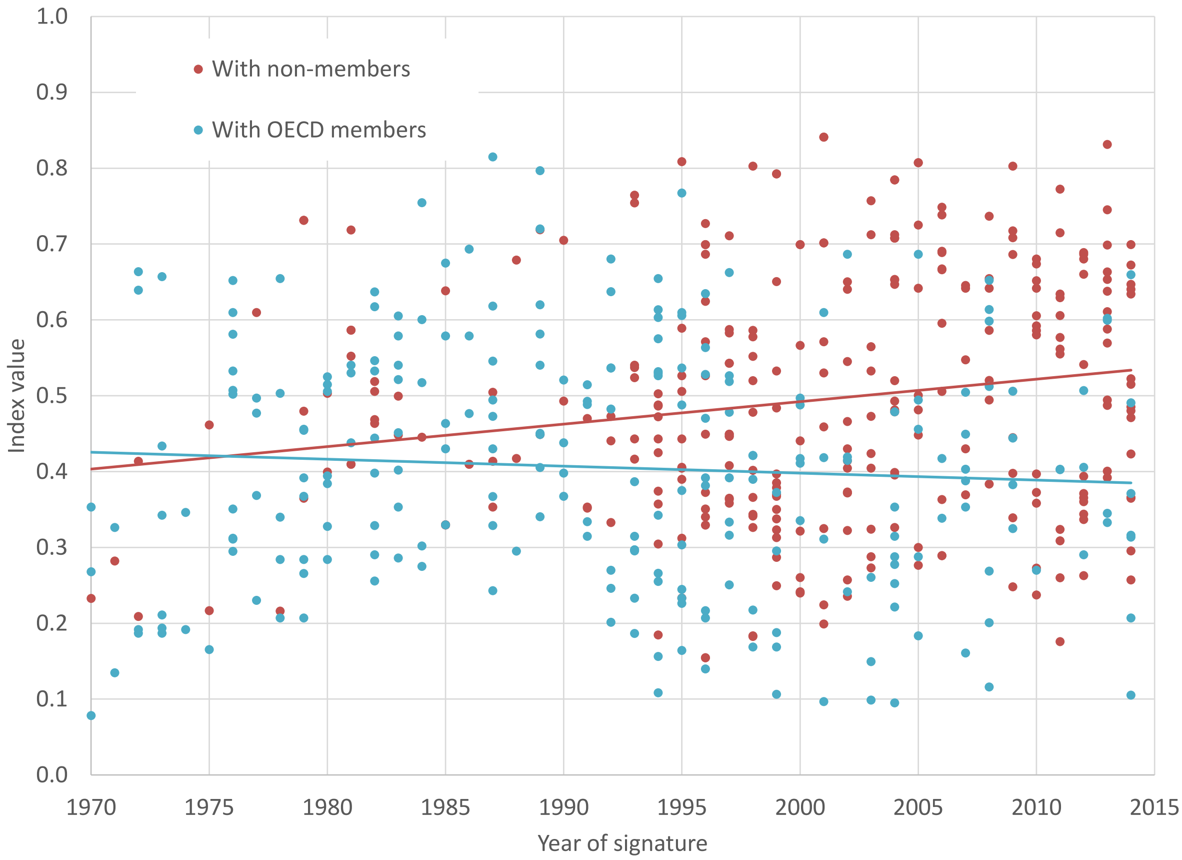
‘The EU has 1947 tax treaties and protocols in force, of which 468 are with developing countries’

18 It should be noted that five EU members have no treaties with the sample of developing countries (Cyprus, Estonia, Greece, Latvia, Lithuania), although all have some treaties with developing countries. Of the remaining 23 with treaties in the dataset, four are not OECD members (Croatia, Romania, Bulgaria and Malta).

BOX 3: THE GROWING DIVIDE BETWEEN DEVELOPED AND DEVELOPING COUNTRIES IN INTERNATIONAL TAX

The charts that follow compare EU members' treaties with developing countries to all other such treaties with developing countries, illustrating the EU's role in the world. Beyond the comparison between the EU and the rest, however, we need to take into account the strong pressures pulling the contemporary international regime in different directions. The OECD and G20's 'BEPS' work has sought to bring developing countries within the tent, but it explicitly avoided any discussion of the distributional tension between groups of countries. Meanwhile, debate over the status of the United Nations tax committee – seen by some as a more legitimate home for international tax negotiations than the OECD – has proved fraught. Strong tensions between developed and developing countries almost led to a stalemate at the Addis Ababa Financing for Development conference in 2015. [1]

To visualise these tensions, we can observe how the overall index of treaty content is changing over time in developing countries' treaties with the OECD Member States, compared with those that are not members. Although the content is very diverse, it is clear that a gap is opening up: treaties between developing countries and OECD members are imposing more restrictions on developing countries' taxing rights, while those with non-members are leaving more of their taxing rights intact.



1 Eliza Anyangwe, Glee, Relief and Regret: Addis Ababa Outcome Receives Mixed Reception, 2015, https://www.theguardian.com/global-development/2015/jul/16/outcome-document-addis-ababa-ffd3-financing-for-development.

HOW DOES THE EU COMPARE TO THE REST OF THE WORLD?

Using the overall aggregate index showing the balance of taxing rights within treaties, we can see that, on average, EU members' tax treaties with developing countries leave less of the latter's source taxing rights intact than their treaties with other countries (figure 2). Not only are developing countries' treaties with EU countries more restrictive of their source taxing rights than their treaties with each other, but they are also more residence-based than those with other OECD members.

To look at the variation over time, figure 3 plots the index values for all 519 treaties by the year of each treaty's signature. EU treaties show an unchanging average value, while the others show trends: the other OECD members' treaties are becoming more restrictive over time, while for the non-members the treaties are becoming less restrictive. Examining the values of indices covering particular parts of the treaty sheds further light on this.

For withholding tax rates (figure 4), all three groups of countries show a consistent downward trend. This downward trend matches changes in countries' domestic laws, where withholding tax rates are also falling. In the EU, this is particularly the case because of the parent-subsidiary and royalties directives, which drive rates down to zero. In developing countries, withholding tax rates have also fallen as rates imposed in past decades have declined, a trend observed in recent years in countries such as Ghana and Vietnam. In other instances, pressure for lower rates from powerful countries such as China has forced countries to accept lower rates than in the past. Zambia, for example, accepted lower rates in its agreement with China than it had in the past, only to face demands from other treaty partners to match this new, low rate.[19] On the other hand, developing countries have begun to reconsider this position as they seek to combat tax avoidance by multinational companies that often exploits the same types of payments. Rwanda, for example, has recently imposed punitive taxes on companies whose interest and service fee payments exceed two percent of profits. As the rates permitted by tax treaties become ever lower, this kind of practical response to the difficulties of taxing multinational companies will become increasingly difficult.

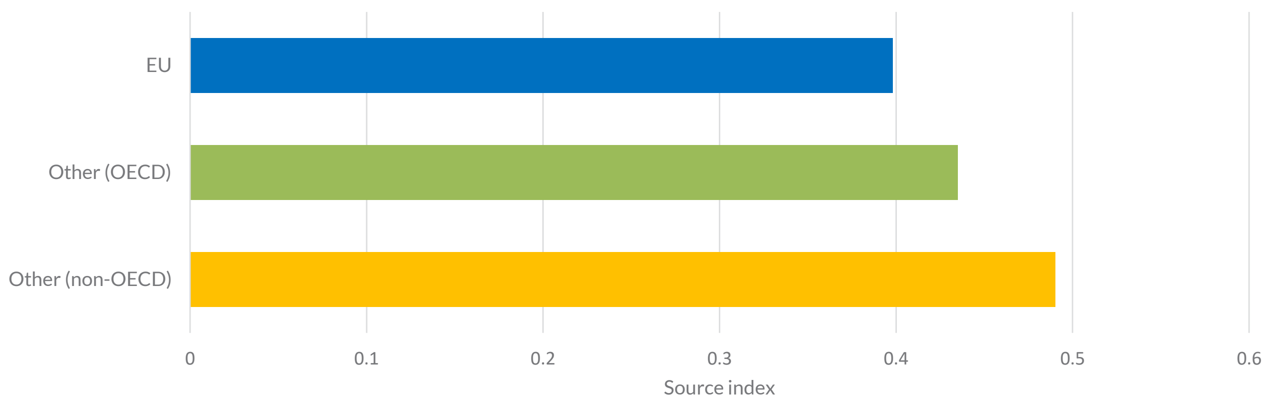


Figure 2: how the overall balance of EU treaties compares to the rest of the world

19 Hearson, *Tax Treaties in Sub-Saharan Africa: A Critical Review*, 2015.

It is permanent establishment definitions (figure 5) that drive the overall difference between the three groups of countries. Here treaties signed by EU countries with developing countries have begun to permit slightly more expansive taxing rights, but the trend among non-OECD countries is much more dramatic. A large cluster of agreements since the mid-1990s have a score close to 1 in the index, indicating that their PE definitions match the definition in the UN model. Few EU treaties offer such generous retention of taxing rights to developing countries.

Table 1 breaks down these results by article. It shows, further, that permanent establishment is clearly the area where EU members' treaties with developing countries are significantly more restrictive than others, across the board for all elements of the PE article.

One conclusion we can draw from this is that, when developing countries negotiate among themselves (many treaties within the non-OECD group) they increasingly prefer to sign treaties leaving more taxing rights intact, particularly in the definition of permanent establishment. That EU and other OECD members do not allow this is indicative of the clash of interests between capital exporters and capital importers. Another conclusion is that, even among EU members' treaties, there continues to be a wide variation. Some treaties signed by EU countries, even recently, impose very large restrictions on their taxing rights, indicated by lower scores on the overall source index and the permanent establishment index. The subsequent section will shine more light on this variation.

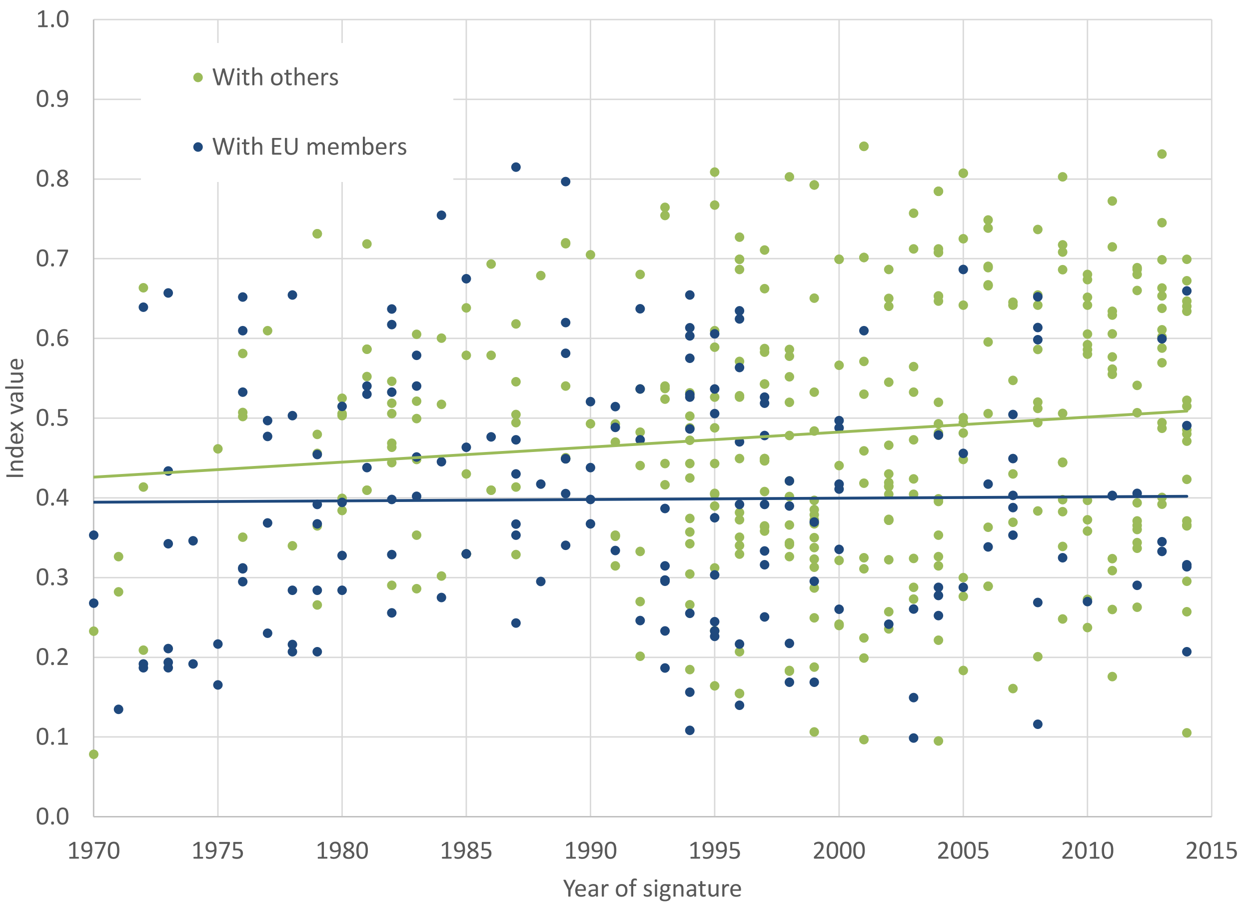


Figure 3: how the overall balance of treaties signed by developing countries is changing over time

The vertical axis measures the balance of taxing rights in treaty, with a score of 1 indicating more source-based, and 0 indicating more residence-based

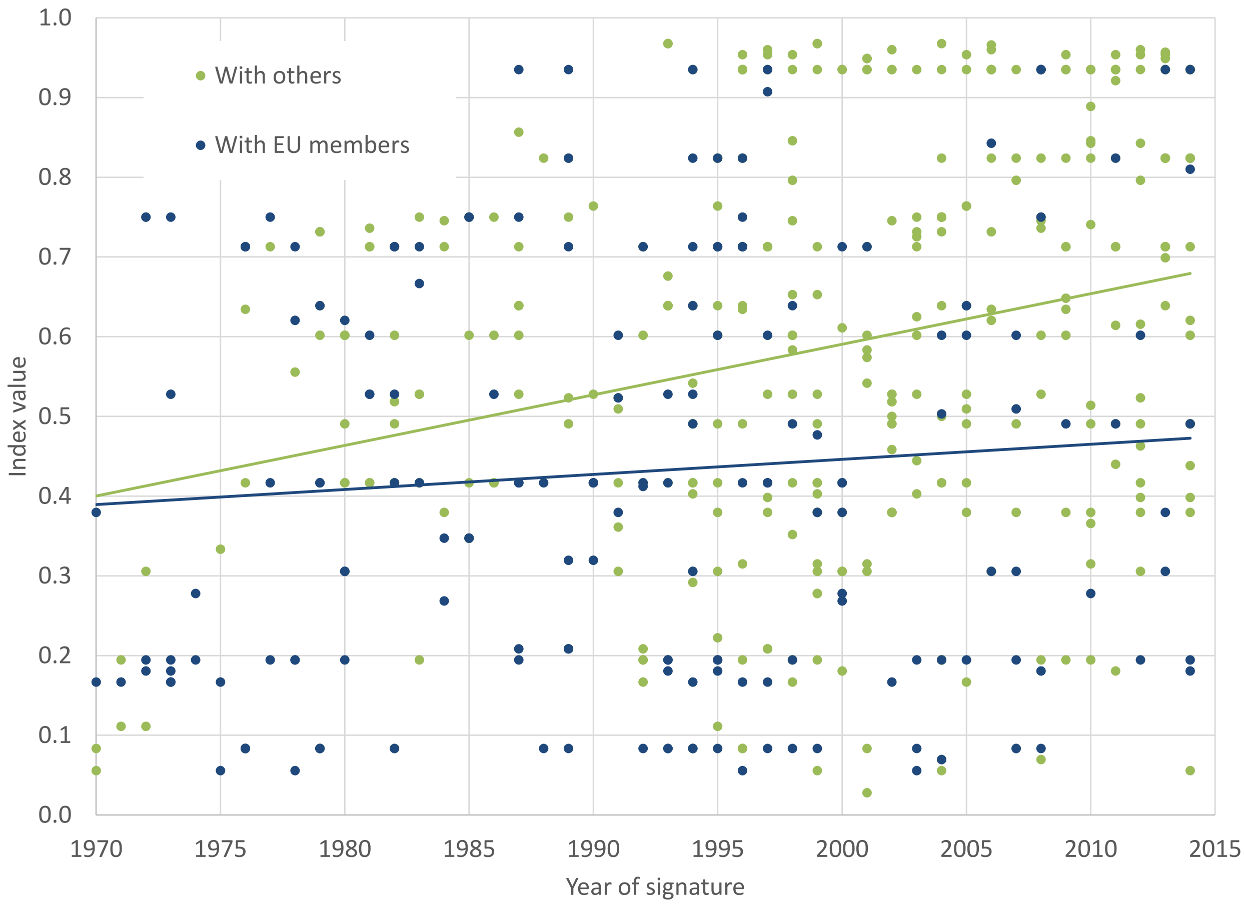


Figure 4: How the index of withholding tax rates in treaties signed by developing countries is changing over time

The vertical axis measures the average withholding tax rates in a treaty, with a score of 1 indicating higher rates are permitted (more source-based), and 0 indicating lower rates (more residence-based)

'In developing countries, withholding tax rates have also fallen as rates imposed in past decades have declined, a trend observed in recent years in countries such as Ghana and Vietnam'

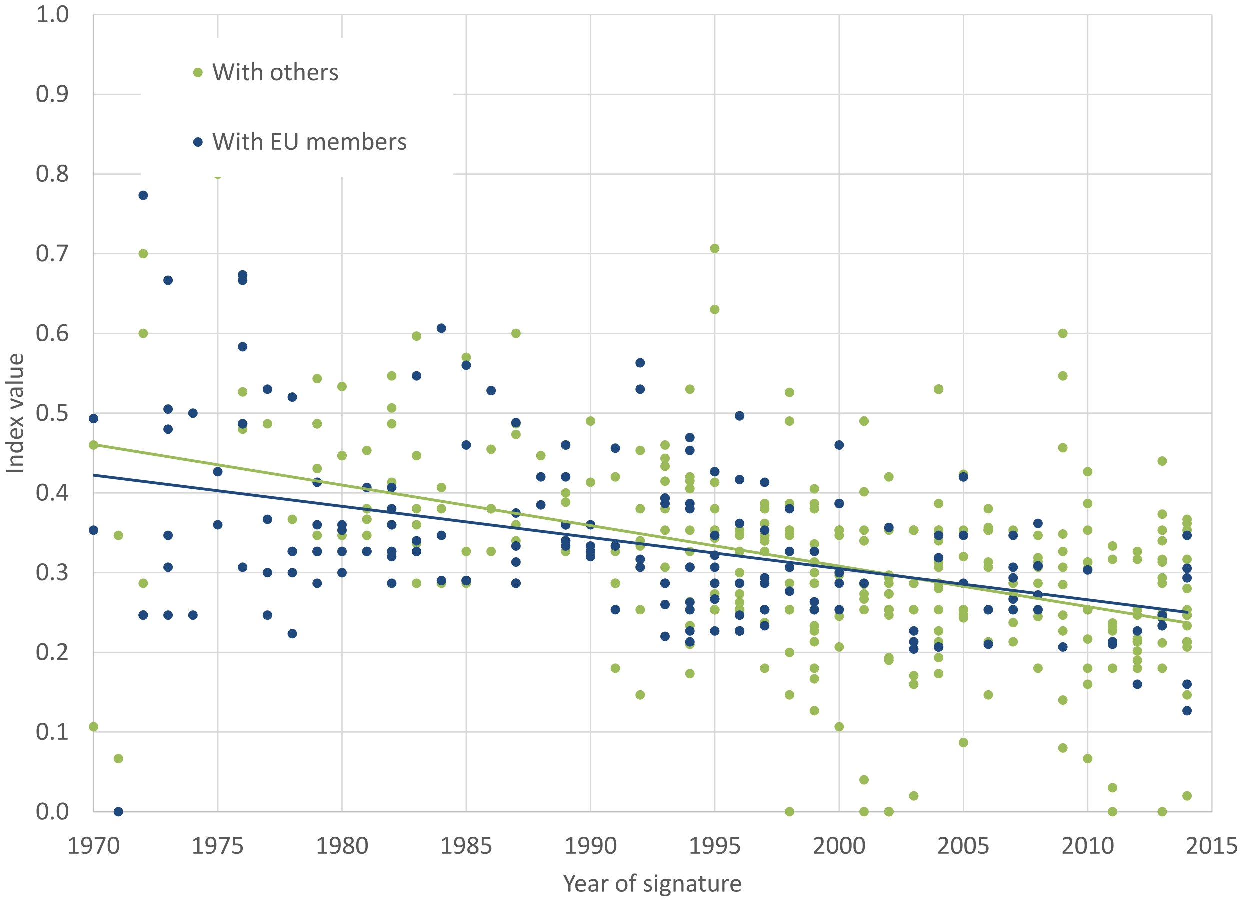


Figure 5: How the index of permanent establishment definitions in treaties signed by developing countries is changing over time

The vertical axis measures the definition of permanent establishment in a treaty, with a score of 1 indicating a wider definition (more source-based), and 0 indicating a narrower one (more residence-based)

TABLE 1: VARIATION FOR INDIVIDUAL PROVISIONS BETWEEN EU TREATIES AND OTHER GROUPS

Area	UN model reference	Description	[1]Proportion included/ [2]Average indexed value		
			EU	Other (non-OECD)	Other (OECD)
WHT	10(2)(a)	Qualifying [FDI] dividend WHT in %[2]	0.41	0.38	0.45
	10(2)(b)	Other [portfolio] dividend WHT in %[2]	0.50	0.40	0.53
	11(2)	Interest WHT in %[2]	0.39	0.35	0.40
	12(2)	Royalties WHT in %[2]	0.23	0.24	0.25
	12(3)	Films or tapes used for radio or television broadcasting[1]	0.80	0.93	0.95
	12(3)	Industrial, commercial or scientific equipment[1]	0.75	0.83	0.77
	12A	Management or technical fees included[1]	0.30	0.30	0.25
	12A	Management or technical fees rate[2]	0.16	0.16	0.14
PE	5(3)(a)	Construction PE length in months[2]	0.72	0.73	0.73
	5(3)(a)	Supervisory activities associated with construction[1]	0.57	0.83	0.69
	5(3)(b)	Service PE included[1]	0.37	0.63	0.48
	5(3)(b)	Service PE length in months[2]	0.25	0.43	0.33
	5(4)(a)	Delivery exception to PE[1]	0.34	0.54	0.33
	5(4)(b)	Delivery exception to PE[1]	0.37	0.55	0.33
	5(5)(b)	Stock agent PE[1]	0.47	0.65	0.53
	5(6)	Insurance PE[1]	0.34	0.48	0.48
	5(7)	Dependent agent extension[1]	0.43	0.58	0.53

Other	7(1)	Limited force of attraction[1]	0.25	0.39	0.34
	7(3)	No deduction for payments to head office[1]	0.40	0.53	0.38
	8(2)	Source shipping right[1]	0.35	0.37	0.34
	13(4)	Source capital gains on 'Land rich' company[1]	0.51	0.55	0.55
	13(5)	Source capital gains on shares other than those covered[1]	0.28	0.34	0.41
	16(2)	Source taxation of earnings by top-level managerial officials[1]	0.07	0.21	0.11
	18(2)	Shared taxation of pensions[1]	0.20	0.25	0.20
	18(2/3)	Source taxation of social security pensions[1]	0.37	0.43	0.31
	21(3)	Source taxation of other income[1]	0.50	0.66	0.50

Red shading indicates that EU treaties are more residence-based on this provision.

Green shading indicates that EU treaties are more source-based on this provision.

'When developing countries negotiate among themselves they increasingly prefer to sign treaties leaving more taxing rights intact, particularly in the definition of permanent establishment'

HOW DO EU MEMBER STATES COMPARE?

The previous section illustrated some general trends, demonstrating that the EU as a whole tends to conclude treaties with developing countries that constrain their taxing rights more than those developing countries sign with other countries, even other OECD members. It also showed a lot of diversity within the EU. This section seeks to untangle that diversity some more. As we can see in Figure 6, although EU members all have a large number of tax treaties overall, not all have many treaties with developing countries. Indeed, it is the largest outward investing countries – the UK, Italy, France and Germany - that have the most tax treaties with developing countries in the dataset. One conclusion we can take from this is that it is these larger countries whose tax treaties will have the most impact on developing countries overall.

Figures 7 and 8 show how EU members' treaties vary in terms of their overall content. The average EU treaty in the dataset has an index value of 0.40, meaning that it leaves intact 40% of its developing country signatories' taxing rights, within the parameters set by the UN model treaty. There is quite considerable variation, however. Figure 7 shows the average treaty content for each country, which varies from 0.53 in the case of Finland to 0.32 in the case of Italy (Malta only has one treaty, with Pakistan, which has a lower value of 0.22). All the four countries that figure 6 showed to have the most treaties with developing countries have an average value below the EU average, meaning that they have the largest concentration of treaties that restrict developing countries' ability to tax inward investment. These countries could look to Sweden and Finland, which appear to have many treaties that are more favourable to developing countries than the EU average.

Figure 8 adds more context to this picture by showing the variation within each country's treaties with developing countries. Each country is represented by a bar, which runs from the source index value for its most restrictive treaty, to the value for its least restrictive treaty. The bar changes from red to yellow at the average value for that country, the same number as used in figure 6. Here we can see that almost all countries have a very wide variation, irrespective of the average value. All therefore have treaties in which they have allowed developing countries to retain a large share of their source taxing rights, and others that impose much greater constraints on developing countries. Austria, for example, signed the most residence-based treaty of any EU country, with Mongolia in 2003 (index value 0.10); it also signed a treaty with Vietnam in 2008 that left an unusually large amount of its source taxing rights intact (index value 0.60). Denmark's 1987 treaty with Pakistan offers the most favourable settlement to a developing country (index value 0.82), while its treaty with Zambia is among the most residence-based (index value 0.21). Austria and Denmark clearly have no principled objection to concluding tax treaties that leave many of their developing country partner's source taxing rights intact – more than half, as measured in this index - but they also have treaties that achieve the opposite.

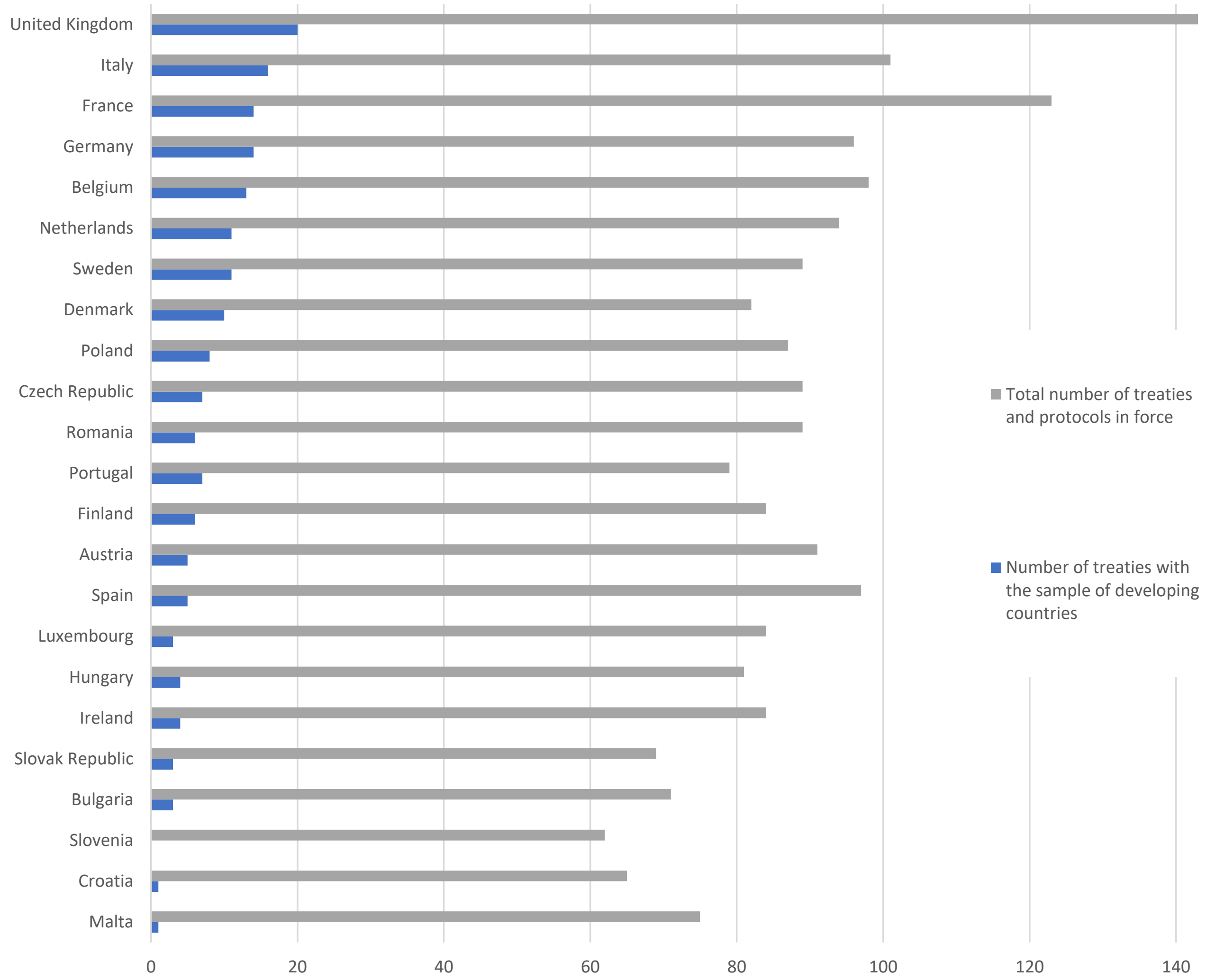


Figure 6: total number of EU members' treaties

Each tax treaty negotiation entails a give and take, with countries giving up some taxing rights in order to retain others. Where the overall index is low, this might imply an imbalanced negotiation, consistent with the evidence that power imbalances and less-developed negotiating capacities produce more residence-based treaties. As mentioned earlier with respect to Denmark, Zambia's early treaties are consistently very residence-based, which reflects its lack of negotiating capacity in the 1970s, a situation that is no longer the case. Vietnam is now known as a tenacious and effective negotiator, hence it has the most source-based treaty that Austria has signed with a developing country in this dataset. Things were not always so, however: its 1994 treaty with the United Kingdom, for example, has an index value of just 0.16. There is clearly a case for identifying more restrictive treaties on the basis of their overall balance and offering an improved settlement to developing countries.

The next stage of the analysis is to look within the treaties in more detail. Figures 9 and 10 begin to do this, reproducing the picture in figure 8 but looking only at the withholding tax rates and the permanent establishment article respectively (in both cases, an average value across the relevant provisions of the treaty is used). Comparing these two charts, we can make a number of observations.

First, consistent with what we noted earlier, there is much more variation in the definition of permanent establishment within the treaty than in the withholding tax rates, reflected in much

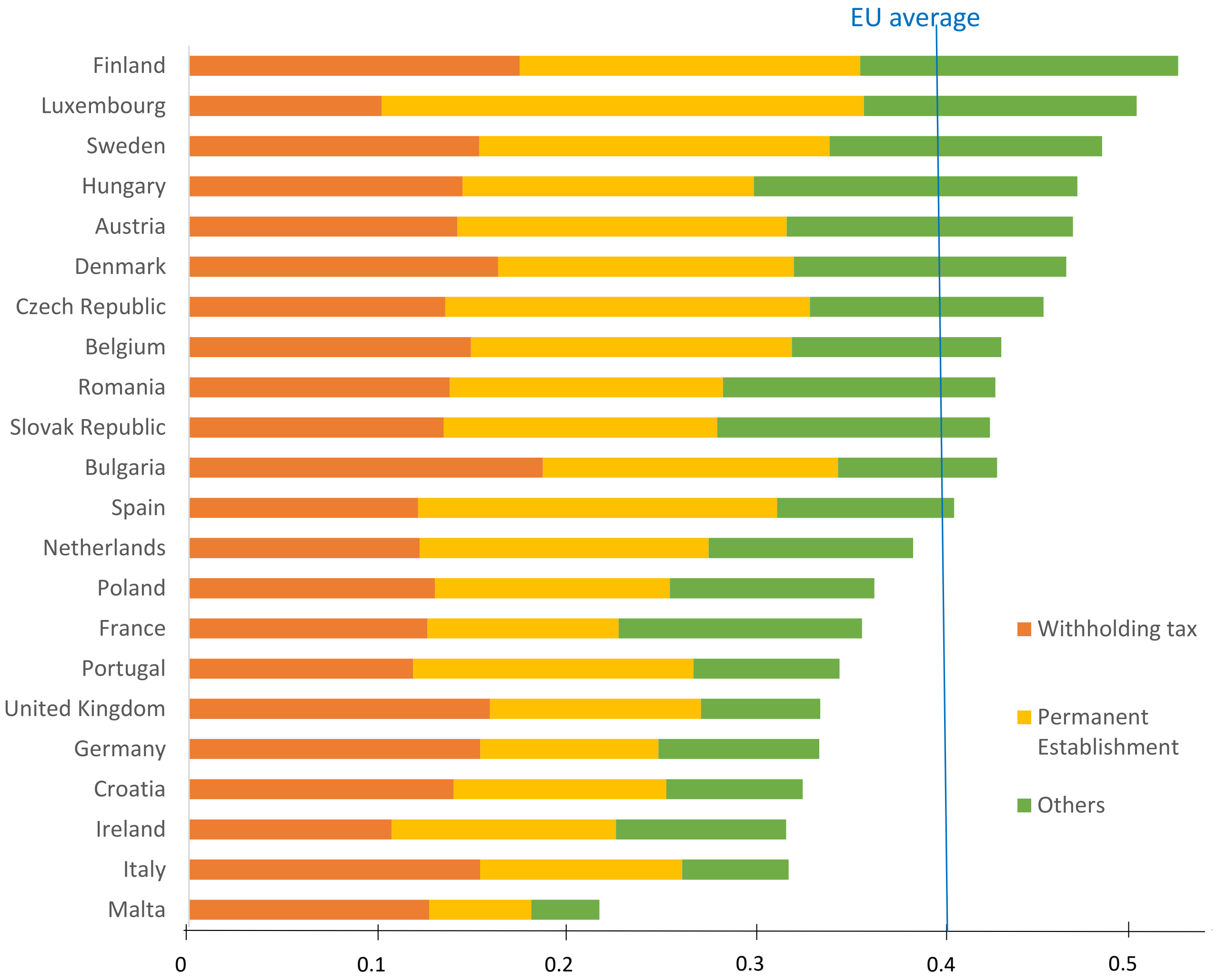


Figure 7: average source index value for each EU member, broken down by component

The horizontal axis measures the balance of taxing rights in treaty, with a score of 1 indicating more source-based, and 0 indicating more residence-based

longer bars within the chart. For PE, therefore, EU members could 'level up' by offering developing countries with narrower definitions the possibility of expanding them consistent with the EU member's other treaties. In the case of WHT, however, the question is more at a policy level: EU countries should consider the policy coherence aspects of the withholding tax rates across all their treaties with developing countries. (A notable exception to this observation is Ireland. Its position at the bottom of figure 9 is partly a result of the zero WHT rates in its 1971 treaty with Zambia, which it has since renegotiated. That said, its 2014 treaty with Ethiopia also imposes very significant restrictions on the latter's withholding tax rates.)

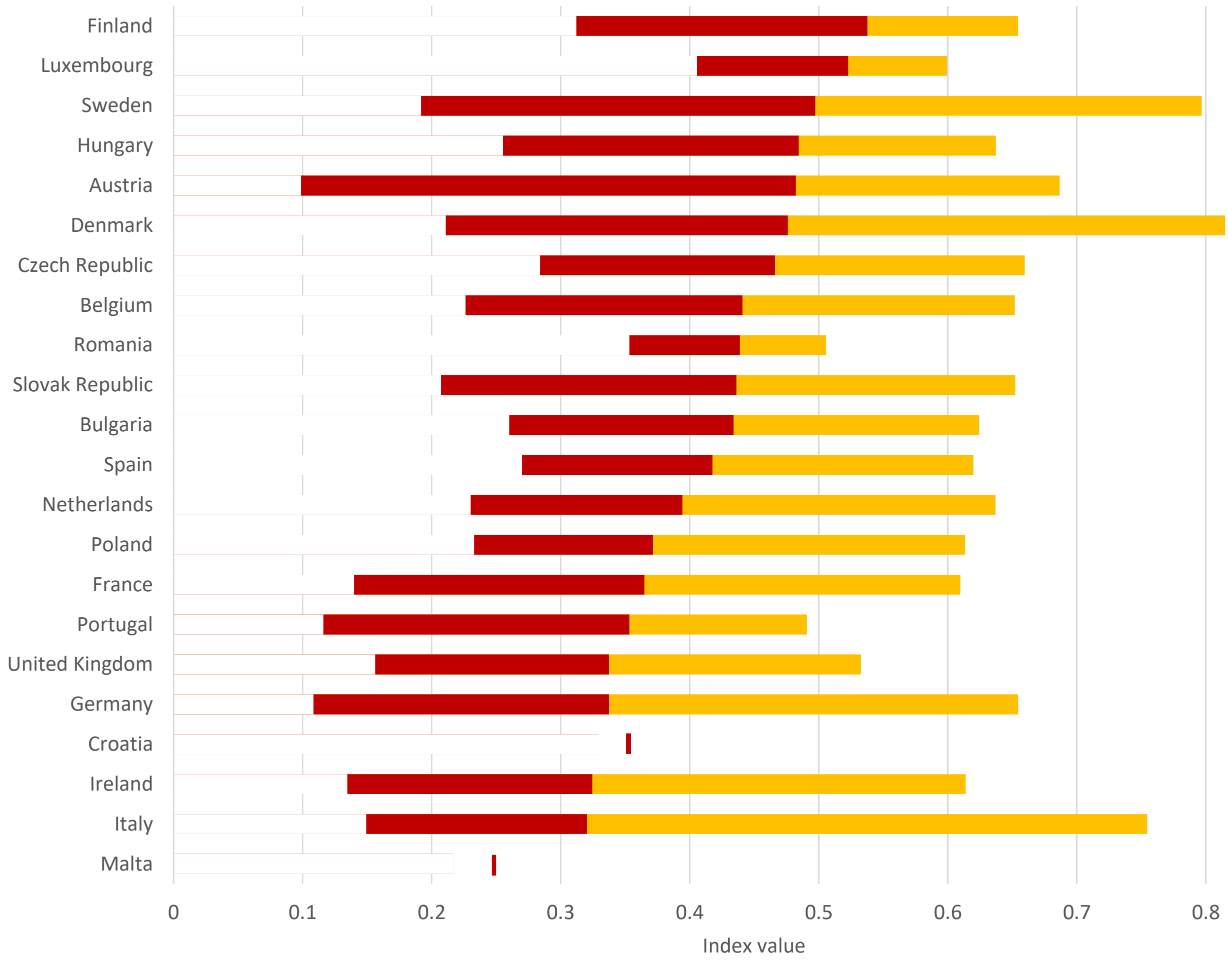


Figure 8: distribution of source index values for across EU member's treaties

The horizontal axis measures the balance of taxing rights in treaty, with a score of 1 indicating more source-based, and 0 indicating more residence-based.

Second, we can note that certain countries appear at the more source-based end of the PE spectrum, while being at the more residence-based end, with tightly consistent treaty content, when it comes to WHT. This applies in particular to Luxembourg and Spain. Both are jurisdictions that can be used for tax treaty shopping structures that reduce the withholding taxes paid when income is transferred from the developing country to its parent. They do so by combining the benefits of these countries' tax treaties with the EU's parent-subsidiary and interest and royalty directives, which eliminate WHTs within the single market. Thus, the PE provisions may be less important than the WHT provisions in these treaties, and the overall index value may be less relevant to such concerns than the WHT rates.

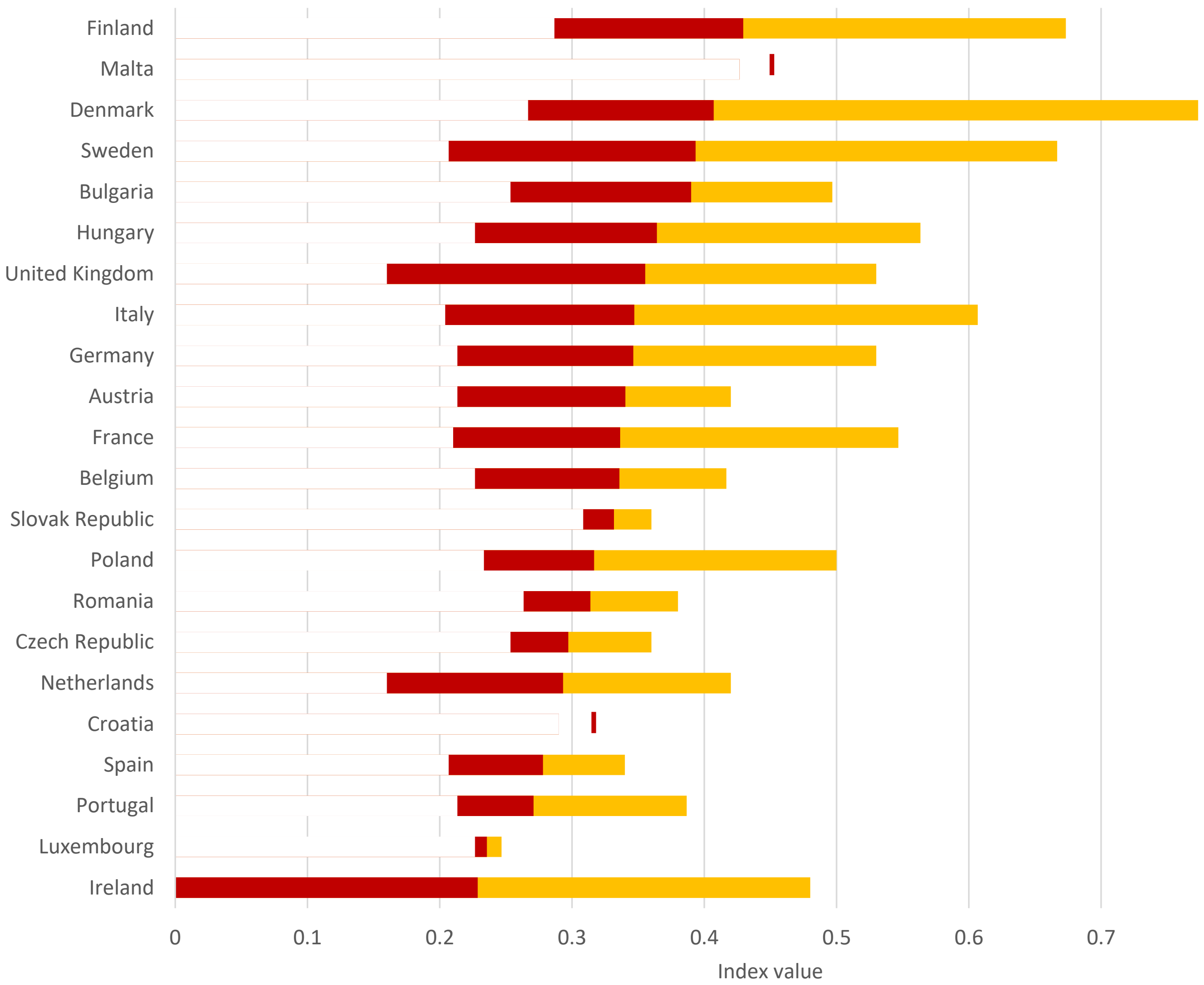


Figure 9: distribution of WHT rate index values for across EU member's treaties

The horizontal axis measures average withholding tax rates, with a score of 1 indicating higher rates are permitted (more source-based), and 0 indicating lower rates (more residence-based)

Example 1: Taxation of services

It's not possible in the scope of this paper to consider every single tax treaty clause in detail. Figures 11 and 12 therefore hone in on a controversial and important topic, the taxation of services. If a European company incorporates a subsidiary, or establishes a bricks and mortar branch in a developing country, other parts of the treaty will determine if and when it pays taxes. But if it provides services in that country without having a permanent physical presence, it becomes harder for the developing country to tax within the historical treaty rules. As the global economy becomes more and more based on transactions in services, this scenario is increasingly important.

The UN model treaty, in its most recent version, provides two options that allow developing countries to tax service providers. The first is the service PE provision, which expands the definition of permanent establishment to include foreign companies if they have a physical presence providing services in the country for more than a certain length of time. The second is a new article permitting developing countries to impose withholding taxes on management, consultancy and technical service fees, regardless of whether the provider of those services is physically present at all in the country. The service PE provision can be seen as a subtler tool that imposes taxes on net

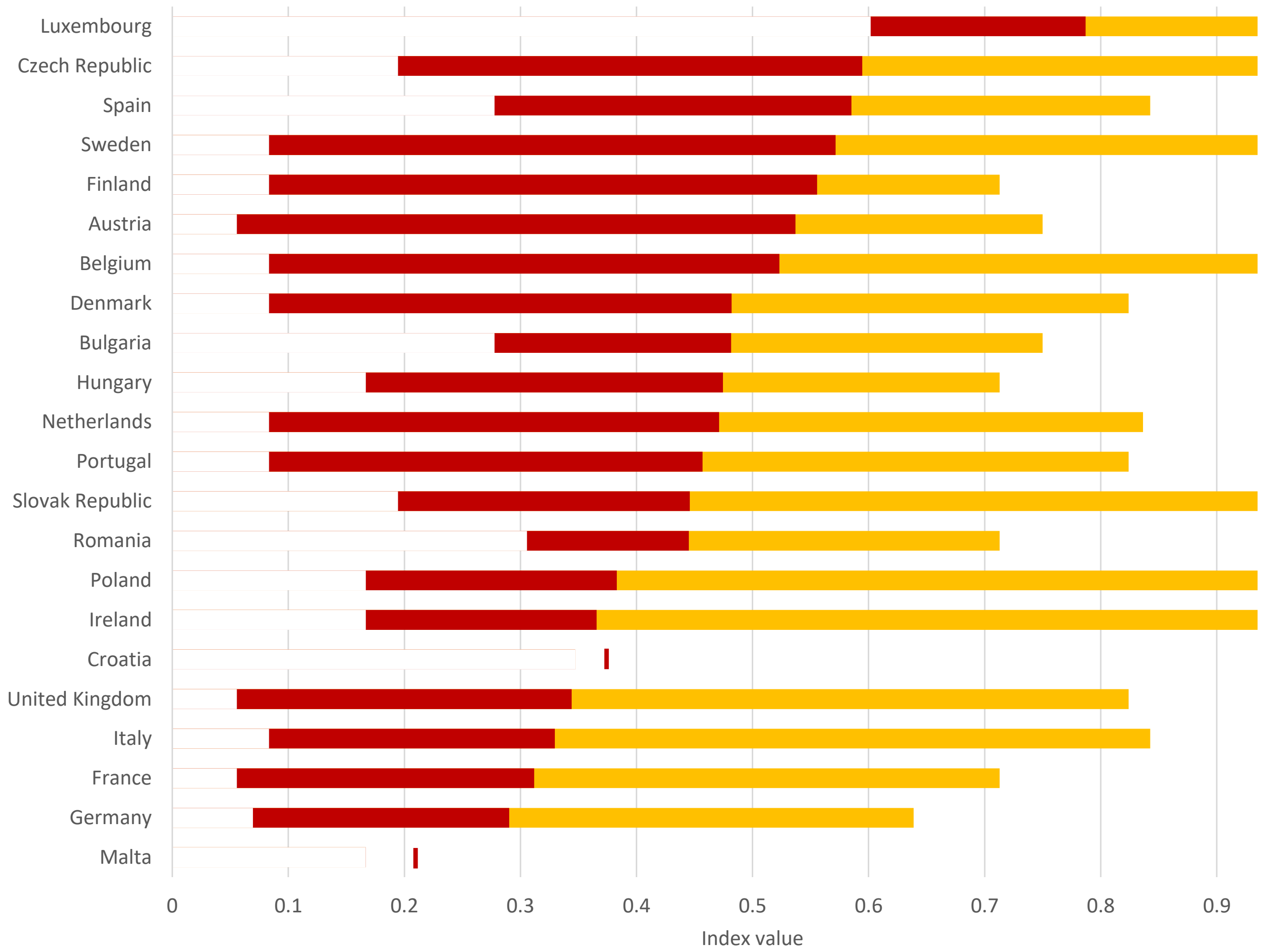


Figure 10: distribution of PE index values across EU member's treaties

The horizontal axis measures the definition of permanent establishment, with a score of 1 indicating a wider definition (more source-based), and 0 indicating a narrower one (more residence-based)

profits; service WHT is imposed on gross income and as such is more controversial, generating considerable debate within the UN tax committee before its inclusion in the model. Nonetheless, both are popular with developing countries, and the services WHT was already widely in use before its inclusion in the UN model, as well as being a staple of developing countries' tax laws.

As figures 11 and 12 show, most EU treaties include neither of these provisions: out of 172 in force, 38% include the services PE, while 30% include the services WHT. While for WHT the EU treaties are broadly in line with the overall sample, for services PE the EU's treaties are notably more residence-based, since the 38% inclusion rate compares to 53% across all treaties signed by developing countries. But these provisions are distributed widely, and very few countries have refused these clauses' inclusion in all their treaties with developing countries. In this area, therefore, EU members rarely have absolute positions, based on the treaties they have signed. Nonetheless, their treaties predominantly act to prevent developing countries from taxing services provided by EU members, except in cases where they meet the physical presence test needed for a traditional permanent establishment. Indeed, 39% of the EU treaties include neither clause.

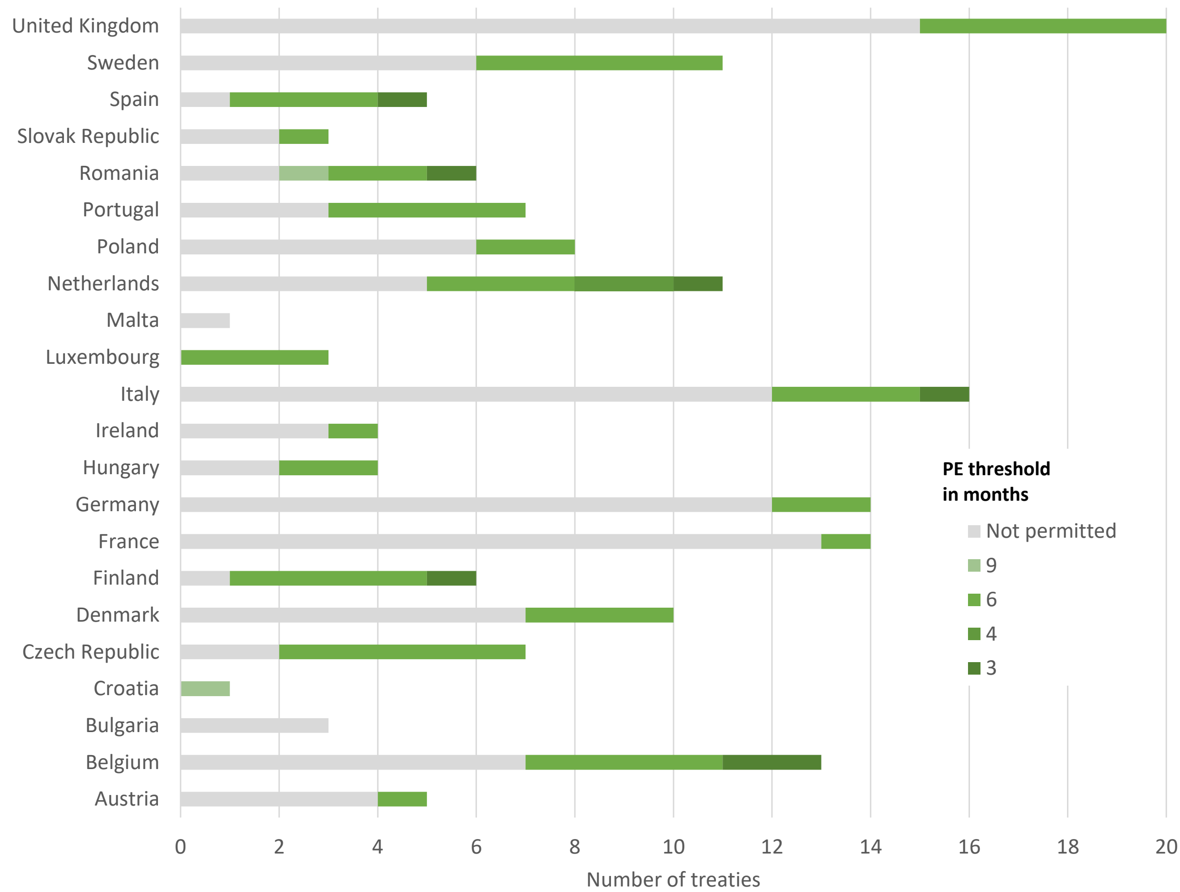


Figure 11: Service permanent establishment in tax treaties

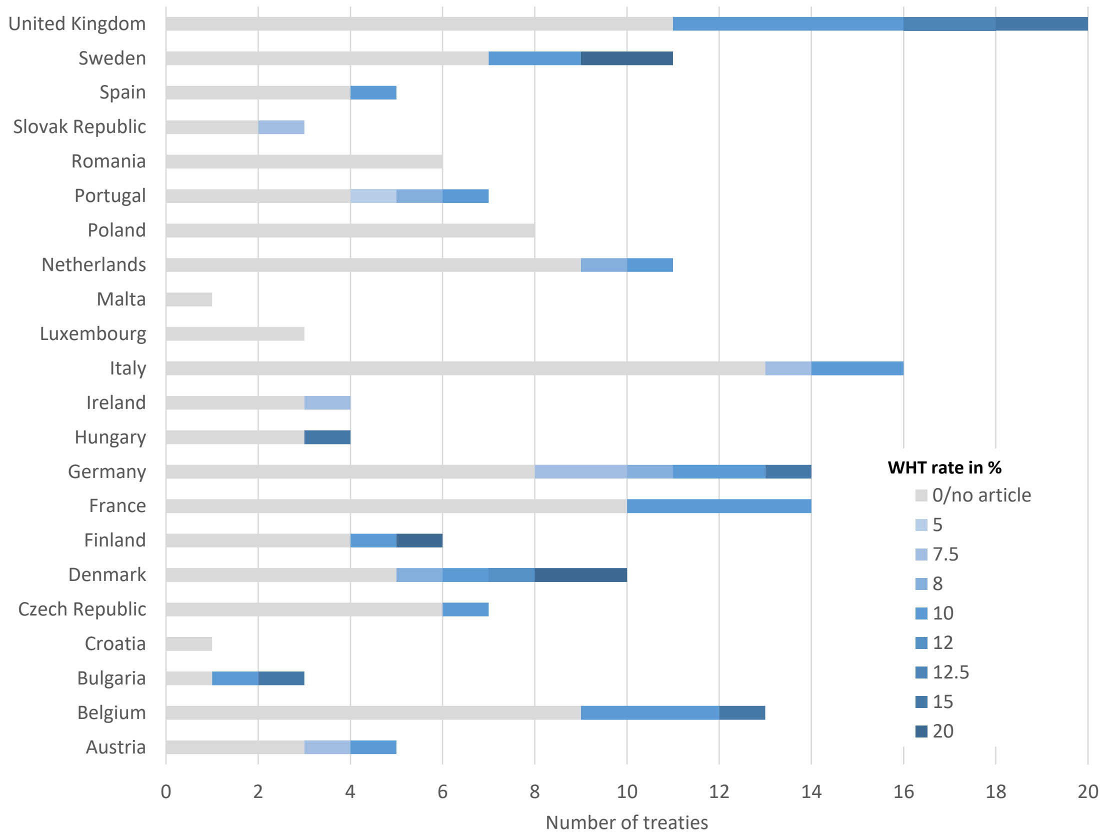


Figure 12: Service withholding tax in tax treaties

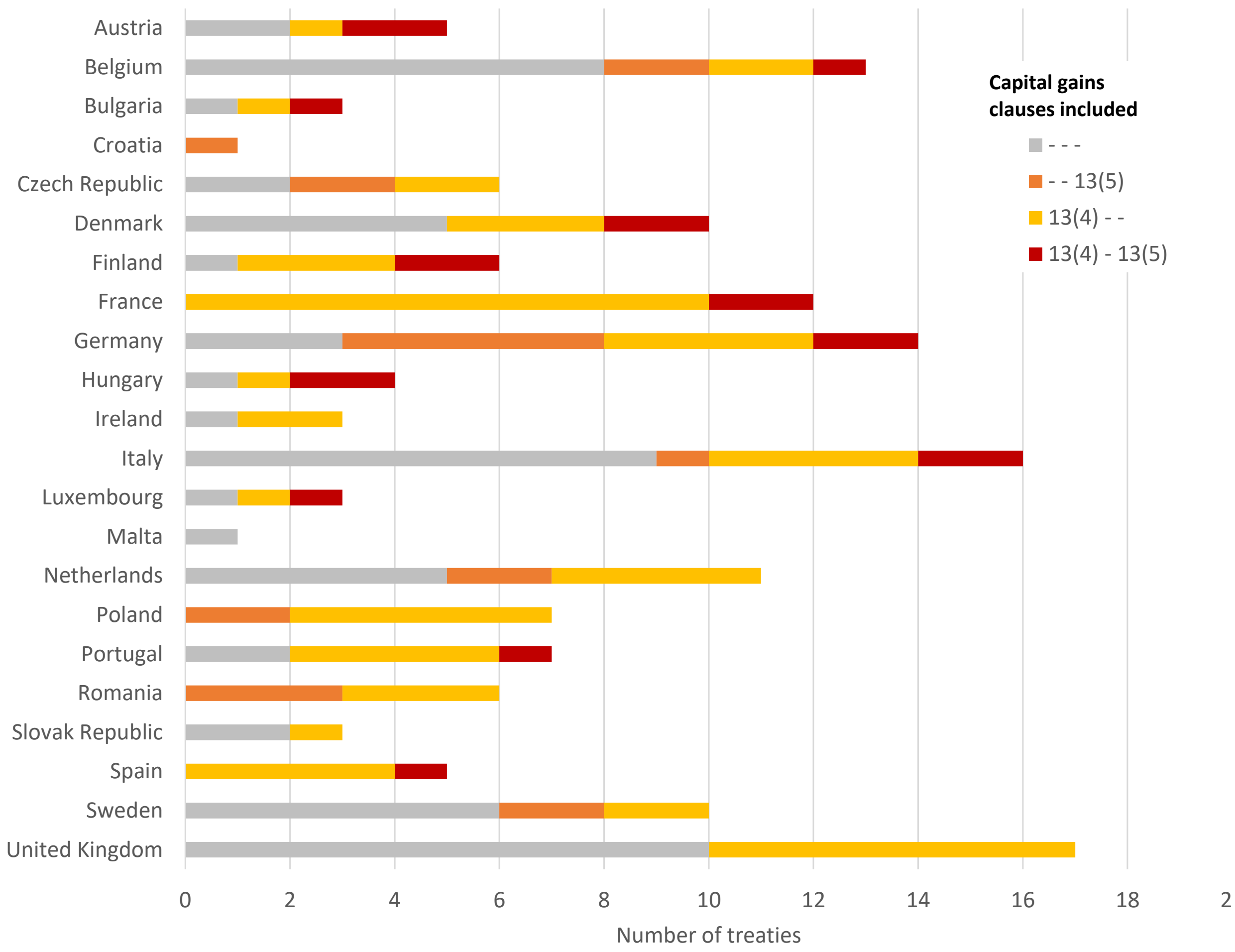


Figure 13: capital gains tax provisions in EU treaties

Example 2: Taxation of capital gains

While treaty clauses such as those related to permanent establishment and withholding taxes cause a steady stream of foregone revenue, those relating to capital gains tax can have large, on-off costs. As an IMF and OECD policy paper highlights, this is particularly the case for sectors such as mining and telecoms, where tax treaties can prevent developing countries taxing transactions worth tens or hundreds of millions of dollars in tax revenue. Two clauses in particular are relevant to such cases. Treaties generally permit the source country to tax the gains realised by foreign residents when they sell 'immovable property', such as real estate, including for example a mine. This can often be avoided by instead selling the shares of an offshore company that owns the property, and so article 13(4) of the UN and OECD model conventions extends the source country's taxing rights to incorporate such 'indirect transfers' of assets. Article 13(5) of the UN model convention goes further, allowing the source country to tax the sale of shares in a local company even if that sale is by a resident of the treaty partner, subject to some limitations.

As figure 13 shows, there is a wide variation in the extent to which EU members allow these clauses to be included in their treaties with developing countries. France, for example, includes 13(4) in all its treaties, while for many other countries it is the exception, rather than the rule. 13(5) is much less common. Overall, we find article 13(4) in 51% of EU members' treaties with developing countries, compared to 53% in the sample as a whole. Article 13(5) is included in just 24% of EU members' treaties, compared to 29%. EU members are thus less willing to accept these provisions than others, but the difference is not as large as it was for the services permanent establishment.

RECENT DEVELOPMENTS

The controversy surrounding tax treaties and the international tax regime more generally has created new initiatives in many forums, some of which are listed below. It has also pushed a few individual states to re-examine and renegotiate their tax treaties. As the brief summaries below demonstrate, however, these efforts have been marked by a lack of ambition and a reticence on the part of OECD Member States, including EU members, to re-examine the fundamental source/residence balance of the international tax regime.

OECD/G20 BEPS project

The OECD's Base Erosion and Profit Shifting (BEPS) project began in 2013, and updates international tax rules to strengthen them against aggressive international tax planning. It offers developing countries the chance to strengthen their tax treaties against tax treaty shopping, primarily by signing up to the Multilateral Instrument (MLI) that will implement many of its recommendations. As noted earlier, the BEPS project has so far left the balance of taxing rights between source and residence countries untouched. The treaty provisions available within the MLI, which were developed among OECD and G20 countries, are also of questionable value to countries with less developed tax law and administrative capacity. In most cases, tax treaty shopping will be tackled through the inclusion of a Principal Purpose Test, which allows tax authorities to override the treaty where they can demonstrate that the main aim of a particular transaction is to avoid tax. Some commentators regard this subjective test as a difficult one for the tax authorities of developing countries to implement, recommending simpler and more objective tests instead. Nonetheless, EU members are all signatories to the MLI, and so their treaties with developing countries that also sign the MLI may see some improvements to their ability to tax inward investment in cases of aggressive tax planning. As Eurodad note, however, these benefits are further limited by the reservations that EU members and other signatories have made, opting out or failing to opt in to some of its provisions, including the inclusion of a simpler anti-treaty shopping rule.[20]

United Nations

While the Parliament and the EESC have made specific mention of the need to strengthen the role of the UN tax committee, which maintains the UN model convention, the European Council remains opposed. In a consultation in 2015, the EU argued against any strengthening of the committee, citing "the increased resource commitments that would be inherent in any suggestion to upgrade or expand the mandate of the UN Committee of Tax experts."[21] A stronger UN committee would both be able to update its model convention more quickly in response to changes at the OECD and elsewhere, and to work independently to address the systemic bias in favour of residence-based taxation within the OECD-centric international tax regime. In the most recent update to its model treaty, it has taken the notable step of adding an article permitting the levying of WHT on technical service fees. Its inclusion in the UN model will strengthen developing countries ability to push for such clauses within their bilateral treaties. While it is at first sight naïve to expect EU members to support the strengthening of developing countries'

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20 Eurodad, Tax Games: the Race to the Bottom, 2017.

21 European Union, "European Union and its members states position on options for Further strengthening the work and operational capacity of the committee of experts on international tax cooperation, with an emphasis on better integrating its work into the programme of work of the council following its reform and effectively contributing to the financing for development process and to the post- 2015 development agenda," 2015. http://www.un.org/esa/ffd/wp-content/uploads/2015/03/ICTM2015_EuropeanUnion.pdf

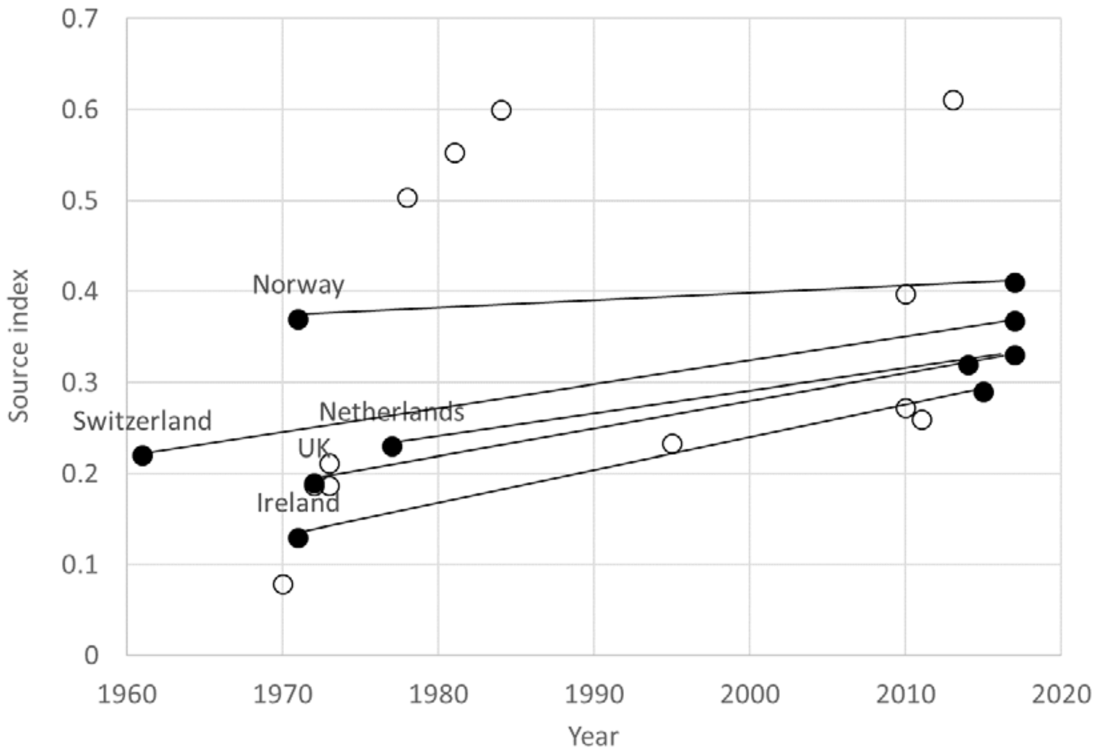

Figure 14: Zambia's tax treaty renegotiations

hands in negotiations, it is a natural corollary to the enlightened approach to bilateral negotiation advocated by the European Parliament.

European Union

At EU level, the main activity of direct relevance to this discussion is the work by the Commission, with the Platform for Good Governance on Tax, to develop a toolkit for spillover analysis. As noted earlier, uptake of this toolkit has not been strong so far. In addition, the EU tax haven blacklist first published in December 2017 puts pressure on third countries to join the OECD's BEPS Inclusive Framework and apply the minimum standards agreed by OECD and G20 countries in 2015. This could have the effect of pressuring tax havens and developing countries alike into signing the MLI, increasing the number of bilateral treaties that include anti-treaty shopping measures. As noted earlier, however, the MLI and other BEPS measures do not rebalance taxing rights towards more source taxation, the focus of this report.

Member States

Outside of these processes, several Member States have begun to renegotiate their tax treaties with developing countries. The Netherlands has offered renegotiations to a number of developing country treaty partners, although few of these renegotiations have yet been concluded. Ireland, the Netherlands and the UK have all renegotiated their treaties with Zambia, which gives us an opportunity to examine the impact of renegotiations. Figure 14 shows all Zambia's tax treaties in the dataset, as well as its renegotiated treaties with five countries. While all of these renegotiations have strengthened the source content of the treaties, the treaties with the three EU members are the most residence-based, and are still below 0.4, the EU average. This may not be surprising: the Ireland treaty shows the greatest increase in the index value, bit it also began from an unusually low base; the Netherlands renegotiation was primarily motivated by the aim introducing an anti-abuse clause into the treaty; improvements in some areas of the UK treaty were counteracted by a reduction in withholding tax rates requested by the UK.[22]

22 Hearson, *Tax Treaties in Sub-Saharan Africa: A Critical Review*, 2015.

CONCLUSION AND RECOMMENDATIONS

The evidence at present doesn't permit us to make any generalised, overall cost benefit analysis of tax treaties, but what is clear is that many developing countries have given up too much of their taxing rights in their negotiations with EU Member States: more than they needed to in order to reach agreement, based on what those states have agreed to elsewhere; more than was wise to ensure that the benefits exceeded the costs. This is not to argue that tax treaties are inherently problematic (though such an argument could be made), but rather that the benefits developing countries may seek to obtain from tax treaties can largely be disentangled from the extensive sacrifice of taxing rights that they have made, and that EU members continue to extract from them in many cases. Allowing developing countries to benefit from tax treaties without expecting them to give up much-needed revenue is a matter of policy coherence for development.

The analysis in this report supports recommendations that have already been made by EU institutions (box 4). In particular:

1. EU Member States should conduct spillover analyses incorporating reviews of their double taxation treaties, based on the principle of policy coherence for development and taking into account guidance from the European Commission and other bodies. It is not enough to focus on tax treaty shopping, nor to test tax treaties against prevailing norms among OECD countries. The balance of source and residence taxation is at issue, and the EU should be leading by example. Countries should therefore review their treaties individually to identify the most restrictive treaties, as well as examining their treaty networks across the board, with a willingness to renegotiate.

2. Spillover analyses should lead to a rolling plan of renegotiations to:

   a. Progressively increase the source taxation rights permitted by EU members' treaties, especially in the area of permanent establishment

   b. Introduce development-friendly measures such as anti-treaty shopping and assistance in the collection of taxes, without requiring any *quid pro quos*.

3. The EU should reconsider its opposition to a stronger UN tax committee, as the Parliament has already requested. This is a natural corollary of the recognition that policy coherence for development requires a rebalanced international tax regime with greater respect for the principle of source taxation. To help developing countries advocate through the UN, the OECD's Inclusive Framework, and other forums, the EU should also pay more attention to organisations advocating on their behalf, such as the African Tax Administration Forum and the South Centre, so that developing countries can develop policy independently.

4. The EU should formulate and publish an EU Model Tax Convention for Development Policy Coherence, setting out source-based provisions that EU Member States are willing to offer to developing countries as a starting point for negotiations, not in return for sacrifices on their part. This would be part of the EU's leadership role.

BOX 4: EXTRACTS FROM RECOMMENDATIONS FROM EU INSTITUTIONS

European Commission suggestions for questions to be asked during a 'spillover analysis' of tax treaties[1]

1. Do my DTAs with developing countries reduce their capacity to levy withholding taxes in a disproportionate way? Is the benefit of the reduced withholding tax (in terms of additional foreign investments) really sufficient to compensate for the loss of tax revenues?
2. Should the notion of permanent establishment be adjusted to accommodate the particular needs of developing countries?
3. Could a new article on "Fees for Technical Services" in tax treaties ensure fairness and new tax resources for developing countries?
4. Does the DTA's provide for a fair allocation of capital gain tax rights by source countries?
5. Which measures could be introduced to simplify the administration of transfer pricing?
6. Should DTAs without a proper anti-abuse clause be re-negotiated?
7. Would it be feasible to introduce a dispute resolution mechanism in DTAs with developing countries?
8. Would developing countries benefit from a specific, supportive approach while negotiating DTAs?

Economic and Social Council recommendation on tax treaties[2]

The EESC sees impact assessments of Member States' international taxation policies as a way of testing the impact of DTAs and tax inducements on developing countries. This should be encouraged and made common practice. Where there are potential conflicts with European development policies, such analysis would also make sense for the European Union. Existing DTAs should be revised and new ones to be negotiated should be concluded while taking these considerations on board.

The OECD Model Tax Convention, which is currently most widely used, was developed first and foremost with a view to developed countries' interests. Therefore, the EESC recommends that, when negotiating DTAs with developing countries, EU Member States take more account of the needs of developing countries. The EESC notes that, based on the OECD convention, the UN also developed a Model Double Taxation Convention to regulate taxation between developing and developed countries in order to give source countries more taxing rights.

European Parliament resolution on tax avoidance and tax evasion as challenges in developing countries

[Parliament] Strongly supports the range of existing international initiatives to reform the global system, including the OECD Base Erosion and Profit Shifting (BEPS) initiative, with a focus on the increased participation of developing countries in the structures and procedures of international tax cooperation; urges the EU and the Member States to ensure that the UN taxation committee is transformed into a genuine intergovernmental body, better equipped and with sufficient additional resources, inside the framework of the UN Economic and Social Council, ensuring that all countries can participate on an equal footing in the formulation and reform of global tax policies; stresses that sanctions should be considered both for non-cooperative jurisdictions and for financial institutions that operate within tax havens.

1 Toolbox spill-over effects of EU tax policies on developing countries. Platform/32/2017/EN https://ec.europa.eu/taxation_customs/sites/taxation/files/toolbox_dtas_spill_overs_en.pdf

2 European Economic and Social Committee. EU development partnerships and the challenge posed by international tax agreements. REX/487. https://www.eesc.europa.eu/en/our-work/opinions-information-reports/opinions/eu-development-partnerships-and-challenge-posed-international-tax-agreements

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