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LECTURES IN :

Tax International

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Course Description:

This course is an introduction to first year Master of Accounting students and represent theoretical framework on International taxation .The purpose of these lectures is to provide Master students with to compare tax systems at the international level by indicates historical development and the factors influencing the built of the tax system. In addition, with the increase of cross border transactions, access to the global marketplace grows. The international tax environment is constantly transforming because of changes in taxes and regulations. Therefore, learners need to comprehend, comply with, and manage these global tax affairs, to reach their strategic business goals. It is teaching in seven lectures, introducing the student to many knowledge related to tax treaties, tax competition, tax harmonization, international tax evasion and tax havens…Etc.

Course Objective:

The purpose of this course is to:

- Research into the historical development of tax systems;
- Identify international organizations and bodies supervising the management of international taxation;
- Analysis of various tax theories and identification of their theorists;
- Identify the importance of tax treaties at the international level;
- Understanding international taxation to avoiding the potential pitfalls of double taxation and to legally exploiting the advantages offered by differences between national taxes systems.

Course structure:

In regards to the organisation of the course, it comprises seven themes. The seven themes are to be covered in the complete academic year. It is also worth noting that teaching the lectures requires a set of acquired knowledge for the student, represented by: international accounting standards, international finance and international law. Each theme is delivered in two lectures. This simply means that the overall number of lectures to teach the course is 14 lectures. As for the teaching approach, using the descriptive analytical approach.

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THEME ONE: INTERNATIONAL TAX AS INTERNATIONAL LAW

Introduction:

Taxes are a compulsory contribution levied by government to raise funds to be spent for public purposes (public services), including the support of the government. At some level, if there were no taxes there would be no government. In the words of the famous American judge Oliver Wendell Holmes, '[t]axes are what we pay for **civilized society**'. The result is an economic or financial relationship between community members and their government.

1- Definition of Domestic and international taxation:

Taxation is an essential function of the modern state. Broadly, speaking, international taxation refers to the 'international' elements of national tax policies. Thus, international taxation encompasses the taxation of cross-border economic activity, both foreign direct investment (FDI) from multinational enterprises (MNEs), and foreign portfolio investment (FPI), by national governments.

Thinking of international taxation as a governance regime helps to conceptualise the collection of rules, norms, and principles that underpin international taxation, as forming part of a cohesive legal 'order.' Broadly speaking, the institutional origins of the ITR stem from the work of the **League of Nations** during the **1920s and 1930**s (Cadzow, L. International Tax.ictd ,2023).

There are researchers who said in Roman law, us gentium was applicable to non-Latin subjects of Rome (Peregrini), foreigners were excluded from the jus civil reserved for Roman citizens, and what we call today **domestic law**. Then, in the 16th century, a shift towards public **international law** was possible thanks to the transformation of jus gentium into jus inter gentes, a set of legal rules governing relations between States, what we called today **international law**.

In addition, Domestic tax rules reflect a permanence over time of national tax systems with foreign elements without any harmonization. This is what some

contemporary authors refer to as the taxation of "transnational" income on the contrary; international tax rules reflect the idea of a mutation, aiming to determine whether the repetition of old rules, practices and procedures is giving way to certain mandatory common rules applicable to each country in tax matters(Sadowsky, M.,2021).

International tax law is the comparative study of the tax laws and tax accounting rules of trading countries, the potential application of tax treaties to alleviate taxation, and strategies for multinational tax burden and risk management planning(https://blog.law.tamu.edu,2023).

Kevin Holmes described International Taxation as “the body of legal provisions of different countries that covers the tax aspects of cross-border transactions.” It is concerned with Direct Taxes and Indirect Taxes. In other words, it is an area of knowledge pertaining to the International aspects of tax laws and global tax treaties. At the onset, it is important to note that there is no codified International Tax Law. There are no generally accepted taxation laws by all countries. Further, there is no separate Court to interpret International tax regime. There are provisions in domestic taxation laws of the countries to handle Cross-Border direct and indirect taxes. Nations attempt to reconcile domestic taxation laws for cross-border transactions by way of taxation treaties(https://nliu-cril.weebly.com,2023).

2- The current international tax framework :

When a business activity crosses national borders, the question arises as to where the profits resulting from that activity should be taxed. In principle, there are at least three possibilities for assigning a taxing right:

- **Source**: the countries where production takes place
- **Residence**: the countries where a company is deemed to reside
- **Destination**: the countries where sales take place.

The current international tax framework is based on the so-called "1920s compromise". In a very basic outline, under the "compromise" the primary right to tax active business income is assigned where the activity takes place—in the "source" country—while the right to tax passive income, such as dividends, royalties, and interest, is given up to the "residence" country—where the entity or person that receives and ultimately owns the profit resides. The system has, however, evolved in ways that considerably deviate from this historic "compromise," and international tax arrangements currently rest on a fragile and contentious balance of taxing rights between residence and source countries(Nersesyan, N.,2021).

The United States concluded its first income tax treaty in 1932. Though aimed generally at facilitating trade and investment between the U.S. and France, the agreement was a limited one even by the nascent international standards of the period(https://heinonline.org,2024).

3- Is International Tax Law Part of public International Law?

International tax law is a big, blind spot on the radar of public international law. This might stem, at least to some extent, from the misnomer that the term "international tax law" entails: it has been used to refer "to all international as well as domestic tax provisions relating specifically to situations involving the territory of more than one state, or so-called "**cross border situations**" […]". Hence, most of what is discussed as international tax law in the literature actually constitutes transnational tax law – which touches upon a second (and much more important) observation: traditionally, international tax has been studied almost exclusively by tax lawyers trained in domestic tax law, without any input by or cooperation with scholars of public international law.

Whatever the reason for this lack of comprehensive research within the field of international law, the existence of "international" tax law and its classification **as part of international law** is now mostly undisputed. However, the implications of

international tax being part of international law remain under-studied(Avi-Yonah, R. S.,2003).

Few would dispute that the network of bilateral tax treaties forms an important part of international law. Thus, the key issue is whether these treaties and the domestic tax laws of various jurisdictions can be said to form an international tax regime that is part of customary international law(Avi-Yonah, R. S.,2007).

4- What is the purpose of cross-border tax rules?

Businesses generally follow what makes most sense from an economic perspective when designing their supply chains and investing across borders. However, the economic reasons for a certain structure may need to align with what makes most sense from a tax perspective.

Multinational businesses have employees and operations in countries all around the world. When a company earns profits in a foreign jurisdiction it will often send some of those earnings back to its headquarters, which may distribute a portion to shareholders as a dividend. Each of these activities could trigger one or more international tax rules.

International tax rules define which countries tax the profits of a multinational business. Generally, the purpose is to ensure that the income of companies is taxed **once rather than multiple times by multiple jurisdictions**. When more than one country taxes the same earnings of a multinational, the result is **double taxation**, which is a barrier to cross-border investment(https://taxfoundation.org,2024).

5- Current State of Scientific Research in International Tax :

So far, almost all scientific research on international tax law has been conducted by academics specialized in domestic and/or transnational tax law. Hence, there is ample literature on the topic of international tax law and international tax policy, but almost all of this research focuses on the transnational/cross-border aspects of specific

domestic tax laws; there are almost no "global" analyses to establish the international aspects of taxation.

Reuven Avi-Yonah's book "International Tax as International Law" from 2007 is the starting point for this thesis, as it was the first book that established certain principles of international tax as customary international law. Yet, the book discusses the international of international tax mainly from the perspective of a US tax lawyer, without paying much regard to other domestic legal systems as would be required to identify customary international law. Analysis on the newly identified customary international tax laws has been sparse, although some scholars have reproduced **Avi-Yonah's** findings. However, at the end of 2017, a new book called "A Global Analysis of Tax Treaty Disputes", edited by **Eduardo Baistrocchi**, appeared; this book contains a compilation of contributions by tax scholars on tax treaty disputes in 28 domestic legal systems (OECD and BRICS countries and six countries "beyond the OECD and BRICS", while three of those six are nonetheless part of the G20). One of the aims of this book is to establish whether the international tax regime entails rules of customary international law character. **Baistrocchi's book** will facilitate the research for this thesis by offering a large amount of evidence on state practice and opinio juris; nevertheless, he does not specifically target the single tax principle and the source primacy principle in the book and does not address potential general principles of law(Mag.a Céline Braumann, LL.M,2018).

6- Sources of International Tax Law :

6-1 Domestic Law: The charge to tax is inevitably found in the domestic law of each country.domestic tax means a tax chargeable on profits or gains, under the laws of a territory in which the head office of an entity is established, that is similar to income tax, corporation tax (including a charge under(https://www.lawinsider.com,2024).

6-2 Tax Treaties: Tax treaties are essentially a bilateral agreement as to how two countries agree to divide taxation of cross-border dealings between them(Harris,

P.,2020).There are three main types of tax treaties: **multilateral** tax treaties, **model** tax treaties, and **bilateral** tax treaties(https://guides.lib.unc.edu,2024).

6-3 foreign law: consists of the rules governing the domestic laws of individual foreign countries(https://law.duke.edu,2024).

7- International Tax Standards:

International tax standards include minimum standards developed by an international effort, such as the **BEPS** Project as well as standards that evolved over the years from a unilateral standard to an international one. The minimum standards are "hard" standards as they are expected to be incorporated into domestic tax laws. The G20/OECD BEPS Project created minimum standards on tax transparency, preventing treaty abuse, country-by-country reporting and disputes resolution. Countries participating in the Inclusive Framework on BEPS are expected to implement these standards. Once implemented, these standards become law.

The international tax aspects of domestic tax laws often reflect well-accepted international tax standards or norms, such as asserting tax jurisdiction on the basis of residence of taxpayers and/or source of income and providing relief from double taxation through a foreign tax credit or foreign income exemption method. The arm's length principle has been adopted by many developing countries. The origin of these standards can be traced to the work of League of Nations in the early 20th century and have been found in the domestic laws of many countries through the process of legal borrowing or transplantation. There are some rules that were originated in the domestic law of one country and were subsequently adopted by other countries, thereby becoming international norms or standards. Examples are the foreign controlled corporation (CFC) rules and general anti-avoidance rules.

A recent example is the reporting standard, which originated in the **U.S. FATCA** (Foreign Account Tax Compliance Act) and was subsequently incorporated into bilateral agreements and then became the basis for the global common reporting standard **(CRS)** (Jinyan Li,2019).

8-Example of Theory of International Taxation (A Theory of Global Tax Hubs):

By (BAISTROCCHI, EDUARDO A.2023)

A Theory of International Taxation combines qualitative and quantitative analyses to shed light on the shaping of the international tax regime (ITR) over the last century. It offers a theory of the ITR as the product of the strategic interaction between three small groups with market power: **international investors**, **tax hubs and endpoint jurisdictions**. These actors play different yet interrelated roles within the same ecosystem(Baistrocchi, Eduardo A.,2023)..In addition, the **first theory** of tax hubs as a global intermediation marketplace grounded on the two-sided platform concept.

What is the theory of global tax hubs?

Legal scholars of international taxation increasingly focus on considerations of justice. Domestic duties of distributive justice are being challenged by the inability of states to collect tax revenues in a competitive global world. Gaps between rich and poor countries add another dimension to the debate, raising questions as to the duties those rich countries may have in narrowing these gaps. These conundrums invite rethinking of the governance of international taxation, its mechanisms and its institutions(https://www.law.ox.ac.uk,2024).

The theory see global tax hubs market is a noncollusive oligopoly of low-tax jurisdictions that, as two-sided platforms, provide an intermediation service to two distinct types of users, specifically international investors and endpoint jurisdictions.

The endpoint jurisdiction concept denotes both the country of residence of the **international investor** and the **country of source**. Moreover, endpoint jurisdictions typically have **high nominal tax rates** on corporate profits.

Tax hubs normally have **low effective tax rates** on corporate profit and charge something functionally equivalent to a fee for their matchmaking service. There are various tests for identifying jurisdictions that play the role of tax hubs.

One of the tests rests on two elements. The first element is a total inward **foreign direct investment** (FDI) position above 100 per cent over gross domestic product (GDP). The second element to identify a **tax hub** is that it is usually a member of at least one international organization with influence on global standard setting in international taxation, like the League of Nations, OECD, and the G20. This membership indicates both the tax hub's potential to influence the agenda setting of this sort of international institution and the tax hub's continuous interaction with endpoint jurisdictions and international investors.

Switzerland, the Netherlands, and Belgium have met both elements since the establishment of the League of Nations in 1919, whereas Ireland and Luxembourg joined the tax hub market after the inception of the OECD in 1961. Hong Kong, as part of the People's Republic of China, became a tax hub with the emergence of the G20 in 2009. On the other hand, tax havens typically do **not belong as members** to such international organizations; thus, tax havens' connectivity with **endpoint jurisdictions** and **international investors** is typically indirect through tax hubs.

Two assumptions are made here:

(1) Jurisdictions (including global tax hubs) are regularly engaged in international tax competition within a compatible standard (rather than between incompatible standards). The current compatible standard is the OECD Model and similar soft laws, which channels international tax competition into areas that are not regulated by the OECD Model; the definition of corporate residence is a case in point.

(2) The global tax hub market is a noncollusive oligopoly because their few members coordinate their interests in an implicit, rather than explicit, way. Moreover, each tax hub member of this market is in a never-ending search for comparative advantages in terms of, for example, industry and regional scope.

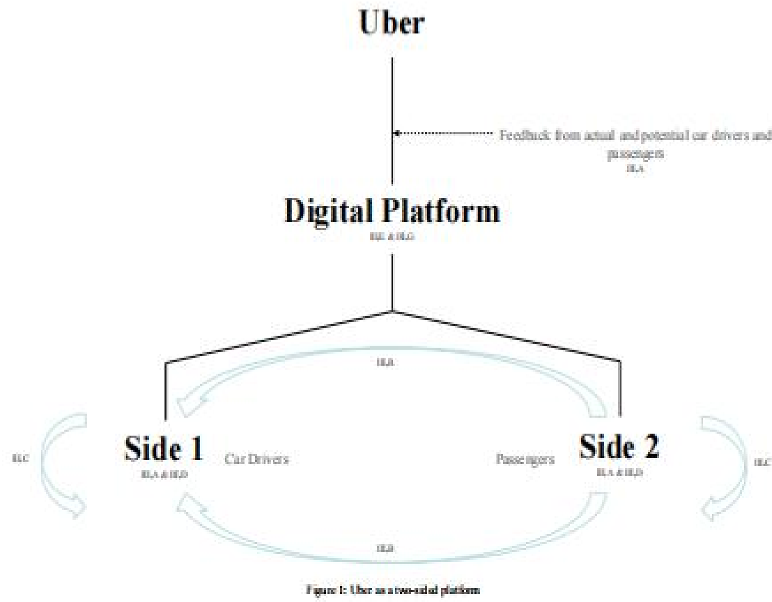
By developing this theory, attempted to put forward three contributions. First, it applies the **two-sided platform** concept as a positive model to explain the logic of intermediation involving tax hubs in the ITR over the last century (1923-2023).

Second, it aims to show the theory's explanatory power by outlining a stress test and answering why both a representative country of **residence of international investors** and a **representative country** of source typically have the incentive to sign tax treaties with tax hubs. Third, it identifies the normative limitations of the theory and its potential impact on international tax policy.

Four alternative names have been used to denote the intermediation role played by this group of jurisdictions in the ITR: tax haven, investment hub, tax hub and offshore finance. There is a strategic difference between tax havens and tax hubs. Indeed, four elements capture the scope of the tax havens concept: 1) low or no taxation that is not correlated with high revenue, relative to needs, from other sources; 2) the attraction of profit shifting more than economic activity. For example, total inward foreign direct investment (FDI) position above 100 per cent over gross domestic product (GDP) imperfect sharing information;4) no membership with at least one international organization with influence on global standard-setting in international taxation, like the League of Nations, OECD, and the G20. This strategic difference between tax havens and tax hubs has a range of implications. For example, tax hubs usually play a front-office role with endpoint jurisdictions, while tax havens play a back-office position, i.e., no direct interaction with endpoint jurisdictions.

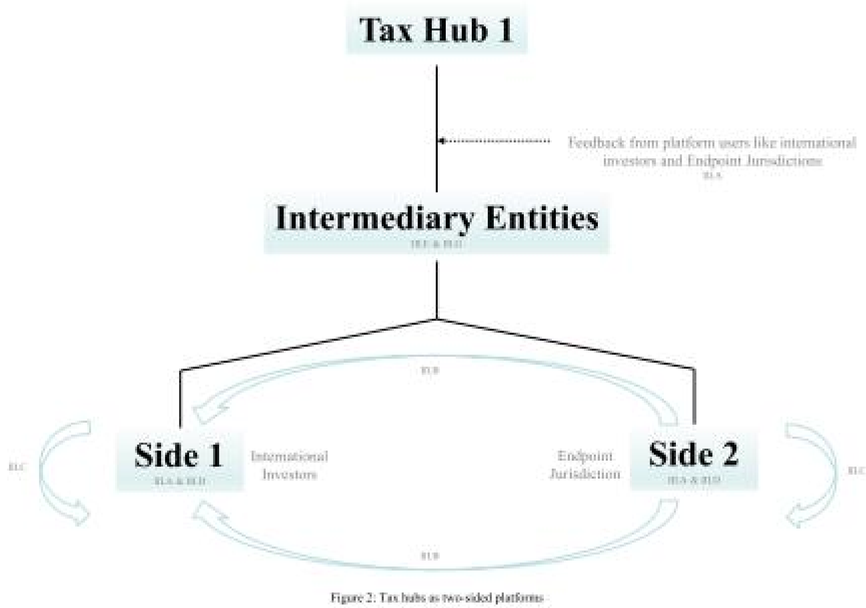
This different allocation of roles between tax havens and tax hubs can be seen in tax planning like the one involved in the Apple Ireland State Aid case Indeed, while Ireland served as a tax hub directly connected with endpoint jurisdictions such as the U.S. and continental Europe, Bermuda, as a tax haven, was only directly connected to Ireland. Therefore, tax hubs and tax havens are different but interconnected markets and, as such, are subject to reciprocal network externalities.

Figure 1 : two-sided platform



Source: Baistrocchi, Eduardo A.(July 9, 2023).A Theory of International Taxation

Figure 2: Tax Hub



Source: Baistrocchi, Eduardo A.(July 9, 2023).A Theory of International Taxation

- The theory maintains that tax hubs are a global two-sided marketplace offering matchmaking services between international investors and endpoint jurisdiction.;

- The theory is positive rather than normative;

- It assumes that offshore finance in general and the tax hubs marketplace in particular happen with the support or at least tacit agreement of endpoint jurisdictions;

- It also assumes that offshore finance (including tax hubs);

- The theory has limitations from a normative perspective. Indeed, taxes are not a standard transaction cost;

Finally, the theory has the potential to offer a new perspective on international tax policy. For example, it might be the starting point to explore the feasibility of transplanting elements of antitrust law governing two-sided platforms to minimize problems like free riding by tax hubs and/or their users. Indeed, antitrust law may provide a fruitful conceptual framework to further understand the driving forces of the international tax regime and how to minimize opportunistic behaviour(Baistrocchi, E. A. ,2023).

Notes:

- A two-sided marketplace (also called a two-sided network) is a **platform** that brings together two groups of users—usually buyers and sellers—around a specific type of product or service.

- Tax Hub support strengthening domestic resource mobilization and international tax cooperation as an important strategic.

- Define two key concepts the strategic structure of the tax hub market: **two-sided platform and oligopoly**. The **purpose of a two-sided platform** is to **minimize transaction** costs between platform users who can benefit from coming together, permitting value-creating exchanges to take place that would not otherwise occur .The core role of a two-sided platform is to enable parties to realize gains from interactions

by reducing transaction costs. Two-sided platforms are frequent in old economy industries, like those based on advertising-supported media and new economy industries, such as those based on web portals like **Uber**.

Table 1:

Taxes as a Percentage of GDP, 2022

Country	Total Tax Revenue as Share of GDP	Rank
France	46.1%	1
Norway	44.3%	2
Austria	43.1%	3
Finland	43.0%	4
Italy	42.9%	5
Belgium	42.4%	6
Denmark	41.9%	7
Sweden	41.3%	8
Greece	41.0%	9
Germany	39.3%	10
Luxembourg	38.6%	11
Netherlands	38.0%	12
Spain	37.5%	13
Slovenia	37.4%	14
Portugal	36.4%	15
United Kingdom	35.3%	16
Poland	35.2%	17
Iceland	34.9%	18
Slovak Republic	34.8%	19
Japan	34.1%	20
Czechia	33.9%	21
New Zealand	33.8%	22
Canada	33.2%	23
Hungary	33.2%	24
Israel	32.9%	25
Estonia	32.8%	26
Korea	32.0%	27
Lithuania	31.9%	28
Latvia	30.2%	29
Australia	29.5%	30
United States	27.7%	31
Switzerland	27.2%	32
Costa Rica	25.5%	33
Chile	23.9%	34
Ireland	20.9%	35
Türkiye	20.8%	36
Colombia	19.7%	37
Mexico	16.9%	38
OECD - Unweighted average (including United States)	34.0%	
OECD - Unweighted average (excluding United States)	34.2%	
OECD - Weighted average (including United States)	32.1%	
OECD - Weighted average (excluding United States)	34.3%	

Source: OECD, Revenue Statistics, Comparative Tables: Tax Revenue (retrieved 01.03.2024).

THEME TWO: TAX TREATIES

Introduction:

The largest tax treaty network among European OECD countries belongs to the United Kingdom, which has treaties with 130 countries. The UK is followed by France (122 countries) and Italy (100 countries)(https://taxfoundation.org ,2023).Tax treaties, as treaties in general, are international agreements and they are binding on the contracting states under international law. Harman J. agreed with Goulding J. in Union Texas Petroleum Corporation v. Critchley, stating,'' … a double taxation agreement is an agreement. It is not a taxing statute, although it is an agreement about how taxes should be imposed ...''.For this reason tax treaties should firstly be interpreted under international law rules, secondly under commentaries of the Model Treaty and the negotiation procedure of the agreements (Uzeltürk, H.,2015).

1- HISTORY OF TAX TREATIES:

The first tax treaty that dealt with the avoidance of double taxation dates back to 1899 and was concluded between the Austro- Hungarian Empire and Prussia. The treaty was based on the 1870 Prussian Imperial Double Taxation Law, which focused on the elimination of double taxation within the North German Confederation and provided the legal basis for Prussian taxation of foreign nationals. Although not in concept, but certainly in wording, it was the first time that taxation of land and business, and income from them, became exclusively taxable in the state of source.

The 1899 treaty between Austria- Hungary and Prussia laid the foundation and had a profound impact on the establishment of a network of ensuing similarly worded bilateral tax treaties during the first half of the 1900s. In the 1920s the League of Nations entrusted four economists to prepare a study on the economic aspects of international double taxation. Their report concluded that in most cases, double taxation penalizes the existing non-resident investor and prevents non-residents from making new investments. To address these concerns, the researchers favored, for practical reasons, allocating sole taxing rights to the country of source (method of

deduction for income from abroad), as opposed to the full allocation of taxing rights to the country of residence (method of deduction for income going abroad) or to the sharing of taxing rights between both states.

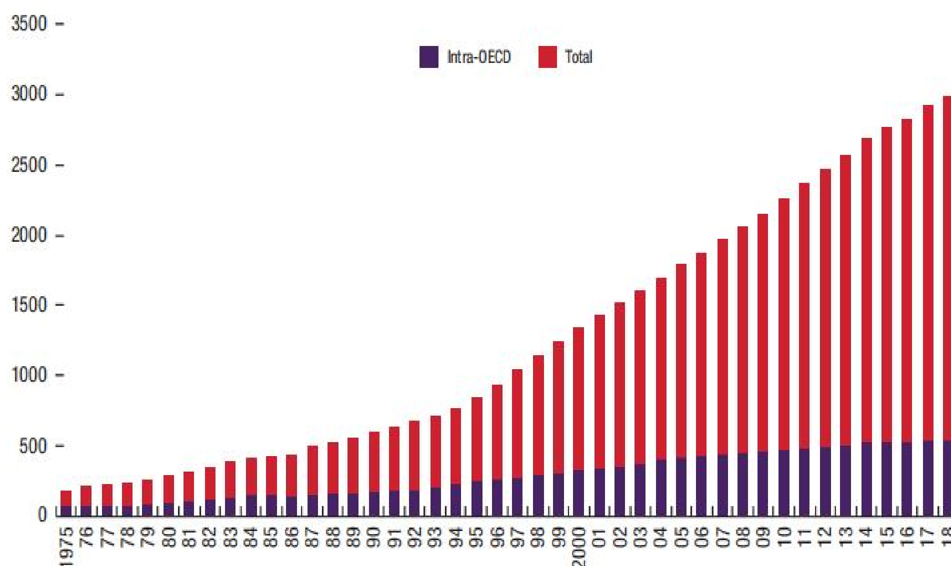
In 1928, the League of Nations adopted and published the Report on Double Taxation and Tax Evasion. Subsequently, the Fiscal Committee of the League of Nations worked on broadening the scope of the 1928 Convention the 1963 Draft Double Taxation Convention was built to account for the interests of the OECD membership and thus allocated considerable taxing rights to residence countries. As international fiscal relations increased, tax systems became more complicated, and new business sectors and organizations were emerging, it became apparent in the early 1970s that the 1963 draft model required updating.

A final version of **the first OECD Model Double Taxation Convention** on Income and on Capital (OECD Model) was published in 1977 and became the standard for bilateral treaty negotiations for years to come (mainly between developed countries). Since the 1990s, the OECD Committee on Fiscal Affairs regularly reviews and updates the model.

In parallel, the **UN** developed its own Treaty Model, which it first published in 1980. Given the premise upon which the OECD Model is written, and the interests of the members of the OECD whom the model serves, it is not unexpected that developing countries (being capital- importing countries) did not feel that it represented a reasonable sharing of taxing rights. The response of the developing countries was recourse to the UN to develop a model tax treaty that better reflected their interests. The Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries finalized the 1980 UN Model Double Taxation Convention between Developed and Developing Countries (UN Model), whose aim was to promote the conclusion of treaties between developed and developing countries, acceptable to both parties. In that sense, the **UN Model** provides a benchmark for a compromise treaty that better balances residence and source taxation. To a large extent, the UN Model followed the 1977 OECD Model. However, it did grant greater

taxing rights to source states, that is, the capital importing and developing countries. The UN Model has been, and continues to be, widely embraced by most developing countries (see Wijnen and Magenta 1997).The following figure explains Development of Worldwide Tax Treaty Network

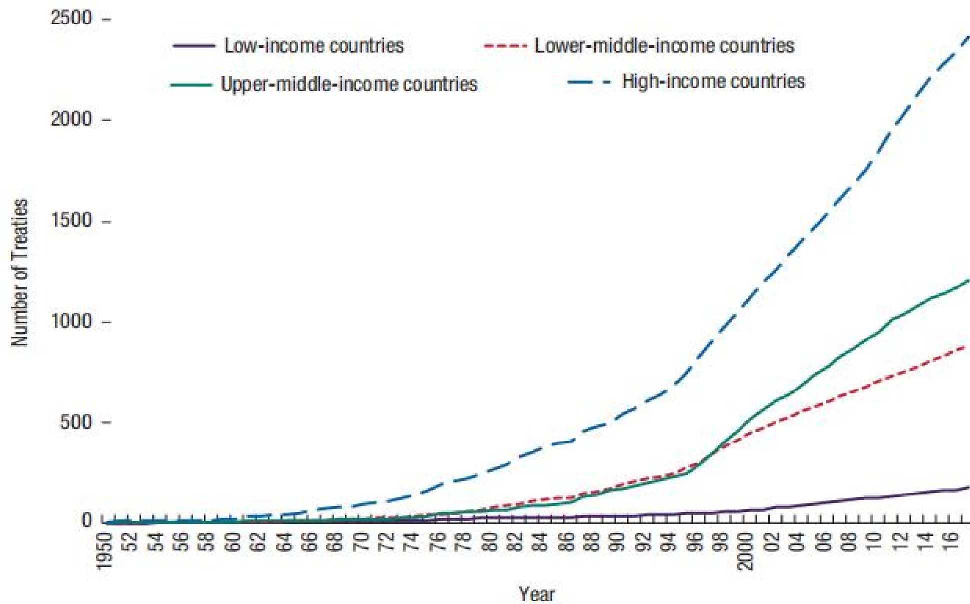
Figure 3: Number of Tax Treaties into OECD



Source: IMF staff based on IBFD data.

The OECD Model favors capital- exporting countries over capital- importing countries. Often, its proposed solution to eliminate or mitigate double taxation is to have the source country forfeit some or all its taxing rights on certain categories of income. Good examples of this are Article 12 on royalty payments and Article 13 on capital gains related to dispositions of shares, for which the OECD Model Tax Treaty proposes exclusive taxing rights to the residence country. **The UN Model imposes** much fewer restrictions on source- country taxing rights. The following figure Total Number of Tax Treaties in Force by Country Income Group

Figure 4: Total Number of Tax Treaties in Force by Country Income Group



Source: IMF staff based on IBFD data.

There are currently about 3,000 comprehensive bilateral income tax treaties in effect. As depicted in Figure 4, high- income countries have concluded substantially more tax treaties than any other income group category, while low- income countries tend to have the narrowest treaty networks. This has important implications for tax treaty negotiations between countries in these two income groups, as the former will typically have greater experience and better institutional and technical knowledge than the latter in terms of treaty negotiations(Leduc, S., and Michielse, G. ,2021) .

2- DEFINITION OF TAX TREATIES :

Treaties are agreements between sovereign nations. Article 2 of the Vienna Convention on the Law of Treaties, which applies to all treaties, provides A treaty is an international agreement (in one or more instruments, whatever called) concluded between States and governed by international law. Tax treaties are often called either “agreements” or “conventions.” As Article 2 of the Vienna Convention indicates, the name used is not important (Arnold, B.,2013).

A tax treaty is an agreement that's developed between two or more countries. The purpose is to help remove the possibility and issues surrounding double taxation. This relates to both active income and passive income for the residents of both countries. A tax treaty is a bilateral agreement between countries to cooperate on tax rules, which often helps workers avoid having to pay taxes on the same income to two separate countries(https://www.thebalancemoney.com,2023).

A tax treaty is a bilateral or multilateral agreement between two or more countries that aims to prevent double taxation and promote cooperation in tax matters. These agreements are designed to provide clarity and avoid conflicts regarding a taxpayer's liability for taxes in different jurisdictions(https://www.genio.ac,2023).

3- THE OECD/UN MODEL TAX TREATY:

There are two primary models of tax treaties that most countries choose to follow. The first one was developed by the Organization for Economic Co-operation and Development (OECD). This model currently (as of 2022) includes a group of 38 countries that have the purpose of promoting and driving world trade. The model imposes more restriction on the taxing rights of the income origin country, which gives them lesser taxing rights.

This model is more favorable towards countries that focus on exporting capital compared to countries that focus on importing capital. It describes that whoever the source country is will have to give up either some or all of the tax earned on specific categories of income. Both countries benefit from these types of treaty agreements if they have a relatively equal flow of trade and investment.

The second tax treaty model is formally referred to as the United Nations Model Double Taxation Convention between Developed and Developing Countries. The United Nations focuses on increasing both economic and political cooperation for all of its member countries. With this model, the foreign country making an investment is going to receive more favorable taxing rights. Despite some of the

differences, the United Nations Model uses many of the same practices that the OECD model does(https://www.freshbooks.com,2023).

The OECD Model Tax Convention on Income and on Capital (the OECD Model) provides a means of settling on a uniform basis the most common problems that arise in the field of international juridical double taxation. The main purposes of the OECD Model Tax Convention on Income and on Capital, which provides a means of settling on a uniform basis the most common problems that arise in the field of international juridical double taxation. The OECD Model Tax Convention provides the basis for the negotiation and interpretation of more than 3000 tax treaties that make up a network that co-ordinate the income and corporate tax systems of most countries with the objective of removing tax barriers to cross-border trade and investment(https://www.oecd-ilibrary.org,2023).

4- ABUSE OF TAX TREATIES :

The 1977 commentary on article 1 of the OECD model convention stated that tax treaties should not enable tax avoidance or evasion. Paragraph 7 provided that it was: "for the States concerned to adopt provisions in their domestic laws to counter possible manoeuvres. Such States will then wish, in their bilateral double taxation conventions, to preserve the application of provisions of this kind contained in their domestic laws." According to **De Broe**, the 1977 commentary therefore clearly implied that domestic anti-avoidance measures could not be applied to tax treaties, even if states perceived certain behaviour of taxpayers as abusive.

In 2003, the OECD's position regarding the relationship between tax treaties and tax avoidance was revised again. In paragraph 7 of the commentary on article 1 it is now emphasised that it is also a purpose of tax conventions to prevent tax avoidance and evasion. As a treaty should be interpreted in light of **its purpose**, the provisions of a treaty should be interpreted to prevent tax avoidance.

In December 1999, A Holding ApS ("A Holding"), a company resident in Denmark, purchased all shares in FAG, a company resident in Switzerland. A

Holding was a letter box company. On 30 November 2000 F AG distributed dividend in the amount of CHfr.5.5 million. F AG paid 35% of this amount as withholding tax to the Swiss tax authorities. The rest was paid to A Holding and the funds received were distributed by A Holding to its shareholder, C. Ltd, a company domiciled in Guernsey, on 15 December 2000. C Ltd was held by D Ltd which was domiciled in Bermuda. The director of D Ltd was E who had its seat in Bermuda.

Under article 10 of the tax treaty between Switzerland and Denmark dividends paid by a resident of Switzerland to a person residing in Denmark are taxable only in Denmark. On this basis A Holding applied for the reimbursement of the withholding tax. The Swiss tax authorities, however, rejected the claim on the ground that A Holding was only incorporated for the purpose of benefiting from the advantages of the treaty.

The tax treaty did not contain any anti-abuse provision. The federal court considered, however, that when applying an international convention, good faith, the aim and the purpose of a convention are to be taken into account. The federal court further held that this included the tackling of abuses: "**the prohibition of abuses is part of the principle of good faith**" Additionally, the court recognised that the principle of abuse of rights is recognised in Denmark. Furthermore, Denmark had during the negotiations of the treaty not made a reservation against the application of the Swiss anti-abuse resolution of 1962.

The court then looked at the question of whether A Holding abused the treaty. The court used the commentaries to the **2003 OECD model** to find guidance as to the circumstances, which could constitute abuse. More in particular, the court examined the transparency provision of paragraph 13 of the 2003 OECD commentary. Under this provision, treaty benefits are disallowed to a company that is not owned, directly or indirectly, by residents of the state of which the company is resident. Had the treaty contained a look through provision, it would have applied to A Holding since the company was indirectly controlled by a resident of Bermuda. However, as the treaty did not contain a look through provision, an abuse could only be assumed if the

Danish company **did not carry out a real economic activity or an active business activity**(Vleggeert, J. ,2015).

5- WHY NEGOTIATE TAX TREATIES :

Countries entering into tax treaty negotiations need a good understanding of why they are doing so, and the **benefits and costs** that arise from having tax treaties. Developing countries will often negotiate tax treaties in order to **attract foreign investment**. In many cases there may be pressing diplomatic reasons, e.g. as a response to pressure from another country. Sometimes they are negotiated because an **advisor has suggested** that it would be a good thing to do. On the other hand, some developing countries may refuse to have tax treaties, either generally or with particular countries, because of a **fear of reduced revenue** as a result of the limitations on source taxation that such treaties impose.

Tax treaties can benefit both developed and developing countries. For treaties between two developed countries, where the capital flows are approximately equal in both directions, the removal of **tax obstacles to cross-border investment** and the prevention of fiscal evasion provide clear benefits to both countries. Any reductions in source taxation are generally offset by increased residence based taxation(Pickering, A. ,2013).

6- BASE EROSION AND PROFIT SHIFTING (BEPS) :

BEPS 1.0 and MLI:

Was the result of the financial crisis of 2008-10, which led to austerity in the EU and the political necessity of imposing tax on multinationals (especially the US digital giants). BEPS 1.0 was a compromise between the EU positions (e.g., action 2, which was aimed at “check the box”) and the US positions (deferring action on the digital economy). On the key problematic elements of the treaty network, namely the permanent establishment threshold and the **arm’s length** standard in transfer pricing, not much was done.

An important innovation of BEPS 1.0 was the **Multilateral Instrument (MLI)**, designed as a mechanism to amend many treaties at once to incorporate BEPS 1.0 changes. The OECD published the MLI on November 24, 2016. The OECD stated that – The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS will implement minimum standards to counter treaty abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies. It will also allow governments to strengthen their tax treaties with other tax treaty measures developed in the OECD/G20 BEPS Project.

The new instrument will transpose results from the OECD/G20 Base Erosion and Profit Shifting Project (BEPS) into more than 2 000 tax treaties worldwide. A signing ceremony will be held in June 2017 in Paris. The OECD went on to explain that— The multilateral convention was developed over the past year, via negotiations involving more than 100 jurisdictions including OECD member countries, G20 countries and other developed and developing countries, under a mandate delivered by G20 Finance Ministers and Central Bank Governors at their February 2015 meeting.

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BEPS 2.0 and the MTC (MULTILATERAL TAX CONVENTION) :

BEPS 2.0 (2018) was the result of countries responding to the problem of how to tax the US digital giants (Amazon, Apple, Facebook, Google, Netflix) in the absence of a PE. Beginning with the UK in 2015, over 30 countries (as well as the EU) have adopted or proposed gross-based **digital services taxes**. These **DSTs** were considered discriminatory by the US, leading to the threats of trade sanctions. In addition, since they were not income taxes and therefore not subject to tax treaties, the OECD regarded them as a threat to its dominance of the ITR via the model.

In BEPS 2.0, the OECD in Pillar 1 finally abandoned both the **PE** limit (Permanent Establishment) and the **ALS** (arm's length standard) for part of the revenue derived from a market by large MNEs (over 20 billion Euros in revenue), but only if the MNE derives over $1 million Euro in profit from the market. This "Amount A" constitutes 25% of the profit that exceeds 10%. Because Amount A requires modifying articles 5, 7 and 9 of all the (double-taxation treaties) DTTs, it requires a MTC to come into effect. This, if Pillar 1 succeeds, the world will finally have a MTC. In the last section, we will examine the prospects for such a MTC(Avi-Yonah, R. S., and Lempert, E. ,2023).

THEME THREE: INTERNATIONAL TAX HARMONIZATION

Introduction:

"Why is policy intervention needed to promote harmonized taxes? The past two decades are characterized by a rapid increase of international capital mobility that raised concerns worldwide about the sustainability of capital income taxation. Distortions of economic activities caused by **fiscal competition** have led to numerous calls for international tax coordination measures to eliminate 'unfair tax competition' (Eggert, W., and Genser, B.,2001). Tax harmonization is an appealing **alternative** to tax competition. In a perfectly harmonized system, there is **no competition**, because there is no independent choice. Instead of a tax landscape strewn with widely differing rates and bases, a harmonized system features a **single tax rate applied** to a **common base**. Since tax rates do not differ, there are no tax-based reasons to prefer locating economic activity in one jurisdiction over another(Hines Jr, J. R. ,2023).

1- Coordination, cooperation, convergence and harmonization :

Consider two countries A and B raising a tax on a specific base so as to maximize some social objective. The reference case is that of tax competition whereby each country sets its tax base and rate independently, considering the tax base and rate of the other one as given. There are different ways to depart from this reference case.

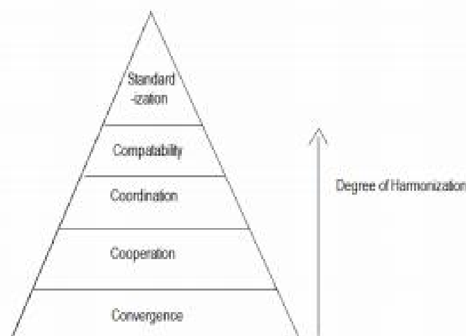
- Cooperation refers to joint optimization: countries A and B jointly determine the tax bases and rates so as to maximize some common social objective. In the European Union, the common external tariff policy is an example of cooperation.
- Coordination refers to commitment: since the choices of country A depend on those of country B and vice versa, there might be multiple equilibria (for instance one with high tax rates and another one with low tax rates). Coordination then consists in a reciprocal commitment to a specific behavior.
- Harmonization refers to an equalization of tax bases and/ or tax rates. A variant of harmonization is to impose minimum bases or rates. Harmonization is one form

of coordination. The minimum standard VAT rate and the Parent-subsidiary directive are examples of harmonization.

- Convergence refers to a narrowing of base differentials or of tax differentials. Convergence may arise from coordination or from competition.

Figure 5: Levels of Tax Harmonization

Diagram 1: Levels of Tax Harmonization



Methodologically Velayos et al. (2007) use political commitment as a criterion for classifying actions of harmonization. Other classifications which may involve the economic importance implied or different legal instruments are less consistent for drawing comparisons. The terms in the pyramid can be explained as follows:

Standardization: the highest form of harmonization, which entails having the same tax, which equalizes the tax burden under equal circumstances.

Compatibility: involves ‘adjusting the tax structure in order to counteract or compensate for the distortionary effects caused by the tax burden disparities upon the integration process (González Cano, 1996). This does not mean that elements in the tax structure are identical in rate or tax benefits fully (otherwise, there would be no difference from standardization. Compatibility is linked with more advanced integration objectives, when internal tax distortions are detected. When free trade areas are created, such as the EU and the AFTA, the compatibility of regulations may occur at an early stage. Velayos et al. (2007) use the example of mutual tariff benefits which may not be uniform but are compatible when all parties involved respect the ‘global reciprocity’ principle.

Coordination: The concept of tax coordination in the literature varies greatly. One explanation by Velayos et al. (2007) is that coordination is an 'in between' category as it may involve various elements of the other classifications. Coordination involves any harmonizing mechanism, which may not be confined to one category of harmonization. Codes of conduct are identified as coordination.

Cooperation: Entails a condition of mutual assistance, either for reasons of reciprocity (for instance, in regards to sharing information regarding taxation between the countries) or out of mutual interest (such as when double taxation is detected and two countries undertake to cooperate). Cooperation does not involve sharing a common tax policy as this would be a higher level of harmonization but may be practical, as in the above examples or theoretical. Velayos et al. (2007) identify taxation advice and sharing of best practice examples as theoretical cooperation. Cooperation contributes to consistent application of tax systems across jurisdictions by establishing bilateral and multilateral cooperation mechanisms, which can align tax administrations.

Convergence: Velayos et al. (2007) define convergence as a spontaneous movement in the same type of taxation policy direction as a result of pressures from globalization and competition. Convergence is regarded as the last step from the stance of voluntary political commitments. No one in particular harmonization action has been taken for reasons of political pressure but rather as the country cannot escape from the trend or concedes that it is in the best interest to take that action.

National sovereignty, an important consideration to any discussion regarding national policy, is most respected under the cooperation classification, as it involves no compromise on policy. According to Velayos et al. (2007), it is the most civilized form of harmonization, which occurs when there is identified mutual interest(Hayes, K. (2008).

2- Definition of tax harmonization :

A term that is opposed to tax competition is tax harmonization. The concept of tax harmonization is a relatively recent, being first mentioned in the EEC Treaty of Rome signed on March 25, 1957.

The most simplistic definition of tax harmonization is "the process by which various states are passing laws”. Tax harmonization is seen as the removal of fiscal barriers and discrepancies between national tax systems. A more complete definition of fiscal harmonization is considered to be: **"tax harmonization is not an optimal with a single goal**, but a search of the best possible compromise between economic imperatives dictated by market integration and free movement, on one hand, and demands autonomy of Member States in terms of tax options, on the other. In fact, for harmonization was and continues to be one of the largest reconcile sovereignty of Member States in fiscal matters to minimize geographical distortions induced by differences between national tax systems. In the absence of European political unity, is therefore more convenient to leave Member States free choice of the level and nature of collective consumption and social benefits, and to the extent possible funding sources. [...] harmonization process is not a simple exercise to align the practices of each state to community resources to achieve **tax uniformity**. **After all harmonization does not mean uniformity**” (C. Tulai, S. Serbu, 2005:133).

Achieving a complete harmonization would mean harmonization on several levels: adjustment of tax procedures, the tax rates and the tax base. Such harmonization is very difficult to accomplish in practice, so we prefer the solution of partial harmonization(Szabo, I. A., and Condea, B.,2012). Harmonization refers to any situation where differences in taxation between the **states** (or provinces) are reduced either by cooperation among the states or by a **federal government** policy. The more moderate and more commonly referred to definition is the specification of uniform definitions either of all state tax bases, or of the bases of specific tax instruments(Rounds, T. A. ,1992).

Tax harmonization represents the process of adjusting different tax systems in different jurisdictions (usually different countries) to a common framework(Sarmento, J. M.,2023).Tax harmonization is understood by **George Kopits** as a process of adjusting the tax systems of different jurisdictions so as to achieve some common fiscal policy objectives (Kopits, 1992, p. 3). **Taryn Rounds** suggests that tax harmonization refers to any situation in which differences between the tax systems of states (provinces) are reduced,either by actions of cooperation between public authorities or by the implementation of government policy measures (Rounds, 1992, p. 24). **Angelo Faria** believes that tax harmonization implies a high level of intergovernmental cooperation that may materialize through regional economic agreements based on factors other than economic development that are common to the signatory states. One such factor might be geographical proximity(Pîrvu, D. ,2012).

Tax harmonization is assumed to be achieved when all countries face the **same effective taxation** regardless of the location of the investment within the regional bloc (Horst, 1980), and may not necessarily mean similarity in statutory tax rates. **While not requiring uniformity** in tax systems, tax harmonization serves to reduce differences across jurisdictions in effective tax rates or bases that are mobile or which can have inter-jurisdictional implications on investment and trade flows(Ayoki, M. (2017).

3- Methods can be used to promote tax harmonization(federal states):

Several methods can be used to promote tax harmonization. States can cooperate in defining tax bases or setting tax rates, or they can make tax-sharing arrangements with the federal government. Tax sharing has at least two forms: **(1) tax-base sharing**, which permits states or provinces to share a **federal tax** base while setting their own tax rate, and **(2) tax-revenue sharing** in which the federal government collects the revenue and returns to the states a specific percentage of the revenue collected from that state. Equalization grants may also limit competition if they reduce payments to states that attract greater economic resources and compensate states with less resources. Therefore, states will benefit less from using tax competition to attract

resources and investment from other states. Finally, sub national tax competition can be limited by federal tax deductions or tax credits for state taxes paid so that residents of high-tax states receive larger deductions or credits. This, of course, encourages states to raise more revenue through these taxes at the federal government's expense(Rounds, T. A. ,1992).

4- European Tax Harmonization :

Indeed, the term "tax harmonization" in the EU context means the introduction of the **minimum taxation** of goods by **increasing the tax** in countries with lower tax rates. The harmonization of indirect taxes conducted in the Central European countries, as the requirement of EU accession, could strongly affect the economies of those countries by restricting the rate of growth of GDP, consumption, investments, and exports and by favouring the growth of imports. The harmonization of indirect taxes, understood as increasing those taxes, **suppressed economic development**(Kulawczuk, P., Bak, M., and Szczesniak, A. (2005).

Think about a single harmonized EU corporate income tax ("CIT"), a traditional tax aimed at raising common resources for a fiscal policy in the broad sense of the term. The priority is obviously constituted by the architectural problems of EU governance, and, in any event, that type of harmonization so far failed as evidenced by a short diachronic view. **Initially in 1962,** the Neumark Report broadly recommended harmonization which was never implemented. In 1966, the Segrè Report examined the measures to develop a European capital market but did not lead to new legislation.

In 1969, the Program for the Harmonization of **Direct Taxation** led to proposals for a directive on cross-border dividends and corporate restructurings, which were enacted only in 1990. In 1970, the Van den Tempel Report concluded that the classical system for cross-border dividends was preferable in view of harmonization but it was not followed up by the ensuing Commission's 1975 proposal, which recommended a partial imputation system, which was eventually withdrawn. Other

draft proposals on loss relief rules were advanced in 1984-1985 and 1990 but were **also withdrawn**. Same destiny for the draft proposal of 1988 on the harmonization of the tax base of enterprises.

In light of these failures, the **1990** Guidelines for Company Taxation8 simply pushed the existing proposals (merger directive and parent-subsidiary directives and the arbitration convention), which were adopted in the same year. In **1992**, the Ruding Report advanced recommendations that were rejected by the Council and the Commission. In 1997, a tax package to tackle harmful tax competition was proposed and included a Code of Conduct on business taxation and other measure on dividends; and, in 1998 the ECOFIN Council approved the first progress report of the Code of Conduct group and asked the Commission for a study on company taxation, in the which in 2001 led to the Commission's Company Tax Study that included Home State Taxation, the European Union Company Income Tax and a Common (Consolidated) Tax Base, an option that was further backed in 2003 and in 2006 by the Commission.

In the period 2006-2011 the Commission published various Communications dealing with cross-border loss relief, exit taxation and anti-abuse measures, double taxation, double non-taxation of companies and aggressive tax planning, as well as a more general Communication on the coordination of Member State tax system in the Internal Market. In 2009, the Commission issued a Communication21 for the promotion of good governance in the tax matters and in 2001 released a report on coordination of corporate taxes. Eventually the Proposal for a Common Consolidated Corporate Tax Base (the "CCCTB Proposal") was released in 2011 (Garbarino, C.,2016).

Consistent with the willingness to create a well-functioning single market, Europeans have agreed on harmonized rules in the area of indirect taxation. Indeed, the **Value-Added Tax (VAT)** is part of the acquis communautaire, and two directives **(1977 and 2006)** closely codify the VAT regime in EU Member states, with a minimum standard rate of 15% and a restricted list of reduced rates. Excise duties are

also subject to minimum rates, based on Articles 191-192 of the Treaty on the Functioning of the European Union (TFEU). This treaty base allows the Council and the Parliament to take decisions, including on taxes, to protect human health, safeguard the environment and promote a “rational utilization of natural resources”.

The second area of **tax harmonization concerns capital income**. **In 1990**, the Parent-subsidiary directive tackled the issue of double taxation of repatriated profits by a mother company from its subsidiaries. Member states are requested either to exempt repatriated profits, or to deduct taxes already paid by the affiliates from the mother’s tax bill (partial credit system). The objective was to avoid discriminating against foreign subsidiaries (taxed twice) in relation to purely domestic firms (taxed only once). In 2003, the Interest and Royalties directive further reduced the incidence of double taxation by abolishing withholding taxes on cross-border interest and royalty payments within the EU.

In recent years, however, the debate has moved from “double taxation” to “double non-taxation”. Indeed, a number of multinational firms have been blamed for paying low taxes thanks to various optimization techniques. In September 2013, the OECD launched an ambitious initiative labeled **Base Erosion and Profit Shifting (BEPS)**, aimed at addressing new challenges of corporate taxation in a globalized economy where the value-added of a firm is not only split up across the globe, but also difficult to measure, a growing part of it resulting from **intellectual property**. The programme will address fiscal challenges of the digital economy (e.g. the growing role of **intangible assets** whose value added is difficult to localize). It will also set standards to neutralize the impact of hybrid financing arrangements (i.e. financings that can be labeled debt in one country but equity in another one), to reduce the scope for double non-taxation through within-group loans, etc(Bénassy-Quéré, A., et al,2014).EU tax harmonization has been carried out at different paces, with indirect taxes (VAT and excise taxes) being almost fully harmonized, however, there is still a substantial lack of harmonization in the case of corporate tax, despite some recent Directives(https://link.springer.com,2023).

In May 2021, the European Commission announced that it would develop a concept for "corporate taxation in the 21st century". A proposal for a new corporate tax system is to be published in the course of 2023. The title is Business in Europe: Framework for Income Taxation (BEFIT). In this context, the European Commission has conducted a public consultation (European Commission, 2023).

The background to this initiative is that there is currently no common corporate tax system in the European Union (EU). Instead, the 27 member states have sovereignty over the structure of the system. The European Commission expects harmonisation to strengthen the EU's competitiveness and reduce distortions in investment and financing decisions (especially when these are made based on tax planning strategies). In addition, compliance costs for companies are to be reduced at the same time.

A prerequisite for the European Commission is that the proposal is consistent with the principles of the inter-national tax reform approach of the Organisation for Economic Co-operation and Development (OECD) and the G20, the group of the 20 largest industrialised countries. The key objectives of BEFIT are to promote fair and sustainable growth and to ensure effective taxation. Simplicity and transparency are central to this. With BEFIT, the European Commission is not entering completely new ground. Rather, past initiatives serve as a template. To what extent BEFIT will differ from the previous concept of the Common Consolidated Corporate Tax Base (CCCTB), for example, remains to be seen until the Commission presents its proposal(Hentze, et al, 2023).

5- Concluding Remarks by ALFRED BOSS:

There is no good reason for **tax harmonization in Europe** (or in the world). What is necessary is more neutrality of the different tax systems. Tax reforms and tax rate cuts are more probable if there is tax competition. Competition is an incentive for reforms and for searching for new solutions of old problems (von Hayek 1968). Competition might help to abolish inefficiencies in the political decision process and

thus to reduce government expenditures. "Therefore, there is no need for tax harmonization, but there is a need for better tax systems" (Salin 1994).

To say it more generally: "**Governments learn from the policy failures and successes of others**. Thus, support of policy competition need not rely on the view that government behavior ist best described by the Leviathan paradigm. All one needs to assume to advocate policy competition is that governments are not omniscient" (Sinn, S., 1990: 169) (Bettendorf, L., et al,2010)).

6- **Concluding Remarks by SIMEANA BESHI AND BEDRI PECI (VAT):**

Today, we cannot talk about **complete harmonization** because of the social, economic, and geopolitical characteristics of various states, as well as the claim of fiscal sovereignty that leaves room for states to define their own tax system (tax structure, tax rates, base taxes, exemptions, etc.). The diversity of tax systems used by member states has deepened the differences between them as well as increased inequality. Therefore, in terms of the degree to which obstacles and differences in tax systems and VAT regulations have been eliminated, we are able to claim that we have achieved a relatively extensive level of harmonization in the domain of VAT.

Nevertheless, the European Court of Justice has a significant impact on this debate. Its role is to interpret the provisions of directives in the function of the special characteristics of taxes in the national legislation given by the national court. The implications of the results of the work lead us to the continuous effort of the states to harmonize the tax system, both from the EU institutions and from the member states through continuous reforms, as was the case with VAT e-commerce. This effort is being made by both the EU institutions and by the member states.

This continuation for VAT harmonization is due to the fact that harmonization continues to be a necessary condition for the operation of the European market. This is accomplished through the promotion of fundamental freedoms and the development of a single market free of barriers(Beshi, S., and Peci, B. ,2023).

Figure 6: Statutory corporate tax rate 2022

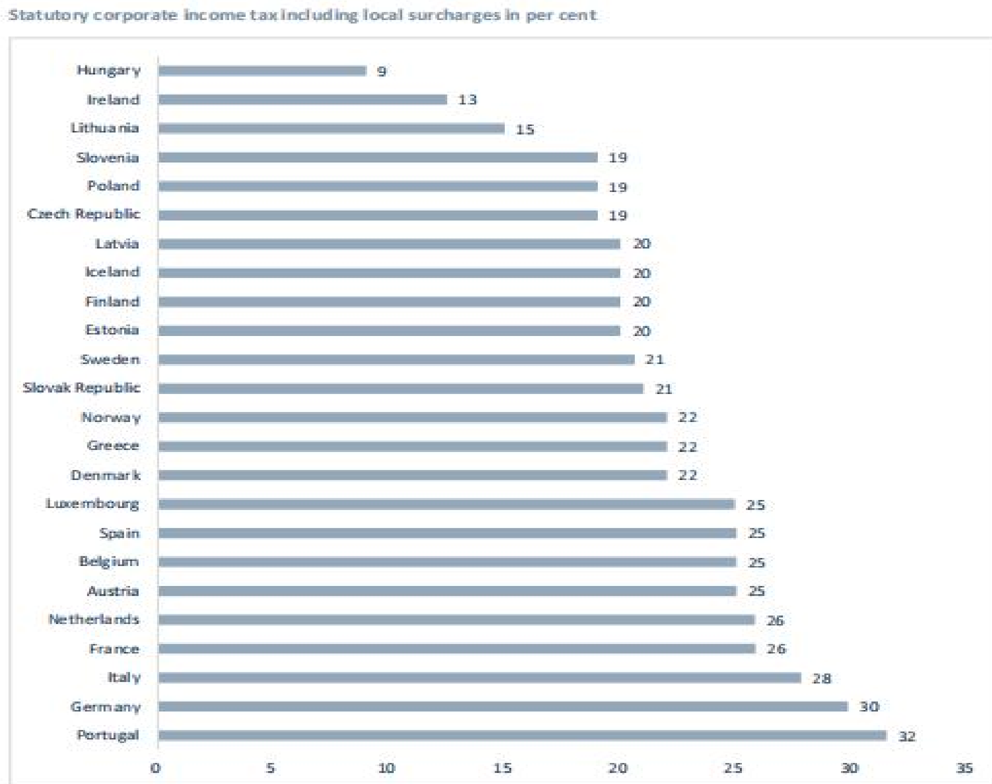


Figure 7: Change in the tax base under a formula-based allocation of profits in the EU

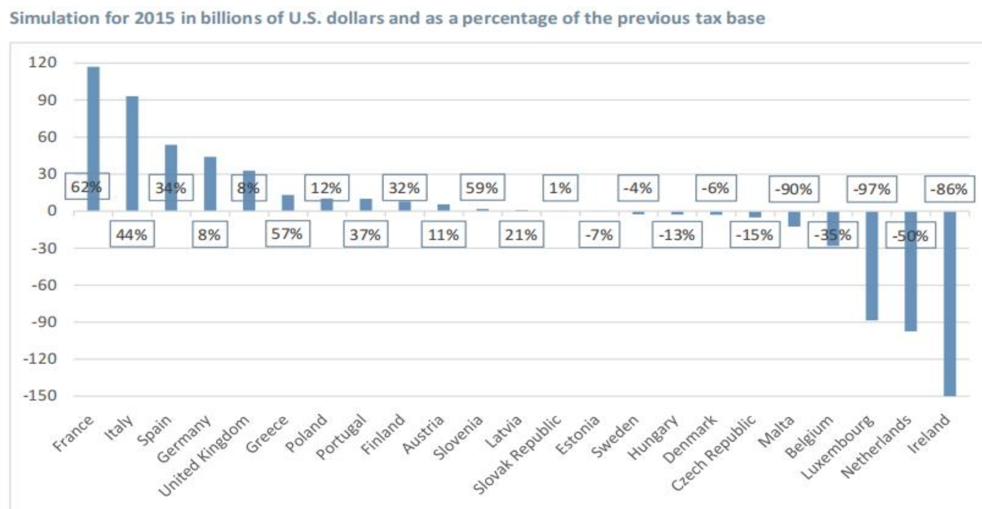
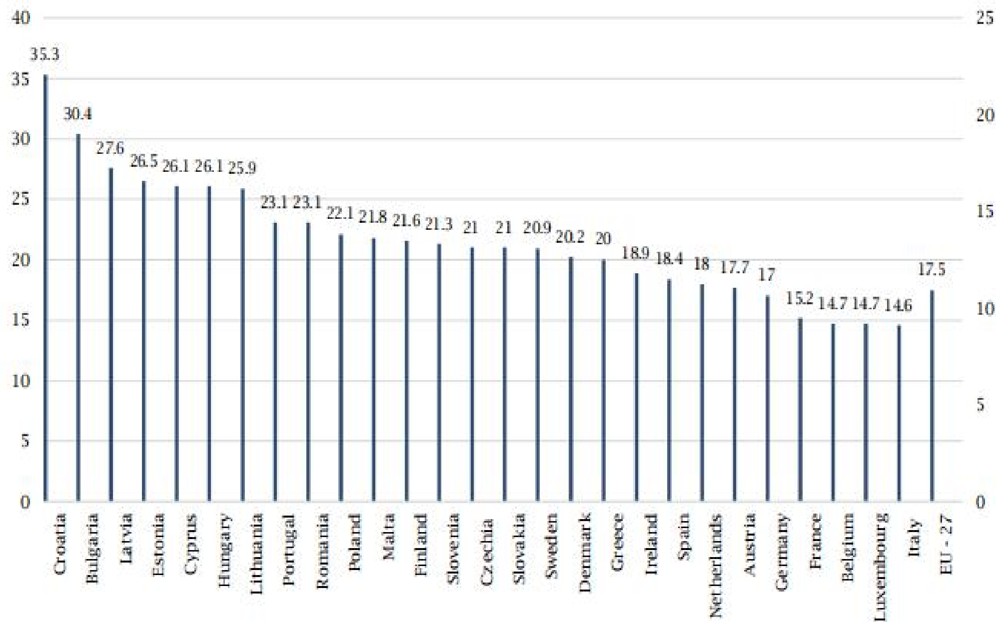


Figure 8: Share of VAT in total tax revenues in EU Member States in 2019 (%)



Source: Eurostat (n.d.).

THEME FOUR: INTERNATIONAL TAX COMPETITION

Introduction:

The globalization, by destroying the barriers to the interstate movement of capital, labor, goods and services, increases their mobility. The latter generates international tax competition, which is an **"uncoordinated tax"** when the country is "restricted by the behavior of other countries" in determining its tax policy, according to Devereux (2013). The mechanism of tax competition lies in the fact that countries, in order to preserve and attract the mobile factors of production, should offer a**ttractive tax regimes**, including lower effective tax rates(Sokolovska, A., et al, 2020).

1- The rise of tax competition:

Tax competition is an old concept, but political and academic interest in it is fairly new. For a long time, taxes were simply too low and cross-national tax differentials too small to trigger significant cross-border movements of taxpayers and bases. In the twentieth century, tax burdens increased dramatically but so did restrictions to **cross-border mobility**: high tariffs, strict capital controls, limited currency convertibility and tough visa and immigration laws greatly reduced the scope for international tax avoidance and evasion. This changed with the onset of **deep economic integration in the 1980s**.

Mobility barriers were being eroded. Trade liberalization, capital decontrol and currency convertibility at the global level, regional integration schemes such as the EU's Single Market or NAFTA, as well as new communications and transport technologies greatly reduced the transaction costs of moving goods, services, capital and jobs across national borders. Many observers feared (Sinn, 1990; Scharpf, 1991; Steinmo, 1994; Tanzi, 1995; Rodrik, 1997), while others hoped (Edwards and Keen, 1996), that this development would pull the fiscal rug out from under the welfare state. Exit, they argued, would become a viable strategy and a credible implicit threat for tax payers, forcing national tax authorities to compete for, rather than to impose on, taxable assets and activities. International tax competition seemed to finally come into its own and started its ascent as a topic for **political and academic debate**.

2- Definition of tax competition :

To investigate the empirical evidence on tax competition, we first need a definition of tax competition. The literature on tax competition has devoted surprisingly little attention to defining this phenomenon. In some cases, tax competition seems to be defined **very broadly** as any form of **non-cooperative** tax setting by independent governments. For our **narrowest definition**, we narrow the reasons for why government budgets are interdependent. In particular, we define tax competition as non-cooperative tax setting by independent governments, under which

each government's policy choices influence the allocation of a mobile tax base among ''regions'' represented by these governments . In particular, governments may compete over the allocation of workers, firms, capital, or shoppers. This definition eliminates ''vertical tax competition'', where different levels of governments (e.g. federal, state, and local) impose taxes on the same tax base. Rather, it encompasses the large class of models known as ''horizontal tax competition'', under which governments at the same level are competing. We refer to this definition as the ''narrow definition'', or simply competition for mobile factors.

Our view is that the **broadest definition** encompasses too many phenomena to be of much interest. In fact, tax competition in this case would exist between two large trading economies that engage in tariff wars in an effort to manipulate their terms of trade in desirable ways. This is not what most researchers mean by ''tax competition''(Wilson, J. D., and Wildasin, D. E. ,2004).

Tax competition is an essentially straightforward instance of the presumption that **non-cooperative behaviour** will lead to inefficient outcomes. Thus Sinn (1994), for instance, foresees a future for the European Union in which "...fiscal competition will wipe out redistributive taxes on mobile factors and reduce the tax system to one of mere benefit taxation". With this view of the world, attention focusses on the appropriate form of policy coordination: on the imposition of minimum tax rates, for example (analysed in Kanbur and Keen (1993)), or the use of corrective subsidies (analysed in Wildasin (1989)). The second view is radically different. It sees tax competition as serving a valuable purpose in supplementing inadequate constitutional constraints on the intrinsic pressures towards excessively high tax rates implied by policy-makers' pursuit of their own interests(Edwards, J., and Keen, M.,1996).

According to received wisdom, competition between governments for mobile capital will result in a race to the bottom. By taxing at a lower rate in order to attract capital from other jurisdictions, each government has an incentive to engage in wasteful competition, with the result that tax rates are set too low and public goods, are under provided.**Zodrow and Mieszkowski (1986) and Wilson** (1986) were the

first to **formalize the intuition** of this argument, expounded by Oates (1972)(Dhillon, A., et al, 2007).

3- The baseline model tax competition:

The economics literature on tax competition traces its lineage to a **study in 1956** by **Charles Tiebout** that examined the provision of public goods by local governments. According to Tiebout is analysis, competition between local governments for mobile households enhances society ís overall welfare. To avoid losing residents, governments must tailor public spending and tax levels to suit local preferences. Individuals sort across jurisdictions according to their demand for public goods relative to local tax levels. If some households desire well financed public schools, they may choose to pay higher property taxes. If not, they may move to a jurisdiction with lower taxes and more efficient, or more limited, government services.

The competition among governments is akin to market competition for products. Market competition encourages efficient production and satisfaction of consumers demands. Tax competition provides politicians with incentives to improve government efficiency and satisfy voters demands. The result of tax competition should be that the level of taxes reflects typical preferences within each jurisdiction. Tieboutís theory focused on local governments but with growing flows of labor and capital internationally, national governments are becoming more like local governments as they compete for taxpayers across national borders. Since Tieboutís study, numerous stylized models have been built in order to assess the effects of tax competition(Edwards, C., and de Rugy, V. ,2002).

In addition, the formalization of the basic mechanics of tax competition is usually ascribed **to Zodrow and Mieszkowski (1986)**. The model is about **two countries sharing** one internationally mobile tax base (usually dubbed 'capital' or, less frequently, 'crossborder shopping'). The tax policies of **both countries are interdependent**: one country's tax revenue depends on the other country's tax rate. For example, high taxes in country A swell country B's revenues by pushing a larger

share of the mobile tax base towards B; low taxes in A depress B's revenues by poaching tax base from B. **The model predicts** this interdependency to trigger a **'race to the bottom'** in taxation as each country tries to attract mobile tax base from the other. In equilibrium, tax rates are lower in both countries than they would be otherwise, resulting in a sub-optimally low supply of tax-financed public goods(Genschel, P.,and Schwarz, P. ,2011).

4- The benefits of tax competition:

Tax competition is the use by governments of low effective tax rates to attract capital and business activity to their country. This is believed to have a two-stage effect on the world's tax systems:

- First, some pioneer countries will reduce their tax rates, or otherwise alter their tax systems to offer low effective tax rates (countries that lower their tax rates to very low or zero levels are commonly known as 'tax havens').

- Second, other countries could lower their own taxes in response to perceived or actual losses from this competition.

This tax competition has grown as part of the general increase in international trade and investment, and is part of the process of globalisation. The opinion across the governments of most of the world's richest countries, however, is that it is bad and must be stamped out, and they are using various bodies (the EU, the OECD and the UN) in attempts to bring this about.Is tax competition really damaging, or is it rather a force for good? There are three main areas where tax competition and tax havens in general, affect the economy: they can have an impact on markets, on companies and on governments.

✓ **Impact on markets – lower taxes mean greater wealth:**

Perhaps the most obvious result of tax competition is its beneficial impact on savings rates. High taxes (particularly high taxes on investment returns) tend to act as

a disincentive to savings, so reducing the pool of available investment capital and therefore slowing growth and possibly leading to fewer jobs being created.

If tax competition can keep tax rates down, particularly those on highly mobile investment capital, and so increase savings, then it will boost overall wealth.

- ✓ **Impact on markets – efficient global capital markets :**

The OECD, while recognising the benefits to the world economy of tax reductions (particularly those since the 1970s), thinks that tax havens cause distortions in the global capital market by attracting disproportionate levels of investment to themselves.

- ✓ **Impact on business :**

If global capital markets are made more efficient by tax competition, this has a knock-on effect in forcing business to be more efficient.

- ✓ **Impact on governments :**

Similarly, tax competition also affects the behaviour of governments. Supporters of the free market should recognise that tax competition is beneficial, just as other forms of competition are beneficial. It is competition, which forces suppliers to provide the public with the goods and services that they require, and to pursue the efficiencies that let them do so at the right price. In the absence of competition, monopoly suppliers have less incentive to be efficient and less need to provide what consumers want. This is generally accepted when applied to commercial situations.

If tax competition acts as a **restraint on governments**' ability to raise taxes, then it should also act as a spur to greater efficiency in the public sector. Governments will be faced with not only electoral demands for improvements in public services, or transfer payments to client groups, but also the countervailing pressure of tax competition restricting their ability to increase revenues by raising taxes. The only way to resolve this is to make better use of the limited resources available(Teather, R. ,2006).

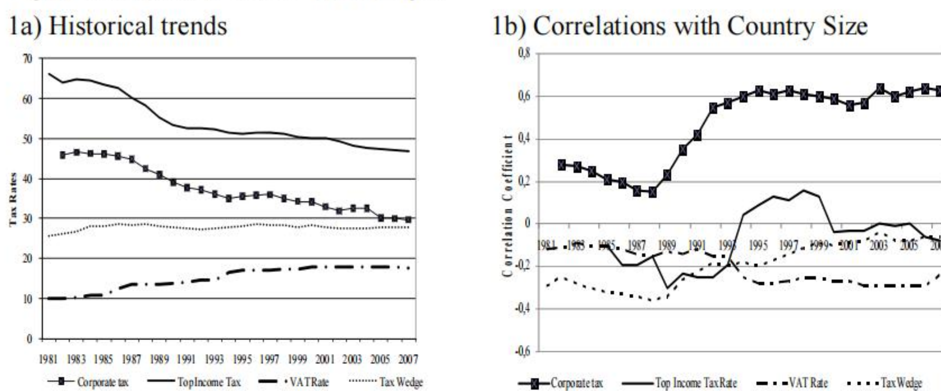
5- Tax competition and tax rates:

Does tax competition trigger a race to the **bottom in tax rates?** Does it cause country size-related asymmetries in tax rate levels? In order to investigate these questions, it is important to distinguish two modes of tax competition: general and targeted (Keen, 2001; Kemmerling/ Seils 2009). Under general tax competition, governments vie for mobile tax base by cutting general tax rates such as, for instance, the standard corporate tax rate. Under targeted tax competition, by contrast, they compete for mobile tax base by offering preferential tax treatment specifically for particularly mobile parts of the base. Think of special corporate tax regimes as an example, which reduce the level of taxation selectively on specific corporate forms and functions such as foreign-held companies, companies located in special business zones, holding companies, and captive insurance.

Figures 1a and 1b provide evidence on general tax competition. Figure 1a tracks historical trends in four general tax rates. It shows a dramatic fall of the corporate tax rate (down, on OECD-22 average, from 46 percent in 1985 to less than 30 percent 2007). The top personal income tax rate also fell by 16 percentage points but from a higher initial level (63 percent in 1985 down to 47 percent in 2007). The VAT rate increased (from roughly 11 percent in 1985 to roughly 18 percent in 2007). The tax wedge4 of an average wage earner (single, no children) has been more or less stable since the mid- 1980s (at around 28 percent). In short, there is evidence of a pronounced race towards the bottom in general corporate tax rates and a relatively less pronounced downward trend in top personal income tax rates but not in tax wedges or VAT rates.

Figure 9: Tax rates, OECD-22 averages (Historical trends and Correlations)

Figure 1: Tax rates, OECD-22 averages



Sources: top income tax rate; VAT rate and corporate tax: Bundesministerium der Finanzen, *Die wichtigsten Steuern im internationalen Vergleich*, several issues; Tax Wedge: OECD, *Taxing Wages*.

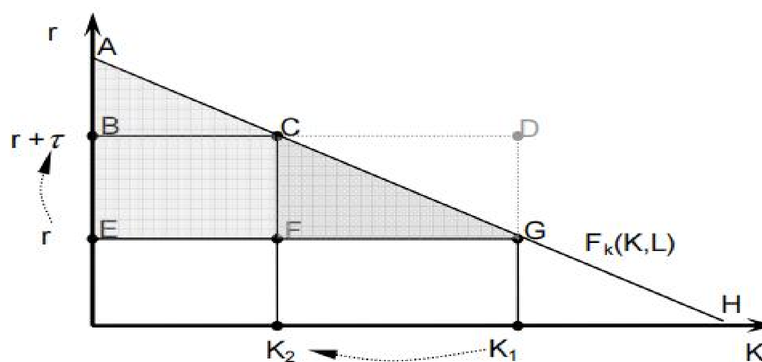
Figure 1b tracks the correlation of the general tax rates and country size of OECD-22 countries over time. If tax competition has indeed asymmetric effects on small and large countries, as the baseline model suggests, we should observe a positive correlation of tax rates and country size. The correlation should gain in strength over time as the level of market integration, and, hence, competitive pressure increases. This is indeed what we find for the corporate tax rate. The correlation of the corporate tax rate with country size increased from 0.21 in 1985 to 0.63 in 2007, indicating a growing tendency of small states to undercut the corporate tax rates of large states. Much of the empirical literature takes this as strong evidence of increasing competitive pressure (Devereux, Griffith and Klemm 2002; Ganghof, 2006; Plümper, Troeger and Winner 2009; Genschel and Schwarz 2011). All other correlations are negative or show no clear trend. In sum, figure 1b suggests that general tax competition affects corporate tax rates but not personal income rates, tax wedges or VAT rates(Genschel, P., and Schwarz, P. ,2012).

6- THE PROBLEM OF HARMFUL TAX COMPETITION (The Theoretical Standard Argument):

The theoretical standard argument, upon which much of the literature on tax competition is based, suggests that the imposition of a tax on internationally mobile capital, in an open and dynamic economy is impossible, as capital will always be able to shift the burden of taxation. Accordingly, the effects of the imposition of a source

tax are twofold: firstly, the increased tax will drive away mobile capital and stimulate a capital flight; and secondly, the tax will cause both the domestic product, and the marginal productivity of the complementary immobile factors, to fall. The crucial point is that the income of these factors declines at a rate greater than it would if the factors were to pay the tax themselves. On the basis of this, tax competition in the modern globalised world means overall losses to the society and an overburdening of the labour factor.

Figure 10: The Effects of an Imposition of a Tax Rates



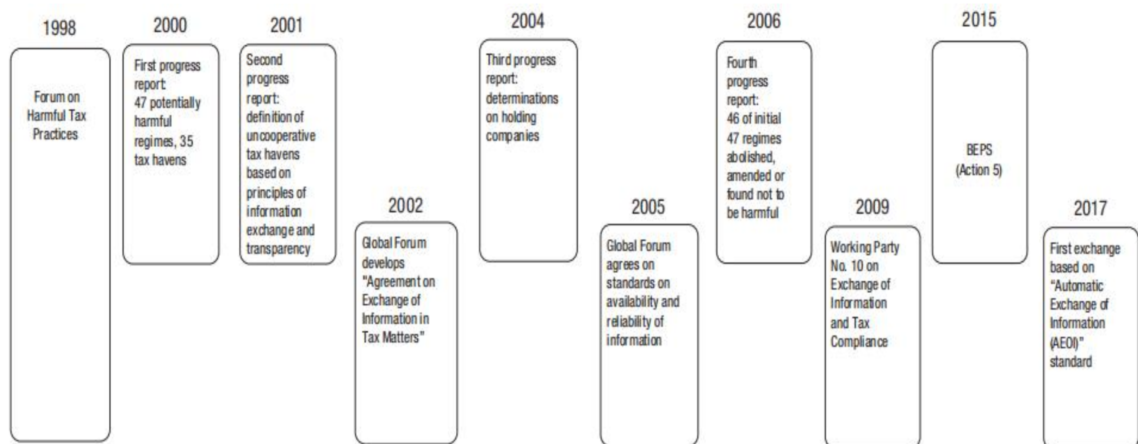
This argument is graphically represented in Figure 9 wherein the decision situation of a single country is illustrated. Here, and summarising Sinn (2003), the country is seen to produce homogenous output according to the downward sloping production function f(L,K), using a fixed and constant amount of labour (L), and a variable amount of internationally mobile capital (K) available at any amount and at the net world market return, r. The downward slope illustrates the marginal product of capital. Where there is no tax, the profit-maximising firm invests up to the point fk = r, and chooses the investment amount of capital K1. The imposition of a source tax levied on capital to the value to τ= BE, however, stimulates a capital flight, and the level of capital invested is seen to fall to the new equilibrium point of K2. As the net return r is given by the world market, capital leaves the country until its net marginal product after tax is again equal to the given world market of fk –τ= r. The result then

is that the tax burden is shifted completely to the immobile factor, causing the wage income to fall from AGE to ACB. The tax revenue – BCFE – is obviously smaller than the reduction in wages; which is BCGE. Even if total tax revenue were paid to the wage earners, they would still face a loss of CGF. Attempting to tax mobile capital thus serves only to hurt the immobile element more. The equilibrium in tax competition between states is therefore K1(McCarthy, K. J., et al,2008).

7- International initiatives on harmful tax practices :

OECD Initiatives— From the Forum on Harmful Tax Practices to the BEPS Project The two major events in the OECD work on harmful tax practices are the 1998 report that established the Forum on Harmful Tax Practices, and Action 5 of the OECD/G20 BEPS Project that was adopted in 2015. Relatedly, in somewhat parallel efforts, since 2002 there has been development in the exchange of information for tax purposes. Figure 10 presents a timeline summarizing selected key publications and progress made since 1998.

Figure 11: timeline summarizing selected key publications and progress made since 1998



Source: Author's illustration.
Note: This timeline is not meant to give a complete summary of important events; rather, it selectively presents key progress steps.

Forum on Harmful Tax Practices

The Forum on Harmful Tax Practices was established with two primary objectives:

1. Identify harmful tax regimes in OECD countries: The Forum on Harmful Tax Practices had the mandate to monitor and review preferential tax regimes in OECD countries for income from geographically mobile activities. The criteria are listed in Table 6.1. The first key factor— low or zero effective tax rate on the relevant income— is a gateway criterion to determine those situations in which an analysis of the other key criteria is necessary, but zero tax per se is not deemed harmful. The main three criteria are ring fencing lack of tax transparency, and offering tax benefits in the absence of substantial activities.

Eventually, in 2006, reviewing preferential tax regimes was completed, and the progress report stated, "The Committee considers that this part of the project has fully achieved its initial aims and that the mandate given by the Council on dealing with harmful preferential tax regimes in Member Countries has therefore been met" (OECD 2006, page 6).

2. Identify non- OECD tax havens: In 2001, the OECD analysed 47 jurisdictions and publicly identified 35 tax havens. Eventually, as of May 2009, all jurisdictions were removed from the list (Table 2). Criteria for identifying Harmful Tax Regimes

Criteria for Identifying Harmful Tax Regimes

Forum on Harmful Tax Practices: 1998 Report	BEPS: Action 5
Four main criteria: (1) No or low effective tax rates (gateway criterion) (2) Ring-fencing of regimes (3) Lack of transparency (4) Lack of effective exchange of information Eight other factors: (1) Artificial definition of the tax base (2) Failure to adhere to international transfer pricing principles (3) Foreign source exempt from residence country tax (4) Negotiable tax rate or tax base (5) Existence of secrecy provisions (6) Access to a wide network of tax treaties (7) Regimes that are promoted as tax-minimization vehicles (8) Regimes that encourage purely tax-driven operations	Revamp and work on harmful tax practices, wi a priority and renewed focus on two criteria: (1) Requirement of substantial activity (2) Improvement of transparency, including compulsory spontaneous exchange of information on ruling related to preferentia regimes

Source: Hebous, S. (2021). Has tax competition become less harmful?. *De Mooij, Klemm, and Perry*

(2021), 87-106.

3. Action 5 of the BEPS Project and Current Standards on the Design of Preferential Tax Regimes

Action 5 of the OECD/G20 BEPS Project— one of the four minimum standards to which the Inclusive Framework members commit subject to peer review— requires substantial activity by the taxpayer (also known as the nexus approach) as a qualification for a preferential tax regime. As documented in Table 2, despite the fact that Action 5 builds on the previous work of the Forum on Harmful Tax Practices, the concept of harmful tax practices has evolved to primarily focus on the nexus approach. Preferential regimes that fail to conform to the nexus approach are deemed harmful. In November 2018 Inclusive Framework members adopted revised criteria for the substantial activities requirement for "no or only nominal tax" jurisdictions. However, this revision does not imply that the absence of a corporate income tax is harmful per se (OECD 2018a, para. 20).

4. Tax Transparency and Non-cooperative Jurisdictions

Initiatives and measures to improve tax transparency can be broadly summarized as follows:

• The Global Forum: This forum, with 160 members, was established in 2000 and restructured in 2009 as a multilateral framework to carry out work on exchange of information, with the two international standards: (1) exchange of information on request; and (2) automatic exchange of financial account information in tax matters.

• The minimum standards of OECD/G20 BEPS initiative: Minimum standards of the BEPS initiative notably include the requirement of

country- by- country reporting for multinationals and exchange of information on tax rulings under Action 5.

• Other transparency initiatives: These initiatives include the extractive industry transparency initiative. While these do not comprise international standards, the

extractive industry transparency initiative, for instance, requests the disclosure of information along the extractive industry value chain. Standards of the Financial Action Task Force were upgraded in 2012 to include tax crimes, and they request that firms make information about beneficial ownership available to competent authorities, including tax authorities.

5. Non-cooperative Jurisdictions for Tax Purposes:

Tearing down the veil of secrecy is important for curbing tax evasion, especially by individuals, and one may argue it is an important aspect of competition over the wealth of individuals as opposed to large corporations. In any case, tax transparency is one of the three criteria endorsed in 2017 by the European Council to list non-cooperative jurisdictions for tax purposes (the so- called blacklist). The other two criteria for the listing are fair tax competition, in line with the European Union's Code of Conduct or the OECD's Forum on Harmful Tax Practices (as in Action 5, jurisdictions with a zero corporate income tax rate should implement the nexus approach), and implementing the OECD/G20 BEPS minimum standards. Selected jurisdictions that do not commit to address EU concerns are listed as non-cooperative jurisdictions. As of October 2020, the list contained 12 jurisdictions. The European Council also adopts a watch list of non-cooperative jurisdictions that have agreed to modify their regimes (informally known as the grey list)(Hebous, S. ,2021).

Table 3: Evaluation of tax harmonization and tax competition

Criterion	Tax harmonization	Tax competition
Fiscal autonomy	no	yes
Stability of budget revenues	no – tax rate does not reflect the specific of individual states	yes – but not in countries with capital outflow
Effectiveness of public expenditures	no	yes
Increase in the competitiveness of the market subjects	yes	no – leads to an increase in the compliance costs of taxation
Inappropriate structure of budget expenditures	no	yes
Excessive taxation of immobile factors	no	yes
Full usage of the advantages connected with the internal market	yes	no
Effective source allocation	yes	no
Existence of asymmetric information	no	yes
A difference in nominal and effective tax rate	no	yes
Tax rate	higher	lower
Economic growth	lower	higher

Source: Kouba, L., Mádr, M., Nerudová, D., & Rozmahel, P. (2016). Policy autonomy, coordination or harmonization in the persistently heterogeneous European Union?. Danube, 7(1), 53-71.

THEME FIVE: INTERNATIONAL TAX ARBITRAGE

Introduction:

Sovereign democratic nations make tax laws that reflect the needs and preferences of their citizens. This straightforward proposition suggests that tax laws may differ from country to country, and they do. Taxpayers may exploit some of these differences to their advantage. Over the past generation, global trade and cross-border investment boomed, and it also got easier to take advantage of tax law differences between nations. This combination — less friction and more opportunity — means that the exploitation of these differences played a growing role in tax planning. This is international tax arbitrage(Greenaway, T. ,2010).

1- Definition of Tax arbitrage :

"International tax arbitrage" (sometimes called "cross-border tax arbitrage") refers to any tax strategy that exploits gaps between the tax systems of different nations. One way to perform this arbitrage is simply to move the entire firm or at least the corporate headquarters ("corporate inversion," cf. Gelles (2013), Webber (2011b)) to a low-tax region. But this might incur substantial overhead costs, cause problems for the organization's human resources, or have some other operational or strategic disadvantages(Shunko, M., et al.,2017).

The term ''international tax arbitrage'' refers to arrangements that exploit meaningful differences between the tax consequences of the same item in two or more jurisdictions. For instance, one of the most basic tax law differences is the effective income tax rate. International tax arbitrage includes more than exploiting tax rate differentials between different ''markets.'' Jurisdictions sometimes ''see'' the same entities and transactions in different ways, differences in perspective that can be exploited. Here are four well-known building blocks used by international tax planners to create these differences:

- dual-resident corporations, incorporated in one jurisdiction but managed and controlled in another;
- hybrid entities, taxed as a corporation in one jurisdiction, but considered a flow-through entity (or disregarded) in another;

- hybrid instruments, treated as debt or royalty rights in one jurisdiction but equity in another; and
- Repurchase agreements, which are treated as a secured lending agreement in some jurisdictions (the United States and the United Kingdom most notably), but as distinct sales or exchanges in other jurisdictions(Greenaway, T. ,2010).

Tax arbitrage is a specific form of legal (and often fully disclosed) tax avoidance, where typically a multi-national company achieves a tax benefit from a commercial transaction that is treated differently by two (or more) jurisdictions, including what is sometimes known as a "double-dip"(Robin Amos,2008)).In addition, Tax arbitrage can be defined as transactions that are designed to take advantage of differences between national tax systems to achieve double non-taxation. Thus, tax arbitrage directly negates the single tax principle(Avi-Yonah, R. S. ,2007).

Tax arbitrage is pervasive. It affects the lives and habits of almost every individual and business in society. Taxpayers continuously engage in tax arbitrage. Examples include borrowing to purchase housing, consumer durables, pension assets, and IRAs, state and local bonds, as well as real estate and corporate stock for which special treatment or exclusions are provided for capital gains. Businesses often engage in tax arbitrage when they borrow to buy stock, create a merger, or engage in a leveraged buyout of another company. Within a business, borrowing to purchase equipment may involve some amount of tax arbitrage, as can borrowing to buy inventory to which favorable methods of accounting are provided. Some corporations purchase stock of other companies and are allowed to deduct dividends from income even when interest costs of financing the purchase are also deducted. Other corporations attempt to make use of partnerships both as tax shelter and tax arbitrage vehicles -- sheltering income from corporate tax first and sometimes adding to borrowing and arbitrage through the partnership in a way that does not show up as debt on their financial books. (Enron engaged in many partnership deals, although the tax enticement may not have been the primary factor.)(Steuerle, C. E. ,2002).

2- Types of Tax Arbitrage Strategies:

These are the different types of Tax Arbitrage Strategies. Here's a brief overview of each one:

2-1 Cross-border tax arbitrage: This involves using tax differences between countries. This can be done by setting up companies or trusts in low-tax jurisdictions or structuring cross-border transactions in a way that minimizes tax liability.

2-2 Product-specific tax arbitrage: This strategy involves taking advantage of differences in tax rates or exemptions for specific products or services. For example, if one jurisdiction has a lower tax rate on a particular product than another jurisdiction, a company could purchase the product in the lower-tax jurisdiction and then sell it in the higher-tax jurisdiction to take advantage of the tax differential.

2-3 Currency tax arbitrage: This strategy involves utilizing differences in currency exchange rates to minimize tax liability. For example, if a company has operations in multiple countries, it could use currency hedging strategies to minimize its foreign exchange exposure and reduce its tax liability.

2-4 Timing tax arbitrage: This strategy involves delaying or accelerating the recognition of income or expenses to minimize tax liability. For example, if a company expects tax rates to decrease in the future, it may defer income recognition until the lower tax rate takes effect.

2-5 Entity tax arbitrage: This strategy involves taking advantage of differences in tax rates between different types of entities, such as corporations, partnerships, and LLCs. By choosing the right entity structure for their business, taxpayers can minimize their tax liability and maximize their after-tax returns(JUANTAX ,2023).

3- Pension tax arbitrage theory:

Pension tax arbitrage may be defined as a process in which a business entity that is the sponsor of a defined benefit (DB) pension scheme makes tax-based risk-neutral financial gains from a debt-financed equity buy-back with a simultaneous shift in the pension scheme ’ s assets from equities to bonds or other debt instruments. Fischer Black and Irwin Tepper developed pension tax arbitrage models in the early 1980s. These studies of three decades ago stimulated discussion in academic and professional circles. The conclusions were controversial in that they recommended that DB pension plans shift all their assets to bonds. The theory was energetically debated in the early 1980s and then there was apparently little development of the discussion until the revival of interest after 2000. A number of studies considered aspects of pension tax arbitrage but it would appear that there has been relatively little impact on pension plan (PP) asset allocation strategy.

Pension tax arbitrage may be illustrated by considering a DB pension plan operating through a PF and a sponsoring company (referred to as ‘ Sponsor Co ’). For analysis purposes, it may be assumed that Sponsor Co funds all the investments by the PF, which may be in the form of equities or bonds. The first basic assumption is that if the PF shifts its investments from equities to bonds there will be a reduction in the risk to the PP and consequently to Sponsor Co. The second basic assumption is that this reduction in risk may be offset by a corresponding increase in the risk of Sponsor Co if it buys back its own shares and issues bonds. If the risk is exactly offset, there will be an overall benefit in the form of a tax reduction on the payment of interest on the bonds(Kirkpatrick, A. K. (2010).

4- Using hybrid financial instrument in Tax arbitrage :

Business entities often possess jurisdiction dependent tax characteristics. When such entities are inconsistently characterized by the foreign and domestic tax laws, they are called “**hybrid**.”

Hybrid instruments are defined as financial instruments that have both debt and equity characteristics and could potentially be classified as equity by one jurisdiction

and as debt by another. Hybrid instruments enable tax practitioners to create a class of transactions with disparate international tax character of payments made. «Such instruments also are widely used in tax arbitrage transactions, not only to provide desired characteristics not present in pure debt or equity instruments, but also to reduce the cost of financing or to enhance returns by securing deductions in one jurisdiction without the inclusion of income in another(Krahmal, A. ,2005).

The majority of existing studies of derivative-enabled tax schemes focus on what we call post-hoc manipulation of taxable events. The key to the use of derivatives and swaps arrangements in post-hoc tax planning is, first, that often the same business deal can be implemented with numerous forms, and second, economically comparable transactions are often taxed differently. For instance, in most countries, profits are subject to one set of nominal rate of corporate taxation, but a different rate of taxation is applied for capital gain tax or personal taxation. Such inconsistencies encourage taxpayers to try to choose structures that shift taxable events towards a preferred category of taxation. The practice, like many arbitrage techniques, is an industry's response to an inconsistent patchwork of rules that emphasize form over economic substance in the tax treatment of derivatives (GAO 2011). The phenomenon has warranted its own term and is known as the **cubbyhole system(**Phillips, R. ,2024).

5- Transfer pricing and tax arbitrage:

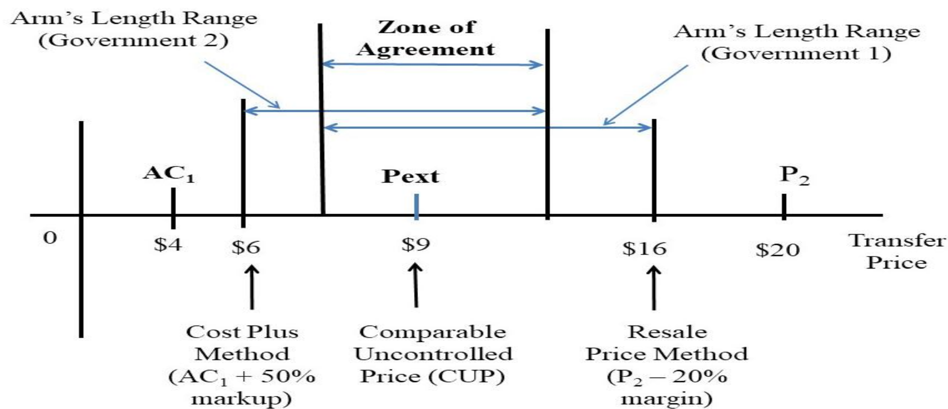
Assume the MNE consists of a commonly controlled manufacturer in country 1 and a distributor in country 2, where the manufacturer exports a product to the distributor for final sale. The higher (lower) the transfer price, the larger (smaller) the MNE's share of profits declared in country 1 and the smaller (larger) the MNE's share of profits declared in country 2. We assume that the MNE's goal is to maximize its worldwide after-tax profits and that each government's goal is to maximize its tax revenues. In effect, this is a principal-agent problem where the transfer pricing policy of the agent (the MNE) is being monitored by two principals (the two governments).

We assume both governments follow a territorial tax system where they levy a corporate income tax at rate ti on MNE profits declared in country i (where i=1,2). Each government applies the ALS and accepts the MNE's transfer price if it lies within the arm's length range as determined by the government. If the transfer price falls outside the range, the government adjusts the MNE's transfer price to the midpoint of the range, and recalculates the tax owed. The government may also impose an additional inaccuracy penalty if the MNE's declared transfer price lies outside the arm's length range.

Assume, for simplicity, that there are only three possible pricing methods: comparable uncontrolled price (CUP, the open market price between arm's length firms), cost plus (average cost plus a gross markup), or resale price (retail price minus a gross margin). The average cost of manufacturing is $4 and the retail price at which the finished product is sold in country 2 is $20. Contract manufacturers are available in country 1 that would produce the product for average cost plus a 50% markup. Contract distributors are also available in country 2 that would distribute the product for the retail price minus a 20% gross margin. There are products somewhat comparable to the intrafirm good available on the open market at $9. In this situation, the three possible transfer prices are $6 (cost plus), $9 (CUP), and $16 (resale price), with some arm's length range around each transfer price.

We start by assuming that government 2 taxes profits declared by the MNE where they are earned and government 1 does not; thus, MNE profits declared n country 2 are taxed whereas profits declared in country 1 are not taxed. In this case, the MNE will use TPM to take advantage of the difference in tax rates. The MNE will choose the highest transfer price ($16, using the resale price method) because it raises the manufacturer's revenues and the distributor's costs, which shifts MNE profits out of country 2 and into country 1. With a CIT rate of 30% in country 2 and a zero CIT rate in country 1, every dollar increase in the transfer price shifts $1 of profit from country 2 to country 1, saving the MNE (alternatively, costing government 2 in lost tax revenues) 30 cents.

Figure 12: Transfer Pricing and Cross-border Arbitrage



Source: Eden, L. (2024). Transfer pricing and cross-border arbitrage. In Encyclopedia of International Strategic Management (pp. 382-387). Edward Elgar Publishing

If the MNE's declared transfer price lies inside government 2's arm's length range of acceptable prices, then TPM is legal and noncontroversial. However, if the transfer price lies outside the government's arm's length range, the government sees TPM as illegal and an additional tax penalty over and above the corporate income tax may apply. Unless the MNE has perfect foresight and knows the government's arm's length range, there is transfer pricing risk for the MNE, especially if the MNE aggressively shifts profits out of country 2. There is also transfer pricing risk for the two governments since TPM shifts the MNE's tax base between the two countries(Eden, L. ,2024).

THEME SIXE: INTERNATIONAL TAX EVASION, TAX AVOIDANCE AND TAX PLANNING

Introduction:

Tax avoidance by multinational corporations (MNCs) has been on top of the international tax policy agenda since the global financial crisis. The tight fiscal constraints in the aftermath of the crisis amplified long-standing concerns in many countries that large MNCs pay very low effective tax rates. In addition, empirical evidence from the US that suggests tax planning costs act as a significant constraint on corporate tax planning activity may explain what **Weisbach (2002)** describes as the "**under sheltering puzzle**" i.e. why firms do not appear to minimise tax liabilities.

In the USA, millionaires and billionaires are evading more than $150 billion a year in taxes, adding to growing government deficits and creating a "lack of fairness" in the tax system, according to the head of the Internal Revenue Service(Robert Frank ,2024).

1- The Difference Between Tax Avoidance and Tax Evasion :

The difference between tax avoidance and evasion was first noted in the UK in 1900 in the case of Bullivant v AG3 where it was stated that 'the word 'evade' is ambiguous … there are two ways of constructing the word evade: one is that a person may go to a solicitor and ask him how to keep out of an Act of Parliament – how to do something that does not bring him within the scope of it. That is evading in one sense but there is nothing illegal in it. The other is when he goes to the solicitor and says, "Tell me how to escape from the consequences of the Act of Parliament, although I am brought within it." This is an act of quite a different character.

However, the distinction in the terms was recognized in the UK in the 1950s when the Radcliffe Commission (1955) distinguished between the two terms by stating 'It is usual to draw a distinction between tax avoidance and tax evasion. The latter denotes all those activities, which are responsible for a person not paying tax that the existing

law charges upon. Ex hypothesis he is in the wrong … By tax avoidance, on the other hand, is understood some act by which a person so arranges his affairs that he is liable to pay less tax than he would have paid for the arrangement(Xuereb, A. ,2015).

Tax avoidance must be distinguished from tax evasion, which is the employment of unlawful methods to circumvent the payment of taxes. Basically, tax evasion is a crime, however tax avoidance is not. Moreover, tax avoidance is legally reducing tax liability, while tax evasion is illegally reducing tax liability based on fraudulent activities. Furthermore, tax evasion is a criminal offense under state statutes. A person who is convicted is subject to a prison sentence, a fine or both. Tax evasion could be any international or domestic fraudulent attempt to escape payments of taxes in whole or in part. Tax evasion is an activity commonly associated with the informal economy(Davidov, D. ,2016).

Figure 13 : Global profit shifting and associated tax revenue loss, 1975-2022

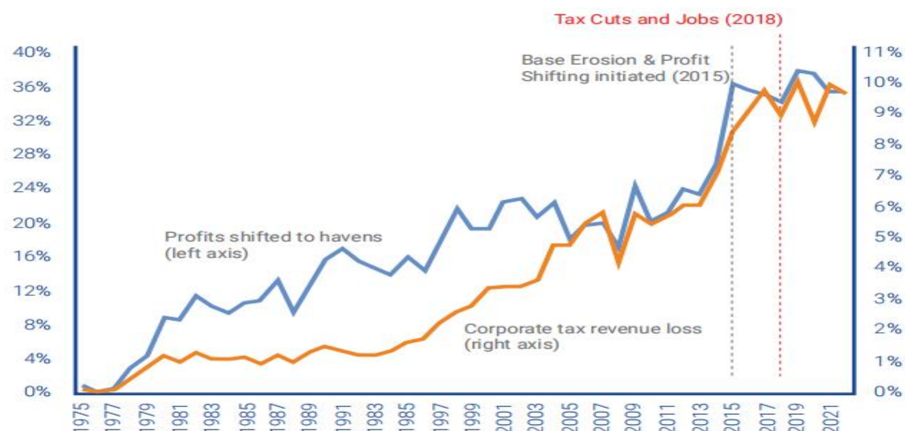


Figure 12 presents the central estimates obtained using this methodology. The results suggest a dramatic increase in profit shifting since the 1970s, with the global tax revenue loss rising from essentially 0 to close to 10 percent of global corporate tax revenue recently. The rise was particularly fast in the first half of the 2010s, perhaps linked to the growing digitization of the economy.

After the start of the Base Erosion and Profit Shifting process in 2015, the amount of profit shifted to tax havens appears to have grown at roughly the same pace as

global foreign profits. This marks a departure from the trend observed in the first half of the 2010s, when profits booked in havens grew faster than foreign profits. It is possible that this change in trend may be due to BEPS and other reforms such as the Tax Cuts and Jobs Act. The fact that profit-shifting remains at a historically high level shows that there remains ample scope for additional initiatives to significantly reduce it(Alstadsæter, A., et al 2023).

2- Main Channels of International Tax Avoidance:

2-1 Avoidance of Source Country Taxation:

Within the international tax framework, MNCs can use a wide array of techniques to shift profits between entities in the group to minimize their overall corporate tax liability. These techniques can be entirely legal, in which case they are referred to as tax avoidance—as opposed to tax evasion, which is illegal. The precise channels of tax avoidance can vary, depending on the specific features of national tax systems and treaty networks. For instance, taxation in source countries can be minimized by : (1) **transfer mispricing** (stretching, violating, or exploiting weaknesses in the arm's length principle); (2) **strategic location of management of IP** to low-tax countries to reduce taxes on associated income; (3) **debt shifting** through intracompany loans (excessive borrowing in high-tax countries and lending to low-tax countries); (4) **treaty shopping** (exploiting treaty networks to route income so as to avoid tax); (5) **avoiding PE status**.

- **Transfer Mispricing:** Transfer pricing is a technique used by multinational corporations to shift profits out of the countries where they operate and into tax havens(tax justice network,2024).The valuation of intracompany transactions within an MNC affects the global allocation of the tax base between source and residence countries. Most countries use the arm's length principle, which stipulates that internal prices between related parties should resemble prices that would prevail between independent parties. Yet, there may be significant room for subjective interpretation. Conceptually, there may even be no "correct" arms-

length price if there are no comparable third-party transactions. Given these weaknesses in the implementation of the arm's length principle, MNCs can charge a lower price for exports sold from high-tax to low-tax countries, or a higher price for inputs coming from low-tax countries, to reduce their global tax liability.

Transfer mispricing, abusive transfer pricing, trade misinvoicing, Base Erosion and Profit Shifting (BEPS), and re-invoicing. All of these fall under the umbrella of trade mispricing or the intentional falsification of transactions on an international level. Arguably, the polynymity of this deceptive practice is evidence of its ubiquity(Tanya Rawal-Jindia,2024).

- **Strategic Location of Intellectual Property(IP):**

Intellectual Property (IP) strategy is a systematic approach that organizations and individuals adopt to manage and leverage their intellectual property assets effectively(evalueserve,2024).Another way to reduce the global tax of an MNC is by strategically moving valuable IPs to low-tax affiliates. Companies can conduct their research and development (R&D) activities in one country, but transfer the ownership of the patent that is subsequently created to another country where the resulting income streams will be taxed at a lower rate.6 As there is often no comparable transactions of IPs between unrelated parties, determining the arm's length price for company's intangible transactions is usually very difficult, leaving room for tax-induced manipulation of transfer prices (see, e.g., Grubert, 2003; Desai et al., 2006).

- **International Debt Shifting :**

A third way for an MNC to reduce its tax bill is through intracompany loans. Cross-country differences in rates of corporate income tax (CIT) create opportunities for lending from low-tax countries to affiliates in high-tax countries or by locating external borrowing in high-tax countries. This debt shifting reduces the group's tax bill without affecting the overall debt exposure of the group (and hence its bankruptcy

risk).International debt shifting serves to lower average levels of corporate income taxation in high-tax countries(Huizinga, H., et al,2008).

- **Tax Treaty Shopping :**

"Treaty Shopping", or "Buying into" a double taxation agreement, refer to the use of tax-driven structures under which a taxpayer creates a corporation to take advantage of a favourable double taxation agreement (DTA) and so receives tax benefits. Example: Investor "I" is resident in State A and intends setting up a corporation "X" in State B. However, State A and B have not signed a DTA. However, a DTA has been concluded between State A and State C, and between State B and State C. In order to make use of the DTA benefits, e.g. for withholding tax on dividend payments, I therefore creates an intermediate company "Y", in State C which becomes the parent company of X in State B. Dividends, interest or royalties can now be paid - and benefit from the DTA privileges - by company X in State B to I, via company Y in state C(Roedl,2024).

Considerable variation in the WHT rates in more than 3000 bilateral Double tax treaty (DTTs) creates opportunities of treaty shopping. This enables MNCs to link different DTTs and divert cross-border payments through the country with the lowest withholding tax (WHT) rate.

- **Avoiding permanent establishment(PE) status:**

Permanent establishment is a complex category of tax law, the purpose of which is "to establish a fair procedure for taxation of the activities of a foreign organization in the territory of the source state. In the system of tax elements, permanent establishment has the closest relationship with the taxpayer, as it is one of the conditions under which a foreign organization becomes obliged to pay tax". According to V. A. Gidirim, "at present, the permanent establishment concept is a generally recognized criterion for differentiation of the tax rights of different states and a guiding principle of international tax policy. It is based on the concept of economic belonging" (Gidirim, 2017: 511). O. Iu. Konnov defines permanent

establishment as a means to determine the degree of presence of a foreign organization in the territory of the state of business and determine its tax status in this regard (Konnov, 2001: 13)(Ponomareva, K. A. ,2019).

Permanent establishment (PE) is a **tax concept** that varies from country to country and is often included in trade agreements, but is generally understood to mean that a tax authority deems a business to have a stable and ongoing presence in the country and is therefore subject to corporate taxes and possibly VAT.A company's auxiliary activities, such as preparatory work that does not generate revenue does not trigger permanent establishment status. The final authority on status, however, is the local tax authority. The burden of proof is with the company to demonstrate that the **activities are auxiliary** and do not warrant a permanent establishment status(Papaya Global,2024).

2-2 Avoidance of Residence Country Taxation:

Worldwide systems can serve as a backstop for the avoidance of source taxes, since income will ultimately be subject to repatriation taxes in the residence country. However, residence taxation can also be avoided. One way is by the artificial use of tax deferral (delaying payment to the parent, sometimes indefinitely). Alternatively, the firm can avoid resident status through corporate inversion (changing residence to escape repatriation taxes or CFC rules) or by choosing the location of a new residence in a country that operates a territorial system(Beer, S., et al,2020).

3- Conceptual Framework of Corporate Tax Planning:

The underlying concept to which all other tax constructs within the unifying conceptual framework relate is that of corporate tax planning (see top in Figure 2). Tax planning, as it is understood throughout the following, is based on the seminal global planning approach to taxes and business strategy proposed in Scholes et al. [2009]. In accordance with the so-called **Scholes-Wolfson** framework, effective tax planning:

- considers the tax positions of all parties to a contract (multilateral approach),

- considers all taxes, both explicit and implicit, and

- acknowledges the relevance of all costs, both tax and non-tax costs.

Figure 14: Unifying Conceptual framework corporate tax planning

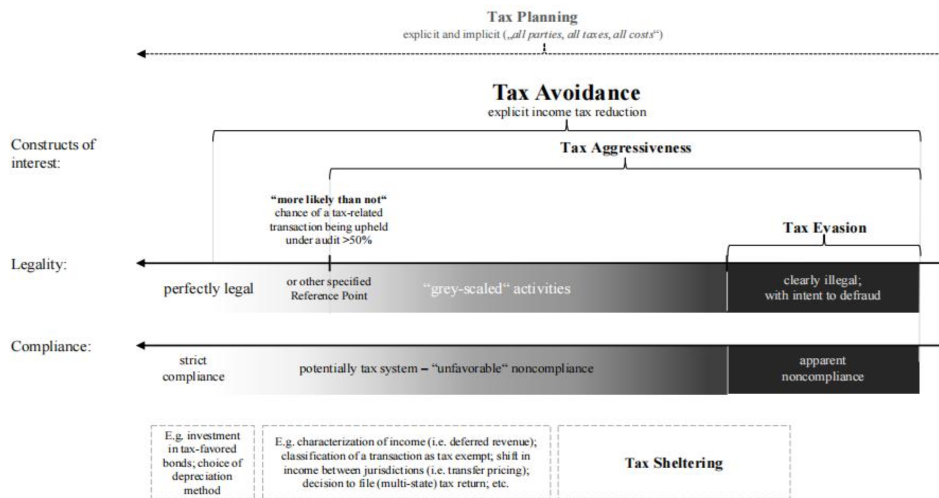


Figure 1: Unifying Conceptual Framework of Corporate Tax Planning

In the **corporate decision making** process aimed at the maximization of after-tax returns. From taking into account the three general themes “**all parties”, “all taxes”, and “all costs**” it follows that mere tax minimization strategies are not necessarily desirable. Besides changes in explicit taxes affecting after tax returns, implicit taxes (e.g. reduced pre-tax rates of returns for tax favored investments) and other non-tax costs (e.g. agency costs, transaction costs, financial reporting costs) may considerably decide over the net effectiveness of corporate tax planning (or tax policy making, vice versa). The role and assertiveness of tax authorities and other relevant stakeholders frequently co-determines the optimal tax strategy and its potential outcome. Regardless of empirical difficulties to measure and quantify non-tax costs, it is important to emphasize that, after-tax profitability of businesses frequently cannot be maximized without affecting other stakeholders’ goals. Tax planning always requires an integral consideration and trade-off of all explicit and implicit taxes as well as non-tax costs(Lietz, G. M. (2013).

4- Definition of Tax Havens :

According to classical definitions, a tax haven is a country, which has a very low taxation or even no taxation at all. However, tax havens are not all about low or lack of taxation. They are also characterized by high levels of secrecy and the availability of a strong network of financial services that allows users sophisticated strategies for achieving their goals. From a historical perspective tax havens have a continuously and complex evolution along the time. Gordon Report identifies one of the first "ancestors" of modern tax havens and implicitly tax evasion: Ancient Greece. In Athens, in order to avoid a custom duty in value of 2% applied by the city on imports and exports of goods, merchants were using nearby islands for storing their goods, which were then illegally introduced in the city (Gordon, 1981: 21)(Mara, E. R. (2015).

There is no standard definition of the term tax haven. In its 1998 report Harmful Tax Competition: An Emerging Global Issue, the OECD defined characteristic features to identify tax havens. With the aid of established criteria, the aim is to identify general practices of tax regimes that favour financial or other economic activities in particular locations and consequently distort trade and investment or generally undermine the trust in tax systems.

This harmful tax competition not only has negative effects on the individual nation states but, seen in a global context, on the one hand the competition between states to cut tax rates is problematic and on the other hand tax incentives and tax exemptions differentiated according to sector are offered as investment incentives (see EU code of conduct). Numerous countries have established special economic zones for this purpose, for example, which offer this incentive effect in the field of real production, as part of so-called production zones. This is used in particular in threshold countries, facilitated by the low level of social regulations, of labour protection or environmental constraints. Trade union organisation is hindered, with the assistance of the countries themselves, who in this way however continue the spiral of exploitation in their own countries and cannot counteract the pressure from

the rich countries and corporations. The utilisation of the international tax differentials through the diversion of transactions in order to exploit tax reductions and exemptions is interpreted only as legal tax planning. In most cases, tax havens are not independent. Either they belong directly to industrialised countries such as Britain, the US, France, the Netherlands or Luxembourg, or there is a close connection with an important financial location, which is indispensable for these constructions

The OECD in any case defines four criteria that a tax haven fundamentally fulfils:

- The tax system in the respective country provides for zero or low nominal tax rates.

- There is no effective information exchange with other countries.

- There is a lack of or inadequate transparency with regard to disclosure requirements. Basic regulations and their implementation are not clearly defined and regulated.

- Economic activity is not a necessary precondition. This results in the conclusion that investments or transactions are carried out purely for taxation reasons.

Further features that lead to tax incentives are identified in connection with these criteria. Frequently, special conditions are offered for non-resident taxpayers in order to attract investment. The measures listed here indicate the variants relating to this:

- Offering the most varied forms of confidentiality, banking secrecy, trusts4 etc.

- Offering off-shore services for non-residents (e.g. zero tax rates for foreigners). To a certain extent, these types of conditions correspond to protection from financial market Regulations.

- A disproportionate financial sector in comparison to the local economy

- The politics of the country do not really interfere in companies' business activity. This makes it easy for taxable persons to evade their countries' tax laws and regulations.

- Political stability is important in these countries.

- An industry of professional consultancy companies provides support.

How Tax Havens Work?

Terms such as base company (Mailbox Company) and flow-through entity are mentioned in connection with the mechanics of tax planning. The term base company corresponds to the colloquial mailbox company and describes a company that is founded in a tax haven for operations in third countries.

Example of a Base Company (Invoice)

A furniture company in Austria has its production in Slovakia. The furniture produced in Slovakia is sold to a tax-haven company. This tax-haven company sells the furniture on to the Austrian company. Most of the price mark-up and thereby the the profit goes to the tax haven company. The Austrian company sells the furniture with the remaining limited mark up. Thus, the majority of the profit (€400 of €500) is passed on to the tax haven and thereby removed from Austrian taxation(Otto, F., Michael, et al, 2015).

5- Famous Tax Evasion Cases :

It is not a crime to reduce or minimize business or personal income taxes by taking advantage of the tax benefits provided in the U.S. tax code, or by structuring your finances to reduce your tax bill. However, you risk sizable penalties and even prison when you resort to deceptive or fraudulent tactics to avoid paying taxes. Although only a tiny fraction of returns are audited each year, the penalties for tax evasion and tax fraud are not worth the risk.

While thousands of Americans end up in court to face tax charges each year, it is usually only those cases involving celebrities or successful businesspeople that draw the public's attention. The Internal Revenue Service (IRS) is often more than willing to use the attention these trials draw to show other taxpayers what can happen if they do not obey the tax laws. The following is a list of famous individuals successfully prosecuted by federal and state tax authorities.

Walter Anderson

An American entrepreneur, Walter Anderson made his millions after the breakup of AT&T in 1984. He was convicted of the largest tax evasion case in U.S. history for evading more than $200 million in taxes. It was reported that in 1998, he paid $495 in taxes on $67,939 of income. The IRS alleged he made at least $126 million that year, hiding the income using offshore corporations. Anderson was sentenced to nine years in federal prison.

Richard Hatch

America was watching in 2000 as Richard Hatch received $1 million for winning the first year of the reality TV show "Survivor." CBS sent the IRS and Hatch Forms 1099 reporting those winnings. However, he failed to pay taxes on that income and other earnings from his new celebrity status. In 2006, Hatch was convicted of tax evasion in federal court and served a 51-month prison sentence as a result. Hatch returned to prison for nine more months after he failed to amend his 2000 and 2001 returns.

Lil Wayne

The Grammy Award-winning rapper, whose real name is Dwayne Carter Jr., has had numerous tax liens against him for back taxes. With liens dating back to 2002, the IRS increased the size of the liens against him until they reached more than $12 million in 2014. In 2019, Lil Wayne finally settled his outstanding tax debt.

Ron Mix

Ron Mix was a Hall-of-Fame offensive lineman with the San Diego Chargers who became a successful workers' compensation lawyer after his playing career ended. He pleaded guilty to reporting $155,000 in referral fee payments as charitable donations between 2010 and 2013 and paid a fine of nearly $50,000.

Nicolas Cage

The IRS filed documents in 2009 alleging that Nicolas Cage failed to pay more than $6 million in taxes for 2006. Cage contended his failure to pay taxes was due to his management team, and he ended up suing his money manager for fraud and negligence. After taking any role he was offered, Cage announced in 2022 that he had finally paid off his tax bills and would be more selective with his film roles.

Willie Nelson

Willie Nelson was a household name for having written and performed such country music standards as "On the Road Again" and "Whisky River" when he began his decades-long struggle with the IRS over unpaid taxes in the 1990s. The federal government ended up seizing most of Nelson's property to pay his reported $32 million tax liability. It's believed that his tax woes were the result of bad advice he received from an accountant who hid Nelson's money in bogus tax shelters.

In the end, Nelson negotiated a settlement with the IRS. And recorded The IRS Tapes: Who'll Buy My Memories? As part of the settlement to pay down his tax debt. The IRS only collected $3.6 million from sales of the album, but Nelson's career eventually picked up and he paid off the rest of his debt.

Al Capone

Alphonse Gabriel Capone was an infamous Chicago gangster in the early Twentieth Century who was linked to murder, extortion, and bootlegging. He was eventually brought down for tax evasion after prosecutors failed to make any other charge stick. In 1931, Capone received an 11-year sentence for not paying $215,000 in taxes. He did not serve the full term and retired in Florida.

Paul Daugerdas

In a case dubbed by federal prosecutors as the biggest criminal tax fraud in history, former attorney Paul Daugerdas received a 15-year prison sentence and was ordered to forfeit $165 million for helping his clients evade taxes. He was convicted of creating a fraudulent tax shelter that would claim fictional losses to reduce the tax

bills of the extremely wealthy. During its operation, the tax shelter generated more than $7 billion in fraudulent losses, resulting in $1.6 billion in lost tax revenue.

Wesley Snipes

Wesley Snipes received a three-year prison sentence for **willfully failing to file** income tax returns(J.P. Finet, J.D. legally reviewed by J.P. Finet, J.D. ,2023).

THEME SEVEN: INTERNATIONAL TAXATION AND ELECTRONIC COMMERCE

Introduction:

Electronic commerce is one of the most important factors in the development of the global economy and the evolution of international economic relations. In addition, taxing e-commerce is a global challenge for governments and business alike. Due to the development of e-commerce, especially the sale of goods and services over the internet on a global scale, the structures of enterprises have changed and new business models are emerging.

The rise of electronic commerce raises fundamental questions of tax policy. Most fundamentally, should electronic commerce be taxed? Is the answer the same in the short run as in the long run? How about arguments that electronic commerce should not be taxed during its infancy? How would the exemption of electronic commerce affect Main Street merchants? What are the implications for tax revenues of exempting electronic commerce? For the distribution of income?

In 2023, global retail e-commerce sales reached an estimated 5.8 trillion U.S. dollars. Projections indicate a 39 percent growth in this figure over the coming years, with expectations to surpass eight trillion dollars by 2027(https://www.statista.com,2023).

1- DEFINITION OF ELECTRONIC COMMERCE :

The **internet was first** conceptualised by visionaries in the early 1960s who saw great potential in allowing computers to share data on research and development in scientific and military fields. **J.C.R. Licklider of MIT** proposed a global network of computers in 1962. This idea went on to revolutionise the business world and created an ever-evolving digital economy ever since (Howe, 2016)(Makhmudov, Lazizbek,2020).The term “e-commerce” has several definitions. The United Nations Commission on International Trade Law (UNCITRAL) has defined electronic

commerce as “commercial activities conducted through an exchange of information generated, stored, or communicated by electronic, optical, or analogous means”. The U.S. Department of the Treasury defines e-commerce as “the ability to perform transactions involving the exchange of goods or services between two or more parties using electronic tools and techniques(Gałuszka, Jolanta,2013).

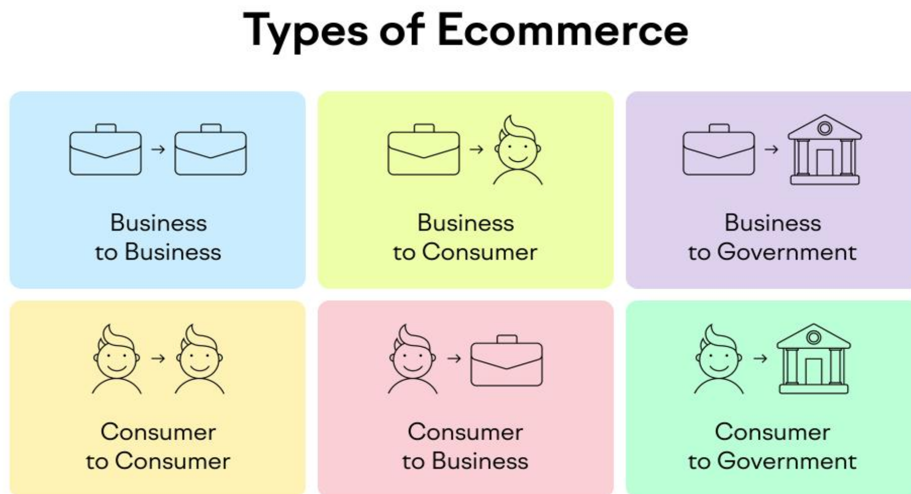
Electronic commerce is the ability to perform transactions involving the exchange of goods or services between two or more parties using electronic tools and techniques." “New information and communications technologies such as the Internet are creating exciting opportunities for workers, consumers, and businesses. Information, services, and money may now be instantaneously transferred anywhere in the world.

Firms are increasing their imports and exports of goods, services, information as the costs associated with participating in global markets plummet, and they are forming closer relationships with suppliers and customers around the world. New markets and market mechanisms are emerging. Consumers can choose from a much broader range of goods and services, and "intelligent agent" software will soon give consumers an unprecedented ability to hunt for bargains.

“One of the main reasons for e-commerce’s booming popularity has been its beneficial effects on business’ bottom lines. By conducting transactions over the Internet, businesses have the potential to significantly improve market efficiencies by eliminating middle persons, and allowing for better management of supplies, production, and distribution(Kerimov, Nuran G,2002).

Electronic commerce can usefully be defined as “the use of computer networks to facilitate transactions involving the production, distribution, and sale and delivery of goods and services in the marketplace.”(McLure Jr, C. E. ,2000).

Figure 15:



2-SHOULD ELECTRONIC COMMERCE BE TAXED?:

There are two logical opinions as to whether electronic commerce should be taxed. Some scholars support the idea while others are against it.

The first group, **the pro-taxation group**, believes that electronic commerce should be taxed just like **any other method of trade.** They state four reasons to support their argument. As the group sees, **first**, that the failure to impose tax on electronic commerce would cause significant revenue losses for state and local governments. **Second**, with no tax status for electronic commerce, businesses will transfer to electronic commerce. That would not only cause a loss of tax revenue, but also many social problems such as job loss might occur.

Third, the pro-taxation group argues that allowing tax exemption to electronic commerce is not fair. It entails discrimination against traditional ways of doing business. It also discriminates against consumers who pay taxes on purchases of traditional stores, while the same item is purchased by other consumers online with no tax.

Finally, the pro-taxation group argues that although some people believe that electronic commerce should receive preferential treatment to encourage its development, there is no evidence to support this idea. In fact, statistics shows electronic commerce is growing rapidly, and is likely to continue doing so with or without preferential tax treatment.

The second group, **the anti-taxation group**, believes that electronic commerce should not be taxed. They stated four reasons in support of their argument, as the first group did. **First,** even without collecting tax on electronic commerce, countries will not witness any loss in revenue. **Second**, the anti-taxation group says that electronic commerce leads economic growth in many countries. Further, it enhances the development of many other types of businesses and services that relates to electronic commerce, such as delivering, shipping or even telecommunications services, which causes high revenue to states and local governments.

Third, countries that tax electronic commerce do not witness the same rapid growth in not tax electronic commerce. In fact, countries with electronic commerce taxation experience a slowing of their economic growth, which ultimately results in a substantial huge loss of revenue.

Fourth, the anti-taxation group argues that beside the difficulties in collecting taxes on electronic commerce, existing tax laws are inappropriate for the internet due to its electronic and cross-border issue.

Some advocates of exemption taxation electronic commerce have adopted a theory, advanced by the mail-order industry. The theory is on line traders located in other countries should not be required to collect tax, because they do not benefit from services provided by the states where their customers are located (Alzaabi, Dr Ahmed.,2013).

3-TWO PRINCIPLES OF INTERNATIONAL TAXATION

A. Defining the Tax Base: **The Single Tax Principle**

International income taxation involves two basic questions: What is the appropriate level of taxation that should be levied on income from cross-border transactions? How are the resulting revenues to be divided among taxing jurisdictions? The answer to the first question is the Single Tax Principle: Income from cross-border transactions should be subject to tax once (that is, neither more nor less than once).

The Single Tax Principle thus incorporates the traditional goal of avoiding double taxation, which was the main motive for setting up the international tax regime in the 1920's and 1930's. Taxing cross border income once also means, however, that it should not be under taxed or (at the extreme) be subject to no tax at all.

B. Dividing the Tax Base: **The Benefits Principle**

Having defined one goal of the international tax regime as taxing cross-border income once, the next question is **how to divide** that base among the various jurisdictions laying claim to it. The Benefits Principle states that the residence jurisdiction has the primary right to tax passive (investment) income, while the source jurisdiction has the primary right to tax active (business) income. As explained above, this division also determines the appropriate rate of tax for purposes of the Single Tax Principle(Avi-Yonah, R. S.,1996).

4-TAXATION OF E-COMMERCE :

In a broader sense, this concept can be understood as the limit of the state's fiscal policy. At present, with regard to the broadly understood matter of human rights, the problem of taxation borders is gaining a new dimension. The classic concept of "taxation limits" includes research, in which the authors directly try to define the concept of **taxation limits** and the amount of maximum tax rates (e.g. **Laffer curve**) (Wanniski 1978). The abstract dimension of defining the limits of taxation in e-commerce is reminiscent of the attempt by Michael Sandel to define the boundaries of markets in the modern world. The title of his publication "What Money cannot buy (...)" indicates the main assumptions of his research. (Sandel 2012, 42) (Satz 2010, 37-45).

Historic tax laws may **not be fit for purpose in the modern economy**. Given today's regulatory, social, political and technological changes, tax authorities, regulations and legislation are struggling to keep up. Technology allows us to create simulations of new phenomena and behaviors of people and allows defining t**ax rules in electronic commerce**. The needs of individuals and countries are also changing all the time, which is why it will be necessary to set new legal regulations, tax policies and taxes (itax) (Ting 2014).The issue of taxation in e-commerce has **both theoretical and practical significance**, including due to **insufficient knowledge** of the direct tax mechanism in the digitized economy, as well as the need to develop new taxation models. (Eccleston 2012, 81-111).

The lack of legal regulations regarding taxation of income from e-commerce should be considered from the perspective of **the principle of tax certainty**, because abstract legal norms should indicate the behavior of entities. Formal certainty of tax law should enable proper organization of their tax law relations by clearly indicating their rights and obligations towards the state in the field of taxes. The requirement of legal certainty in tax law should be of a special nature and should result in very precise legal regulations and control mechanisms by the state, including in the area of e-commerce taxation. Legal regulations regarding the taxation of e-commerce transactions and scientific research in this respect should take into account the specificity of international commercial law (Lipniewicz 2018, 24-134).

The problem of e-commerce taxation is global. **The exchange of tax information between states** is considered to be the greatest achievement in international, or actually global (Stewart 2013, 316-344). **The issue of tax justice** should in particular be addressed to these new issues, which also involve the problem of the impact of tax policies and taxation rules of some countries on other countries and is included in the literature in the context of tax competition (Badura, Ewelina,2019).

The recommendations of the OECD (Organization for Economic Cooperation and Development) are devoted to the taxation of ecommerce. In **Ottawa in 1998**, he adopted the basic principles of taxation of electronic commerce, which subsequently

formed the basis of recommendations for electronic commerce. Since then, the recommendations have been constantly improved, as this problem requires more and more attention from year to year. These principles are relevant today and are the basis for taxation of the digital economy. The main principles of taxation of electronic commerce are:

* **Neutrality.** Tax systems should be neutral to various types of ecommerce, as well as to traditional forms of e-commerce and business. Taxpayers performing the same operations are required to fulfill the same tax obligations.

* **Efficiency**. The costs of taxpayers to comply with all requirements of tax legislation and administrative expenses of tax authorities should be minimized.

* **Clarity and simplicity**. Tax rules should be clear and understandable so that taxpayers can determine in advance the time, place and procedure for calculating taxes payable on transactions, including taxes.

* **Efficiency and fairness**. Tax rules should ensure that the taxpayer calculates the correct amount of tax in a timely manner. The possibility of tax evasion should be minimized, and the scale of measures taken and the size of fines should be the most appropriate way to pay tax.

* **Flexibility**. The tax system must be flexible and dynamic, it must be constantly integrated with innovations in technology and trade .We believe that a balanced tax burden on e-commerce will be reduced if countries consider these principles when setting up their tax systems(Makhmudov, Lazizbek,2020).

E-commerce can be **intangible**, multi-jurisdictional, and easily located in tax havens. It poses great challenges to tax authorities. Effective administration relies on the tax authorities' power and means to obtain information in order to assess a taxpayer's tax liability by identifying taxpayers, identifying and verifying transactions, and establishing a link between taxpayer and the transactions. E-commerce has the

potential to make it difficult or impossible for tax authorities to obtain information or to enforce tax collection.

Taxpayers may disappear in cyberspace, reliable records and books may be difficult to obtain, and taxing points and audit trails may become obscure(Basu, S. ,2016).

5-PERSPECTIVES TO STRUCTURE THE TAXATION PROBLEMS IN THE INTERNET:

For an overview of the taxation problems connected with the electronic new economy, one can, in a first step, distinguish between legal and illegal courses of action of taxpayers. Because of the technical and institutional characteristics of the Internet, such as

- Decentralisation, encoding and anonymity;
- Commerce without receipts and dis intermediation;
- Infinite reproducibility of digital products, and the;
- Absence of public authorities in the net.

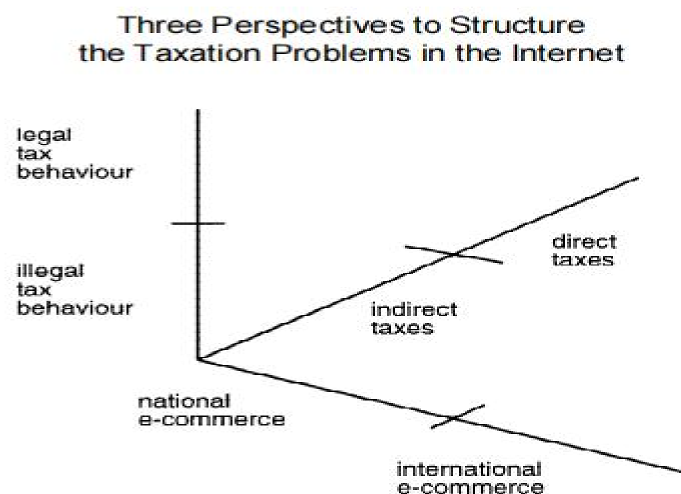
Tax evasion becomes easy and bears low risk. The Treasury is frequently unable to enforce its tax claims or requires considerable expenses on staff and material to do so. The fiscal aim of a revenue-intensive tax collection and the aim of a just and equal taxation will therefore hardly be obtainable. Closely connected are distortions of competition between the old and the new economy, if considerable tax evasion in e-commerce leads to lower gross prices there, compared to traditional trade.

For the systematisation of the taxation problems in the Internet one can, in a second step, distinguish between national and international transactions. The network forces economic globalisation, while fiscal sovereignty mainly remains on the national level This leads to internationally different tax systems, that, on the one hand, are in a competitive relationship as important location factors, but, on the other hand, need to

be co-ordinated, in order to avoid an unwanted double-taxation in e-commerce as well as taxation shortfalls and competition distortions.

A third and last clustering aspect relevant for the taxation of e-commerce can be conducted with regard to the affected tax types. Among the taxes levied on the application of income (so-called indirect taxes) the tax enforcement of the special excise duties (on mineral oil, tobacco, coffee, alcohol and spirits, etc) seems to be less problematic within the European Union (EU), because of the system of connected tax stores and a rather small total number of producers or wholesalers. Against this, the turnover tax is much more important. This is due to the very broad basis of assessment and the correspondingly extremely high number of taxable suppliers and chargeable transactions in the net. Looking beyond the EU border line, tax enforcement problems might arise even with the excise duties on tobacco, coffee or spirits, but only if the Internet will be used by smugglers as an instrument for direct marketing.

Figure 16: Three Perspectives to structure the taxation problems in the internet



Besides the taxes on the use of income, there are the so-called direct taxes that tax income generation. Among these are the income tax (in Germany consisting of the wages tax, assessed income tax and capital income tax), the corporation tax and other business taxes (in Germany the local business tax). For a regular collection of tax the legal status, the place of residence and the owners of a company or the identity and the place of residence of the taxable person must be known. Therefore, the anonymity of Internet transactions creates problems for tax collection. However, there are problems specific to Internet taxation even when considering legal tax behaviour, especially with internationally operating legal taxpayers. Here, the determination of taxable profits and their distribution among the involved states are challenging(Bach, Stefan et al,2000).

6-PROPOSALS TO TAX E-COMMERCE AND INTERNATIONAL COOPERATION:

A. "Bit Tax"

One of the most controversial solutions to tax electronic commerce was the "bit tax." **Arthur J. Cordell and Thomas Ide** initially proposed the "bit tax" in a paper presented at The Club of Rome in December 1994.230 "The tax would apply to all digital 'bits' of information that flow through telecommunications traffic lines that carry interactive digital information. The tax would be applied on the flow volume of bit data, and then collected by telecom carriers, satellite networks, and cable systems, who would send it directly to government The European Commission rejected the idea of the "bit tax" and it did not find practical support neither in the United States.

B. Trusted Third Parties

The Clinton Administration made a proposal for taxation of electronic commerce which is similar to the traditional VAT scheme. It has been proposed that consumption taxes on e-commerce could be collected through advanced technologies using third-party collecting agents. "Consumers would purchase digital cash cards (also known as "smart cards," or "e-cards") at banks that would allow the seller to

identify the country the purchase was from. The VAT would be calculated, based upon the place of consumption, and immediately collected with the sale. The funds would then be placed by the seller with a third party escrow agent, who would funnel the money to the appropriate government."

The proposed scheme is a tax-neutral and treats equally both conventional and ecommerce transactions. In addition to this advantage, the proposal would allow to preserve the consumers' privacy.

C. US trend to adopt residence-based Taxation: Potential Unfairness to Developing Countries As the discussion throughout the thesis shows, it is extremely difficult to determine the source country in the world of cyberspace. Moreover, e-commerce complicates the application of the tax threshold concepts of permanent establishment. The U.S. Treasury, in its 1996 report entitled "Selected Tax Policy Implications of Global Electronic Commerce" proposed a shift from source-based taxation to residence-based taxation. The report explains:

"In the world of cyberspace, it is often difficult, if not impossible, to apply traditional source concepts to link an item of income with a specific geographical location. Therefore, source based taxation could lose its rationale and be rendered obsolete by electronic commerce. By contrast, almost all taxpayers are resident somewhere. An individual is almost always a citizen or resident of a given country and, at least under U.S. law, all corporations must be established under the laws of a given jurisdiction.

D. Tax Administration and International Cooperation

Unique features of electronic **commerce complicate** enforcement problems for taxing authorities. Unlike transactions with physical goods, e-commerce of digital goods is hardly be subjected to control and taxation. "Taxpayers may disappear in Cyberspace, reliable records and books may be difficult to obtain, and taxing points and audit trails may become obscure. «It is obvious that traditional mechanisms of control and audit are not fully capable to meet all aspects of e-commerce.

It is important for tax authorities of different countries to cooperate and assist each other in the process of tax collection. The absence of provisions regarding tax collection assistance between countries leaves significant taxes revenues uncollected. The OECD is trying to make changes to the OECD Model Treaty to include tax collection assistance provisions(Kerimov, Nuran G,2002).

SYLLABUS OF LECTURES
THEME ONE :INTERNATIONAL TAX AS INTERNATIONAL LAW
1- Definition of Domestic and international taxation
2- The current international tax framework
3- Is International Tax Law Part of public International Law?
4- What is the purpose of cross-border tax rules?
5- Current State of Scientific Research in International Tax
6- Sources of International Tax Law
7- International Tax Standards
8- Example of Theory of International Taxation (A Theory of Global Tax Hubs)
THEME TWO : Tax Treaties
1- History of tax treaties
2- Definition of tax treaties
3- The OECD/UN model tax treaty
4- Abuse of tax treaties
5- Why negotiate tax treaties
6- Base erosion and profit shifting (BEPS)
THEME THREE :International Tax harmonization
1- Coordination, cooperation, convergence, harmonization
2- Definition of tax harmonization
3- Methods can be used to promote tax harmonization(federal states):
4- European Tax Harmonization
5- Concluding Remarks by ALFRED BOSS
6- Concluding Remarks by SIMEANA BESHI AND BEDRI PECI (VAT)
THEME FOUR : International tax competition
1- The rise of tax competition
2- Definition of tax competition

3- The baseline model tax competition
4- The benefits of tax competition
5- Tax competition and tax rates
6- The problem of harmful tax competition (the theoretical standard argument)
7- International initiatives on harmful tax practices
THEME FIVE : International tax arbitrage
1- Definition of Tax arbitrage
2- Types of Tax Arbitrage Strategies
3- Pension tax arbitrage theory
4- Using hybrid financial instrument in Tax arbitrage
5- Transfer pricing and tax arbitrage
THEME SIXE : International Tax Avoidance and Tax Evasion
1- The Difference Between Tax Avoidance and Tax Evasion
2- Main Channels of International Tax Avoidance
3- Conceptual Framework of Corporate Tax Planning
4- Definition of Tax Havens
5- Famous Tax Evasion Cases
THEME SEVEN :International taxation and electronic commerce
1- definition of electronic commerce
2- Should electronic commerce be taxed?
3- two principles of international taxation
4- taxation of e-commerce
5- perspectives to structure the taxation problems in the internet
6- proposals to tax e-commerce and international cooperation

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