

Trends in the conclusion of tax treaties by developing countries

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Presentation outline

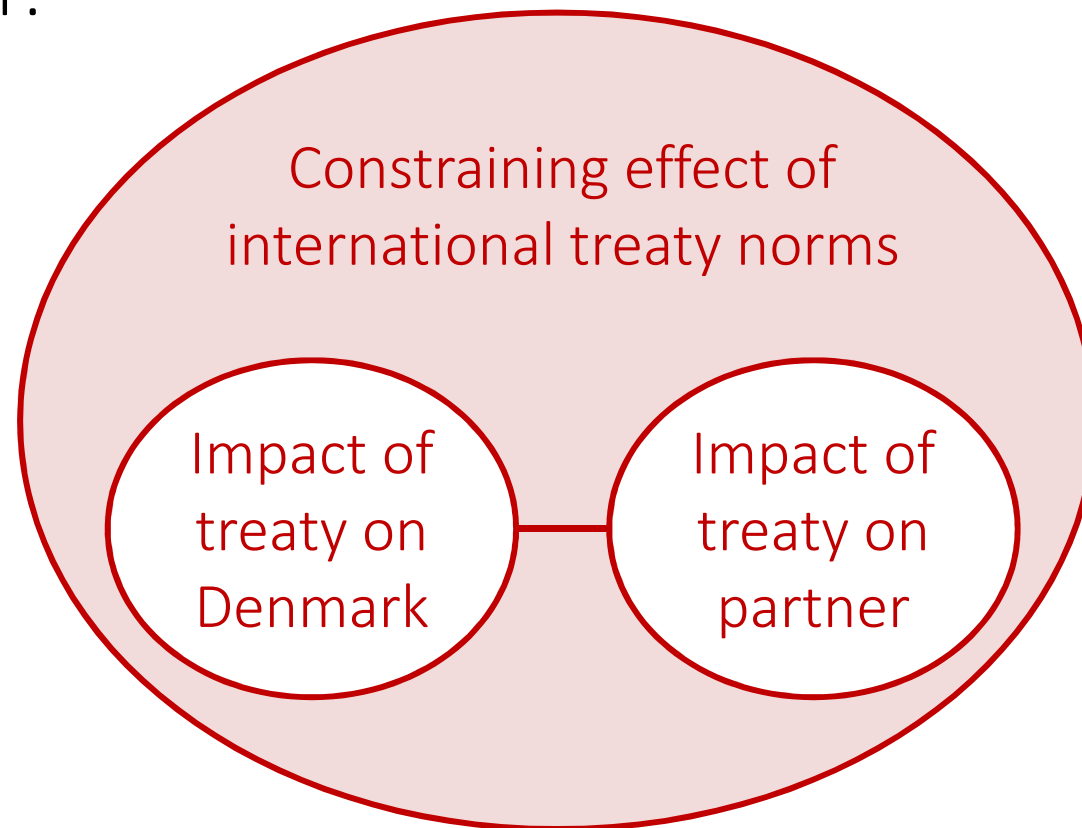
1. A political science perspective on tax treaties
2. The diffusion of tax treaties to developing countries
3. Evidence on the effect of tax treaties

A political science perspective on tax treaties

- Tax treaties are political settlements, which divide the fiscal gains from cross-border investment between two countries.
- They bind future governments into specific tax policy decisions, including certain tax rates.
- Legislative scrutiny of tax treaties is usually either a formality or, especially in developing countries, non-existent.

A political science perspective on tax treaties

There are three sites of impact for this committee to consider:

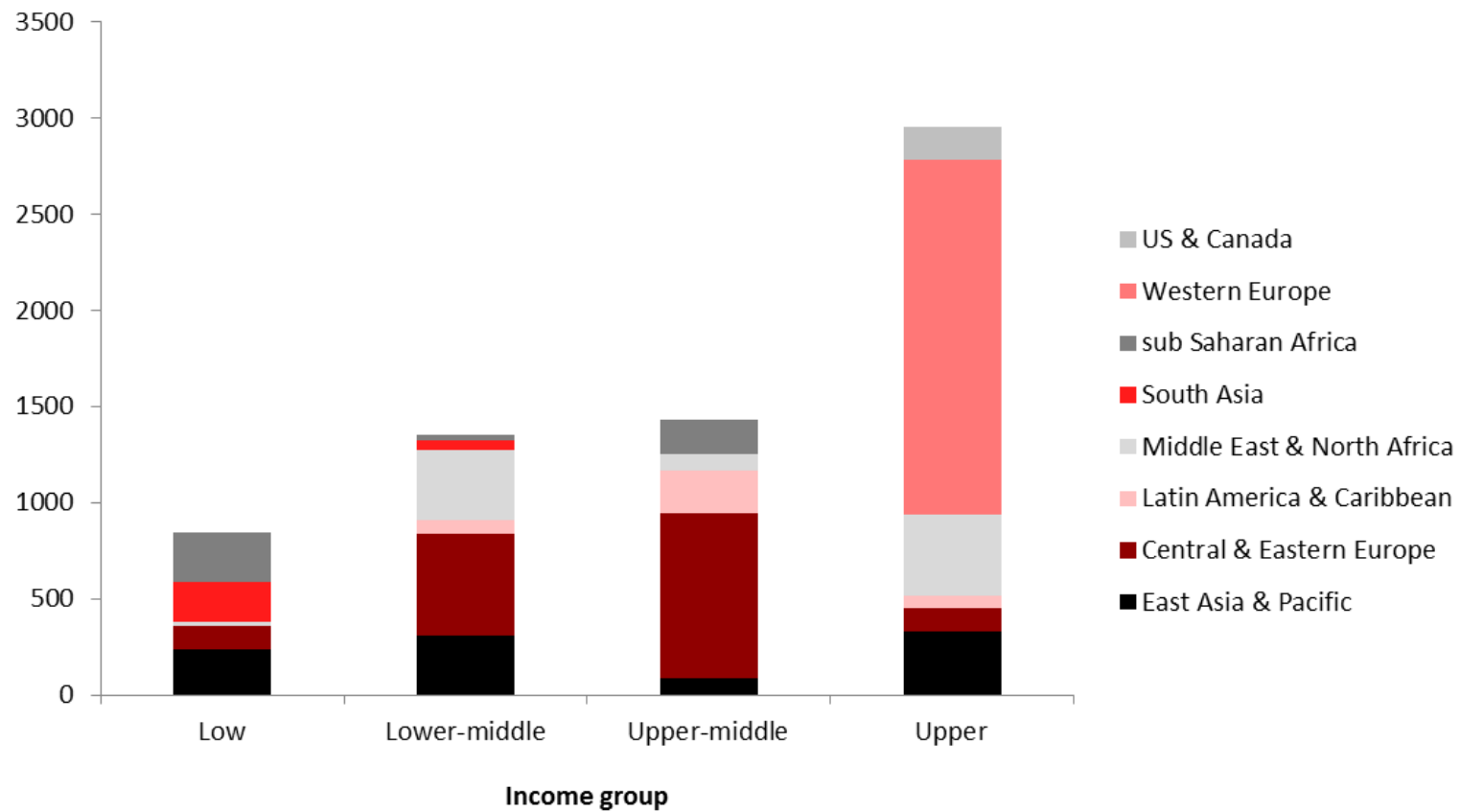


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1. A political science perspective on tax treaties
2. The diffusion of tax treaties to developing countries
 - State of play
 - Historical trends
 - Trends in treaty content
3. Evidence on the effect of tax treaties

State of play

Treaty signatures by income group and region



Based on IBFD data

State of play

Number of tax treaties signed by income group

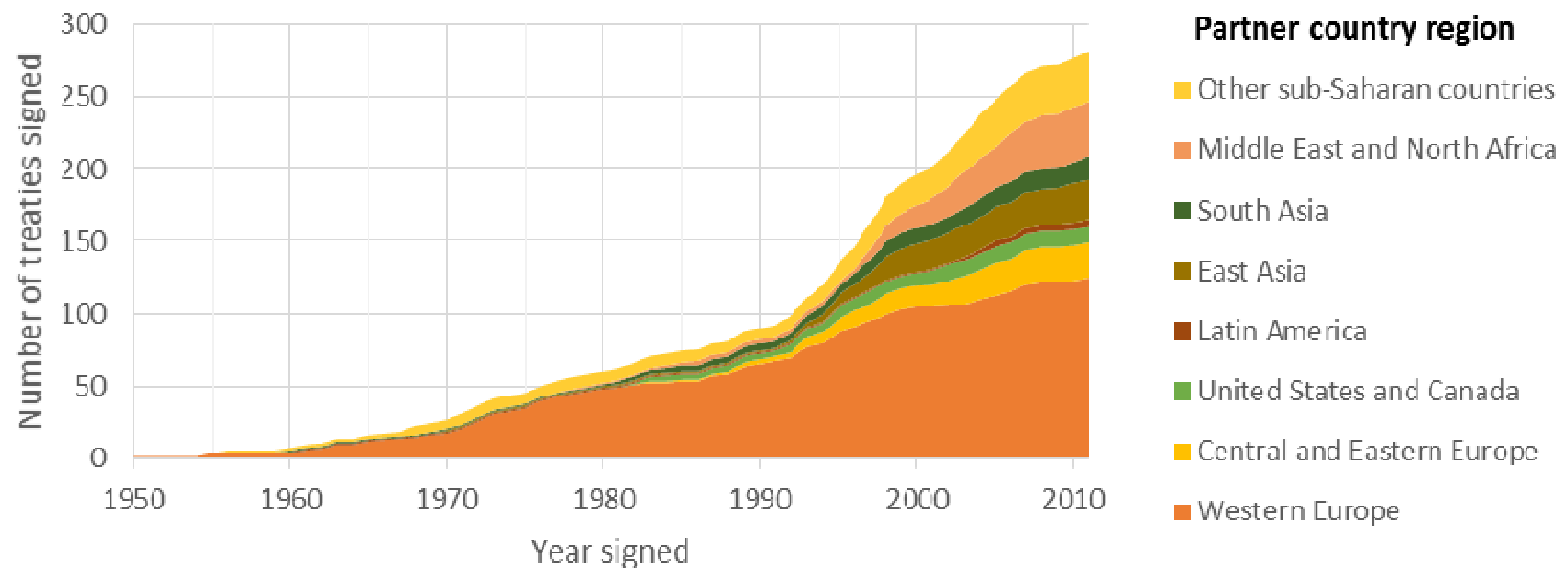
	Low	Lower-middle	Upper-middle	Upper
Low	61			
Lower-middle	173	134		
Upper-middle	178	305	151	
Upper	372	606	646	629

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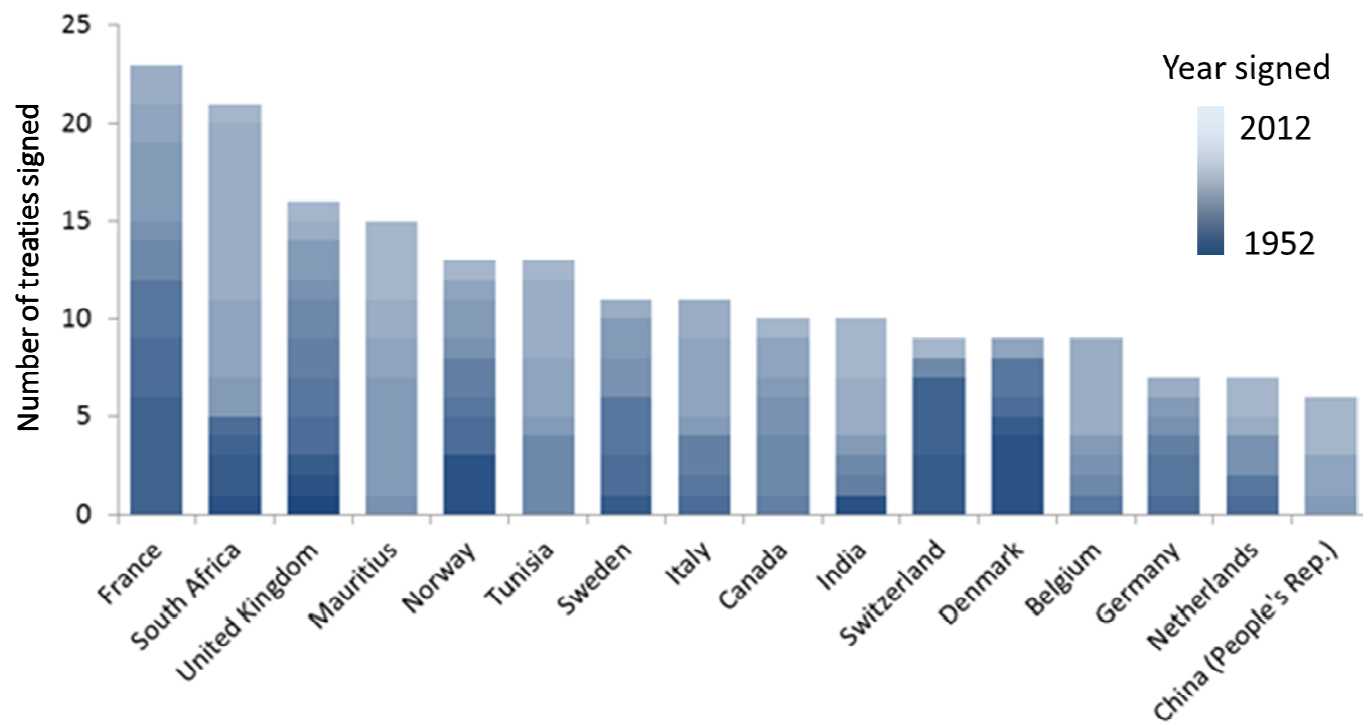
Historical trends

Treaties signed by sub-Saharan African countries



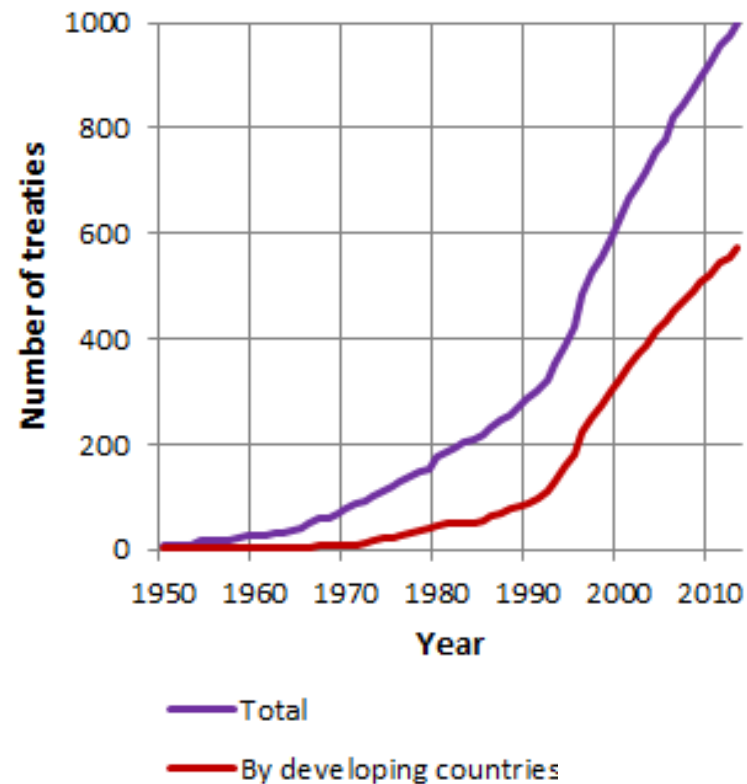
Historical trends

Treaty partners of sub-Saharan African countries



Historical trends

Cumulative renegotiations



Selected recent cancellations (C) and/or renegotiations (R):

Mongolia-Luxembourg 2012 (C)
Argentina-Spain 2012 (C,R)
Rwanda-Mauritius 2012 (C,R)
South Africa-Mauritius 2014 (R)
Malawi-Netherlands 2014 (C)
Zambia-UK 2014 (R)

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Trends in treaty content

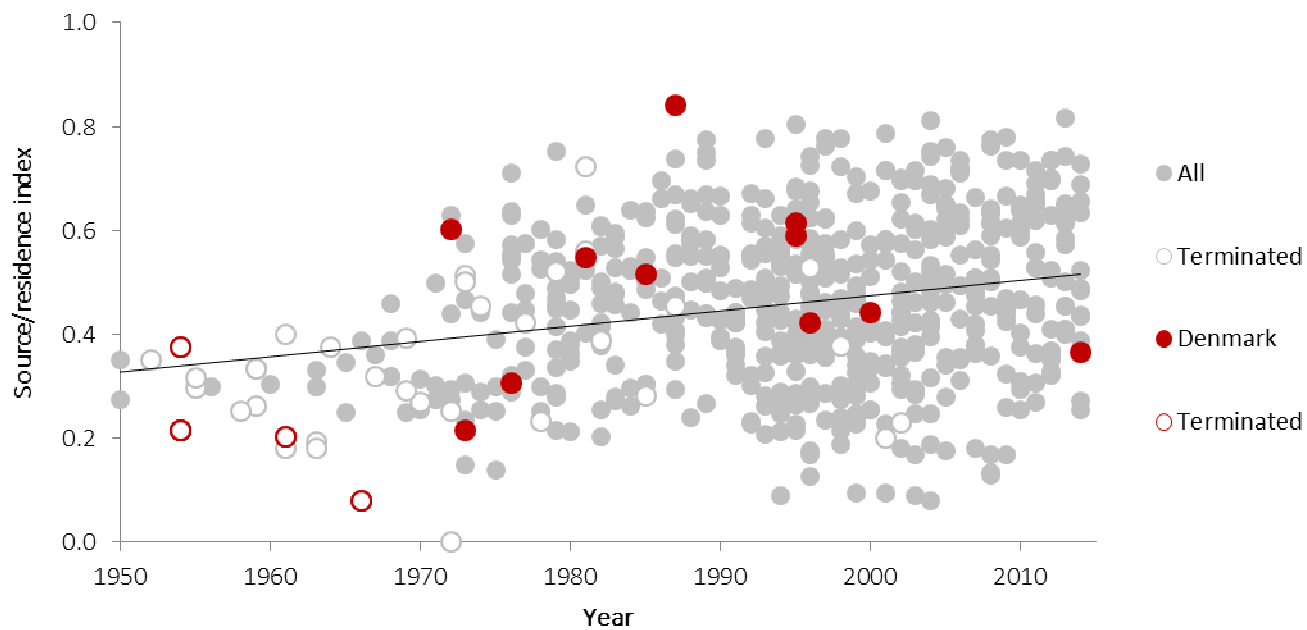
- The two main models for tax treaty conclusion are:
 - The OECD model, originally intended for treaties between developed countries.
 - The UN model, explicitly designed for treaties between developed and developing countries.
- Despite this, most clauses of most treaties between developed and developing countries follow the OECD model (IBFD, 2013).

Trends in treaty content

Clauses favouring developing countries are becoming more common on average

Changing source/residence balance in treaties overtime

Low/lower-middle income countries in Africa and Asia

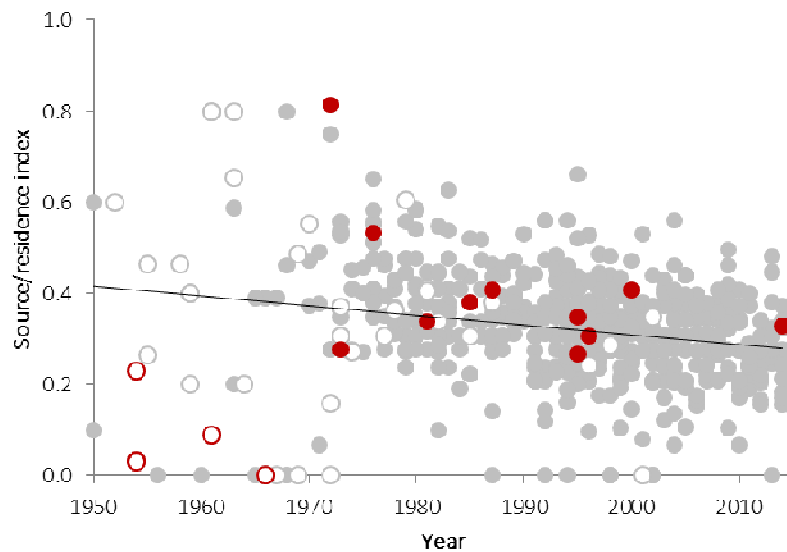


Trends in treaty content

Declining withholding tax rates are balanced by more expansive definitions of permanent establishment

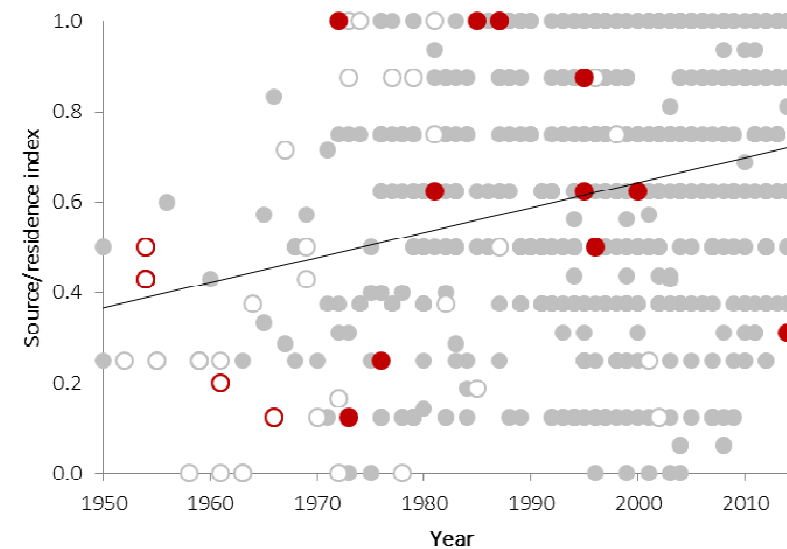
Withholding tax rates

Low/lower-middle income countries in Africa and Asia



Permanent establishment definition

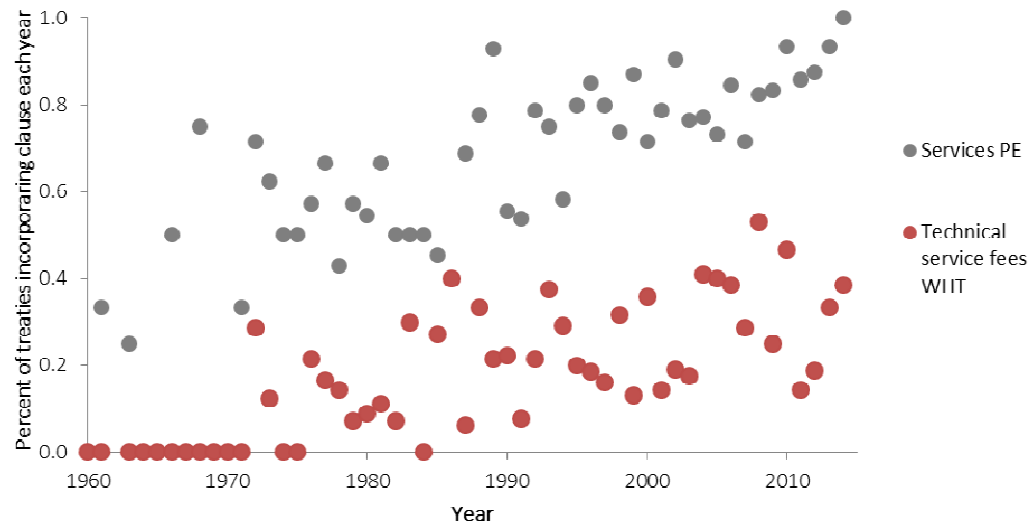
Low/lower-middle income countries in Africa and Asia



Trends in treaty content

It is becoming more common for developing countries to retain the right to tax services

Spread of source taxation of services in tax treaties
Low/lower-middle income countries in Africa and Asia



Danish treaties in this dataset:

- Services PE in 4 of 16.
- Services WHT in 5 of 16.
- The most recent two treaties (Ghana and Uganda) permit a services WHT.

Trends in treaty content

Implications:

- The major part of treaties signed by developing countries are with traditional capital exporters, although there is a growing trend towards treaties with emerging economies.
- Much investment into developing countries is taxed under treaties negotiated decades ago.
- Treaty norms have changed significantly since then, in some ways in developing countries' favour.
- Denmark went through a generous phase, but has become less so since the mid 1990s.

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2. The diffusion of tax treaties to developing countries
3. Evidence on the causes and effects of tax treaties
 - Legal analysis
 - Econometric evidence
 - Political science

Legal analysis of tax treaties

There is a strong seam of critical analysis in the academic legal literature (eg Irish, Brooks, Dagan, Thuronyi, Avi-Yonah, Christians):

- Most developed countries (including Denmark) take unilateral steps to alleviate double taxation.
- The main effect of treaties is to shift the burden of double tax relief onto the developing country.
- Strategic interaction between countries leads to tax competition.
- Treaties also export tax concepts to developing countries that may not be appropriate for them (e.g. dispute settlement, transfer pricing rules).

Legal analysis of tax treaties

“The present system of tax agreements creates the anomaly of aid in reverse— from poor to rich countries.”

– Charles Irish, 1974

“In treaties between developing and developed countries...re-allocating tax revenues means regressive redistribution - to the benefit of the developed countries at the expense of the developing ones.”

– Tsilly Dagan, 2000

“Developing countries...would be well-advised to sign treaties only with considerable caution.”

- IMF, 2014

Legal analysis of tax treaties

Tax treaty advocates argue that they:

- mop up outstanding double taxation
- standardise definitions
- guarantee tax stability
- reduce certain tax rates overall
- create a framework for cooperation/dispute resolution
- send a signal that a country is open for business

Treaties clearly have benefits for businesses.

The question is whether they outweigh the costs.

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Econometric evidence

Do tax treaties increase foreign direct investment (FDI) into developing countries?

- Until recently, the evidence suggested not (Sauvant & Sachs 2009).
- Newer studies find a positive effect. Eg Swedish firms 0.7% more likely to establish a new affiliate if there is a treaty (Davies, Norbäck & Tekin-Koru, 2009).
- Methodological problems mean this evidence should be interpreted with caution:
 - Poor data coverage of developing countries
 - Distinguishing cause from effect
 - Treaty shopping
 - More bilateral FDI \neq more total investment or growth (cf Klemm & van Parys 2010)

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Political science

“Most of the time developing countries are disadvantaged by treaties. Treaties do not attract investment. It is other factors.”

“I know there’s empirical evidence that it [a treaty] has no effect on investment, but the reality country-to-country is that there’s a bluff goes on, and countries don’t want to take the risk of losing big investments.”

“There is currently no evidence to show that tax treaties have helped to attract investment...In my personal view one of foremost reason for signing tax treaties is to signal that [the country] is open to inward investment and bilateral economic cooperation .”

“We are thinking we should have a policy.”

- Officials involved in treaty negotiation

Political science

How do developed-developing treaties come about?

- Treaties sometimes requested by developing countries, sometimes by developed countries.
- Developed countries: clear benefit from a tax treaty - fiscal gain to government and/or reduced costs to outward investors.
- Developing countries: cost/benefit less clear.
- Most treaty negotiators, most investment promotion officials, and many tax advisers do not expect treaties to attract new investment (although some individual cases).
- Poor policymaking and poor negotiating by developing countries over several decades has created treaty networks whose costs probably outweigh any benefits.

Thankyou

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