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Eleventh meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters

Report of the Secretary-General**

Summary

The present report provides a summary of the proceedings of the eleventh meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters, held from 15 to 19 December 2003 at Geneva. The Group of Experts held extensive discussions on the following topics: mutual assistance in the collection of tax debts and protocol for mutual assistance procedures; treaty shopping and treaty abuses; interaction of tax, trade and investment; financial taxation and equity market development; transfer pricing; cross-border interest income and capital flight; electronic commerce and developing countries; revision of the United Nations Model Double Taxation Convention and the *Manual for the Negotiation of Bilateral Tax Treaties*; and the institutional framework for strengthening international cooperation in tax matters. Based on the discussions, the Group made recommendations on further work in selected areas and on the agenda of its twelfth meeting.

* E/2004/100.
** The present document was submitted late to ensure the inclusion of the most recent information.

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I. Introduction

1. Pursuant to Economic and Social Council decision 2003/313, the eleventh meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters was held at Geneva from 15 to 19 December 2003.

2. In its resolutions 1980/13 and 1982/45, the Council defined the terms of reference of the Group of Experts as including, inter alia, the formulation of guidelines for international cooperation to combat tax evasion and avoidance and the study of possibilities for enhancing the efficiency of tax administrations and reducing potential conflicts among tax laws of various countries. With the significant growth of international trade and investment, tax authorities in developing countries and economies in transition face increasing challenges in assessing and collecting the taxes due to them from international transactions. The Group of Experts provides advisory services for strengthening the administrative and technical capacities of the tax administrations in developing countries and countries with economies in transition through the organization of interregional workshops on international taxation and through technical cooperation and assistance.

3. For over three decades, the United Nations has demonstrated its commitment to international tax cooperation through its support for the Group of Experts. In the report of the Secretary-General on implementation of and follow-up to commitments and agreements made at the International Conference on Financing for Development,[1] it was recommended that the Group of Experts be converted into an intergovernmental body, either in the form of a committee of governmental experts or of a special new commission, as a subsidiary body of the Economic and Social Council. The General Assembly subsequently adopted resolution 58/230, in which the Assembly requested the Economic and Social Council, in its examination of the report of the Group of Experts at its next substantive session, to give consideration to the institutional framework for international cooperation in tax matters.

4. The eleventh meeting of the Group of Experts was attended by 23 tax experts, a record-number of 68 observers and various consultants and staff. The United Nations Secretariat prepared the basic documentation for the meeting and organized a meeting of the Steering Committee of the Group of Experts in New York in May 2003 to review the work of the Group of Experts on transfer pricing, new financial instruments, tax of electronic commerce, mutual assistance in tax collection, the possible upgrading of the Group of Experts in light of the implementation of the Monterrey Consensus, the revision of the United Nations Model Double Taxation Convention between Developed and Developing Countries and the *Manual for the Negotiation of Tax Treaties between Developed and Developing Countries*. The Committee also reviewed arrangements for the twelfth meeting and formulated recommendations on the issues to be discussed at that meeting.

5. The following members of the Group of Experts attended the eleventh meeting: Mr. Antonio Hugo Figueroa (Argentina), Mr. Kenneth Allen (Australia), Ms. Luciana Mesquita Sabino de Freitas Cussi (Brazil), Mr. Liao Tizhong (China), Mr. Abdoulaye Camara (Côte d'Ivoire), Mr. Mahmoud Mohammed Ali (Egypt), Mr. Pascal Saint-Amans (France), Mr. Wolfgang K. A. Lasars (Germany), Mr. John Evans Atta Mills (Ghana), Mr. Panna Lal Singh (India), Mr. Surjotamtomo Soedirdjo (Indonesia), Mr. Mayer Gabay (Israel), Mr. Errol Hudson (Jamaica),

Mr. Armando Lara Yaffar (Mexico), Mr. Noureddine Bensouda (Morocco), Mr. Joseph A. Arogundade (Nigeria), Mr. Riaz Ahmad Malik (Pakistan), Mr. Babou Ngom (Senegal), Mr. Keith Engel (South Africa), Mr. José Antonio Bustos (Spain), Mr. Daniel Luthi (Switzerland), Mr. Andrew J. Dawson (United Kingdom of Great Britain and Northern Ireland) and Ms. Patricia A. Brown (United States of America).

6. The meeting was also attended by observers from: Azerbaijan, Bahamas, Barbados, Belgium, Cameroon, Cayman Islands, Chile, the Congo, Cuba, the Czech Republic, Egypt, Iran (Islamic Republic of), Ireland, Israel, Italy, Kenya, Malaysia, Morocco, Nicaragua, Nigeria, Norway, Romania, the Russian Federation, Rwanda, Singapore, Slovakia, South Africa, Spain, Thailand, Tunisia, Uganda, Ukraine, Venezuela and Viet Nam.

7. The meeting was also attended by observers from the following international bodies and other institutions: the Commonwealth Secretariat; the Organization for Economic Cooperation and Development (OECD); Fairleigh Dickinson University; the International Association of University Presidents; California State University, Sacramento; the Catholic University of Louvain; London Metropolitan University; World Association of Former United Nations Interns and Fellows; the Tax Justice Network; the Associaçao Comercial de Sao Paulo, Sheltons, International Tax Counsel; Shacham Tax Law Office; Adachi, Henderson, Miyatake and Fujita; International Chamber of Commerce, Paris and KPMG International.

8. The Secretariat provided support to the Group of Experts and was assisted by the following advisers and resource persons drawn from different areas of international taxation: Professor Michael J. McIntyre (Wayne State University Law School), Professor Francisco Alfredo Garcia Prats (University of Valencia), Mr. Jon E. Bischel (tax attorney) and Mr. David E. Spencer (tax attorney). The Group of Experts elected Antonio Hugo Figueroa (Argentina) as Chairman and Mayer Gabay (Israel) as rapporteur. Mr. Abdel Hamid Bouab served as Secretary and was assisted by Mr. Masakatsu Ohyama (Assistant Secretary).

9. The agenda for the eleventh meeting was as follows:

1. Mutual assistance in collection of debts and protocol for the mutual assistance procedure.
2. Treaty shopping and treaty abuses.
3. Interaction of tax, trade and investment.
4. Financial taxation and equity market development.
5. Transfer pricing:
   (a) Simplified safe harbour procedures;
   (b) Intermediation and arbitration: European Union experience.
6. Tax treatment of cross-border interest income and capital flight: recent developments.
7. Electronic commerce and developing countries.
8. Revision and update of the United Nations Model Double Taxation Convention between Developed and Developing Countries.

9. Revision and update of the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries*.

10. Institutional framework for strengthening international tax cooperation.

The discussion of the main items on the agenda is summarized below.

II. Mutual assistance in the collection of tax debts and protocol for mutual assistance procedures

10. The Group of Experts reviewed the existing United Nations, OECD and European Union agreements and mechanisms for mutual assistance in tax matters. The central question raised was whether a provision similar to article 27 of the OECD Model Convention, dealing with assistance in collection, should be included in the United Nations Model Tax Convention.

11. The Group of Experts noted that, traditionally, mutual assistance in tax matters has been provided for in the exchange of information article (article 26) in income tax treaties. The fundamental issue in any tax system is the collection of taxes. It is natural, therefore, to consider cooperation on collection.

12. During the discussion, a question arose as to whether mutual assistance should be limited only to taxes covered by the convention or should extend to all taxes of the contracting states, including local taxes and social security. One approach would be to postpone requests for collection assistance until all internal remedies have been exhausted. In any event, requests for collection must be accompanied by the proper paperwork. Precautionary measures, such as seizures, must not interfere with normal business conduct. It might be desirable to allow assistance in collection on a voluntary basis before a full exhaustion of remedies, when the administrative costs of assistance are small and the costs of exhausting remedies are large.

13. It was suggested that assistance in the collection of taxes might be limited solely to taxes covered by a tax convention or might be extended to other taxes. Whether a country should agree to a broad assistance-in-collection provision would depend in part on its capacity to provide assistance.

14. It was noted that some countries may have serious constitutional problems in collecting foreign tax debts. Therefore, the proposed addition of article 27 to the United Nations Model Convention must clearly establish what sorts of debts can be collected. In many cases, domestic laws must be changed to permit the collection of foreign tax debts. Other members suggested that constitutional issues generally be covered during the treaty negotiations.

15. The Group of Experts established a focus group (Belgium, Chile, France and Morocco) at the meeting to prepare a recommendation with respect to the adoption of an assistance-in-collection article. The focus group prepared some draft language for the Model Convention and for the Commentary. It was decided that the members of the Group of Experts should exchange views on the draft, with the expectation that the matter would be taken up at the next meeting of the Group of Experts.

III. Treaty shopping and treaty abuses

16. Many significant international developments have occurred since the topic of treaty abuses and treaty shopping were last addressed by the Group of Experts.

17. Three main questions were addressed in the meeting. First, what is considered a treaty abuse? In that connection, it is necessary to decide who is to determine the existence of an abuse. Second, how are the standards for dealing with treaty abuse being established? In that connection, the standards for determining an abuse might be included in the treaty itself. Third, is it acceptable to deal with treaty abuse with domestic anti-abuse mechanisms? In that connection, it may be necessary to take account of the legal nature of treaties and the obligations derived from the public International Law of Treaties.

18. Representatives noted that although a precise definition of the term “treaty abuse” is not available, there is a broad recognition that treaty abuses exist and must be dealt with. The impossibility of reaching a common definition of a treaty abuse was partly due to the mechanisms for dealing with tax treaty abuse. Persons covered by a tax treaty are its ultimate beneficiaries, despite the fact that a treaty is signed by contracting States and is intended to advance the interests of the contracting States.

19. The existence of a treaty abuse implies an indirect violation of the law, contrary to its goal and objectives. Such a violation can only be determined after taking into account the specific circumstances of a particular case. In general, a treaty abuse is determined by national authorities under their domestic law and according to their legal tradition. For this reason, the concept of a treaty abuse is likely to vary from State to State. The question of treaty abuse is often a question of who are the bona fide beneficiaries of the treaty.

20. Normally, the term treaty abuse is used to refer to situations in which the taxpayer is seeking to circumvent the law. But consideration should also be given to cases in which one of the contracting States takes advantage of the good faith of the other contracting State to the Treaty by making a future amendment to its laws or by administrative practices that lead to significant losses of resources of the other contracting State. The two situations, abuse by the taxpayer and abuse by the contracting State, should be distinguished in the framing of the rules used to determine the existence of the abuse, in identifying the bodies that would declare the existence of an abuse and in establishing the legal consequences of identifying an abuse.

21. Treaty abuse and treaty shopping should not be confused. Treaty shopping relates to situations in which an individual benefits from a treaty without being the legitimate beneficiary of it. Treaty abuse, on the contrary, refers to situations in which the result of a certain operation is in contradiction with the treaty. Whenever the treaty shopping issue is considered important, it should be addressed specifically in the treaty, including countervailing measures to combat it. Nevertheless, in certain treaty shopping situations, general measures countervailing abuse could be used even in the absence of a specific provision in the treaty.

22. It was noted that a real need exists for new tools to deal with treaty shopping, taking into consideration the willingness of some States to promote it. In that respect, countries should look carefully into the practices of those States before entering into a treaty with them.

23. OECD has attempted to deal with treaty abuses through amendments to the commentary to article 1 of its Model Tax Convention on Income and on Capital (OECD Model Convention). A proposal on the update of the commentaries on article 1 of the United Nations Model Tax Convention between Developed and Developing Countries (the United Nations Model Convention) was presented at the meeting. The proposal assumed that any update of the Commentary on article 1 of the United Nations Model Convention should take into account, as a point of departure, the update carried on by the OECD in 2003 to the Commentary on article 1 of the OECD Model Convention. Nevertheless, it was stressed that it was impossible to automatically assume and translate all the amendments made by OECD to its Model Convention, since there had been little discussion on certain issues at the United Nations meeting. The Group of Experts adopted the view that the discussion of changes to the Commentary should continue and should be taken up at the next meeting of the Group of Experts.

24. The general consensus was that the amendment of the Commentary on article 1 of the United Nations Model Convention deserved further attention and that a final decision should not be made until the next meeting of the Group of Experts. It was decided that the process of discussing the different approaches would continue so as to promote a consensus on the substantive amendments to the Commentary prior to the next meeting of the Group of Experts.

25. **On the basis of the discussion, it was recommended by the Group of Experts that the question of whether the United Nations should recommend an article in the Model Convention on the limitation of benefits that would be responsive to the needs of developing countries should be discussed. In particular, many developing countries have difficulty negotiating treaties with some developed countries because the major taxpayers in those countries are able to get the benefits of a treaty by using the treaty negotiated with another country.**

IV. Interaction of tax, trade and investment

26. Tax competition among developing countries can have harmful effects and is a major issue with regard to international tax cooperation. Tax competition and how to address it can be well understood by evaluating the interaction of tax, trade and investment, as embodied in the bilateral tax treaty network and the World Trade Organization.

27. The goal of free and fair trade cannot be achieved through tariff agreements alone because non-tariff policies such as quotas, preferential treatment and subsidies can also generate trade-restricting effects. Of special concern are direct and indirect tax structures, which can act as implicit production and export subsidies. Likewise, internal taxes should not discriminate between domestically produced and imported goods, especially when they are used in a particular sector, because such use produces a subsidy effect. Finally, taxation of income flows from foreign direct investment in both the source and the resident State can constitute a fiscal barrier to trade and capital flows. The resulting double taxation problems can be alleviated by bilateral tax treaties. These tax treaties should maintain an equitable distribution of revenues between the two countries while being conducive to capital flows to developing countries.

28. A multinational enterprise may shift income to affiliates resident in a low-tax country in order to take advantage of the lower rates on manufacturing income in the source country or in order to avoid residence jurisdiction. Owing to their bilateral nature, tax treaties cannot deal effectively with harmful tax competition. What may be needed is a multilateral approach to the tax competition problem. The international community is however, not ready for a multilateral agreement on tax competition.

29. Developing countries have to compete for limited capital. This creates a dilemma for developing countries as the competition may cause them to offer overly generous tax concessions and, hence, rely on tax incentives that may not be in their best interest or that may not have the desired effect in attracting investment.

30. Developing countries that decide to employ tax incentives should try to select incentives that minimize their revenue cost and other harmful effects.

V. Financial taxation and development of equity markets

31. The effects of a country's tax structure on equity markets are uncertain. In principle, a country's tax structure can affect: (a) economic growth; (b) capital inflows; and (c) the development of equity markets. In addition, empirical research shows there is a linkage in all three areas. The research is limited in scope, in that there are numerous non-tax factors that affect economic growth and market development. In addition, it is not clear whether biases have been introduced, for example, by including only short-term effects or by failing to distinguish between harmful, beneficial and neutral tax concessions.

32. It was noted by many participants that tax is only one of the factors among others affecting development of capital markets. Therefore, tax incentives alone will not be effective for the development of capital markets. Other factors include the fiscal framework, transparency, good infrastructure, sustained economic growth and political stability. Tax treaties would also be important.

33. The United Nations Model Convention does not provide for tax on capital gains of non-residents, although it permits the taxation of dividend income. It was pointed out that the non-taxation of capital gains in the source country probably results in double non-taxation in many cases.

34. Taxation on capital gains and dividends are treated differently in the United Nations and OECD Model Conventions. In many important cases, dividends can be converted into capital gains quite easily. Conversion of dividends into capital gains is less of a problem for portfolio investment.

35. In practice, one could not equate the taxation of capital gains with that of dividends. To a large extent, the tax on capital gain is a "secondary" tax, imposed after the stock has been issued by its initial public offering. A tax on dividends, however, is a direct tax on corporate income being distributed to a shareholder. If the corporation does not pay a dividend, its income remains within the corporation. This distinction may be a valid basis for treating capital gains and dividends differently, but only if dividends cannot be converted into capital gains, as occurs in many countries.

36. In summary, although taxes have an impact on equity markets, the observation alone is not helpful, because other factors play a role and all markets are not homogeneous. In some developing countries, generous tax incentives aiming at stimulating the stock exchange failed while in some countries such policies have worked. Moreover, markets at different stages of development cannot be compared. The tax factor may not be as important in one market as it would be in another when the market is growing rapidly. However, it was felt that, based on past experience, new tax policies for capital markets should not be introduced in times of fiscal crisis.

VI. Transfer pricing

A. Simplified safe harbour procedures

37. A safe harbour for setting transfer prices may operate in favour of the Government or the taxpayer. Unfortunately, no one seems to be able to develop effective safe harbour rules that are satisfactory to both. One approach would be to divide the profits from an enterprise through some type of formula, for example, using worldwide combined reporting with formulary apportionment. Several of the states of the United States have used such a method successfully, and the European Union is exploring the use of some type of apportionment method owing to the problems of applying a transactional-pricing method for companies operating within the European Union.

38. Transfer pricing is a worldwide problem. All countries have experienced difficulties in finding comparable transactions and comparable companies under the arm’s length rule. Frustration with the practical aspects of the arm’s length approach has led some countries to favour the use of a safe harbour method. A problem may arise in reconciling safe harbour rules with treaties because safe harbour rules may move away from the arm’s length approach. Unfortunately, safe harbours are not a panacea. Although the arm’s length system works reasonably well for sales of tangible property, when intangible property is being considered, the transfer pricing system is less successful, because intellectual property income is difficult to locate by source and is very hard to price. The consequence is a tendency to use the profit-split method when profits are generated in large part by intangible property.

39. A first step in dealing with transfer-pricing matters might be to get international agreement on accounting standards and on the types of accounting documents that the taxpayer would be required to divulge to the tax authorities of particular countries. The European Union has made major strides in developing uniform accounting standards over the past several years. With the development of uniform accounting standards, the problems of assessment could be reduced significantly if multinational enterprises were required to disclose their intergroup trading. Affiliated groups would be required to file unconsolidated accounts. Tax administrators could use this information to locate aberrations in the distribution of the profits of the multinational enterprises among affiliated companies.

40. One possible approach to dealing with transfer pricing problems, increasingly common in developed countries, is to adopt what OECD refers to as advanced pricing arrangements. Under the advanced pricing arrangement structure, multinational enterprises are invited to reach agreement with the tax office on their

pricing methodologies for future transactions. Often an advanced pricing arrangement is negotiated with treaty partners as well through the mutual agreement procedure. To obtain an advanced pricing arrangement, the multinational enterprise must supply evidence of the arm's length price. The process tends to result in the development of a secret body of law, not subject to the usual public scrutiny. Many developing countries may not be able to administer an advanced pricing arrangement programme because they do not have the technical capacity to do so. Some developing countries may also be concerned about the possibility of corruption in the administration of such a programme.

41. Although the arm's length approach is supposed to result in realistic prices, it often falls short in reality. Rather than focusing on overly general rules, it may be more useful to address some specific areas of concern. For example, a country might develop different transfer-pricing rules for areas such as commodities, intangibles and value-added products. In at least some of these areas, progress might be possible. In many cases, what is needed is expertise. OECD has meetings of transfer pricing inspectors to develop issues that are further developed by the tax administrators in the Group of Experts.

B. Intermediation and arbitration: experience of the European Union

42. Various business groups, including the International Chamber of Commerce, have been promoting the inclusion of an arbitration provision in tax treaties. They contend that such a provision would provide assurance that tax disputes would be resolved in a timely fashion. An arbitration provision may be binding or discretionary. The business community has tended to favour binding arbitration, whereas many Governments have been unwilling to surrender their power to set tax rules to an outside authority. The experience within the European Union is that the arbitration provision of tax treaties is almost never invoked. The claim is made, nevertheless, that the existence of an arbitration provision tends to promote prompt settlements. No data were available to show whether settlements were being made more promptly as a result of an arbitration provision or whether the decisions made under the threat of arbitration were appropriate ones.

43. Many developed and developing countries are sceptical about the merits of including an arbitration provision in the United Nations Model Convention. It was suggested that the Group of Experts had more pressing matters to address. A concern was expressed that a developing country might be put at a disadvantage in an arbitration proceeding because its resources and expertise may be much less than those at the command of a developed country on the opposite side of an arbitration process. It was estimated that an arbitration event would cost €50,000, a very significant sum for the tax departments of many countries.

44. Arbitration might be an attractive option if it could be implemented at low cost and resulted in prompt and fair decisions. It would be undesirable if it imposed heavy costs or if the threat of arbitration resulted in hasty, ill-considered settlements. The proponents of arbitration have assumed that arbitrators would be neutral and competent and that arbitrators could be supplied when a country did not have the resources to engage an arbitrator. Whether these assumptions are warranted is far from clear.

VII. Cross-border interest income and capital flight

45. Capital flight is a growing problem for many developing countries. Capital may flee to other developing countries or to developed countries and to both onshore and offshore financial centres. Although precise figures on the total amount of flight capital from developed and developing countries are unavailable, the amounts are very substantial, perhaps in the several trillions of dollars. The amount of capital flight from developing countries alone is not known. Some, but by no means all, capital flight reflects an attempt at tax evasion.

46. In recent years, efforts at controlling capital flight have focused on international tax cooperation and the exchange of tax information. Capital flight is promoted by bank secrecy regimes and by the tax-free treatment of interest on bank deposits in major financial centres. Governments in major financial centres, both onshore and offshore, argue that they cannot reduce capital flight by adopting tough measures because the capital currently coming to their country would go to a more accommodating country. As a result, it is widely believed that multilateral efforts are required to confront the problem of capital flight and any resulting tax evasion.

47. The European Union has taken some important steps against capital flight, including the promulgation of the directive 2003/48/EC on the taxation of savings. The directive has established the principle that cross-border interest payments within the European Union to individuals resident in the Union should be subject to taxation. The mechanism for such taxation is either: (a) the automatic exchange of information between countries of the European Union; or (b) a withholding tax in the country where the payer of the interest is located. The above-mentioned directive does not, however, apply to interest paid from European Union countries to residents of third countries. The directive will, therefore, have no direct impact on capital flight from residents of third countries into the European Union, especially capital flight into the financial centres of the Union.

48. A second significant development is the effort by OECD and its Fiscal Committee to limit the use of tax havens and to limit capital flight from OECD countries to those tax havens. In 1998, the OECD Committee on Fiscal Affairs issued a report, “Harmful Tax Competition: An Emerging Global Issue”. The OECD followed up the 1998 report with additional reports on the subject as well as releasing its Model Agreement on Exchange of Information on Tax Matters. The immediate impact of the OECD proposals is to limit capital flight from OECD countries to low-tax countries and to limit tax evasion within the OECD. Those proposals do not, however, attempt to limit capital flight from third countries into OECD countries and financial centres.

VIII. Electronic commerce and developing countries

49. The existing norms of inter-jurisdictional revenue allocation may not be valid in the digital era. To promote tax neutrality, the United Nations may consider revising its Model Convention to allow fuller taxation in the source country of income derived from e-commerce.

50. The existing international tax rules make sharp distinctions between the tax treatment of income from capital, labour, property and services. Those distinctions are becoming increasingly less valid in the digitalized era. The advent of e-commerce has caused the traditional concept of a permanent establishment to break down. Tangible property can be sold over the Internet in much the same way that it is sold in a bricks-and-mortar store. In addition, the taxation of services becomes difficult because valuable and important services can be provided across the globe without physical contact with the place where the service is used. For example, technical support for computer equipment can be provided over the Internet.

51. To allow for effective taxation of income from e-commerce in the source state, article 7 (Business profits) of the United Nations Model Convention might be modified to permit the source country to impose withholding tax upon all payments to a non-resident e-supplier in general, or, at the taxpayer's election, upon payments to a non-resident e-supplier from a domestic business that can deduct the payment. In addition, article 7 might be modified to allow a source country to adopt formula apportionment if an e-supplier has a permanent establishment in that country or if the e-supplier has sales in that country in excess of a threshold amount.

52. Another approach to the new problems created by e-commerce would be to modify the permanent establishment concept only as it applies to e-commerce activities. One suggested rule would provide that income from e-commerce could be taxed in the market State if the gross income from e-commerce in a country exceeded a *de minimis* amount. A second suggested rule would treat royalties, service income and sales income as active business income, taxable under the rules of article 7, with the caveat that income from e-commerce would be taxable if it exceeded the *de minimis* amount referred to in the first suggested rule. A third proposed rule would employ some type of global profit-splitting formula to determine the amount of income from e-commerce that each country would be permitted to tax.

53. Various issues need to be addressed to tax income from e-commerce effectively. The list of issues include: (a) identifying the participants in an e-commerce transaction (or set of transactions); (b) identifying the location of the business; (c) securing documentation and proof of the transaction; (d) identifying the specific economic characteristics of the e-commerce business; and (e) collection of the taxes due.

54. Most electronic commerce currently is between businesses, not between businesses and their customers. Taxation of income from business to business e-commerce is much easier to accomplish than the taxation of income from business to customer. For example, it is difficult to tax income from digital services, such as providing access to information databases and income from the sale of intangible products, such as digital music and digital games. Thus far, projections of the extent of e-commerce have been inflated, especially with regard to business to customer e-commerce. The ease of establishing e-commerce operations in offshore locations

has also been exaggerated. There is little doubt, however, that e-commerce will continue to grow and that the taxation of income from e-commerce will eventually become an important issue in developing countries.

55. **The current permanent establishment definition has proved difficult for many developing countries, in particular the requirement of a "fixed" location when there is the use of multiple permanent establishments for related business activities. On the basis of the discussion it was recommended by the Group of Experts that the United Nations might want to examine whether its Model Convention should be modified in various ways to deal with the practical problems that have resulted from the current definition.**

IX. Revision of the United Nations Model Double Taxation Convention and the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries*

56. At its 10th meeting, the Group of Experts decided that the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries*, published in 1979, was a valuable tool for developing countries and transitional-economy countries and should be updated. A revised draft, which did not alter the basic organizational structure of the original manual, was presented to the Group of Experts at its eleventh meeting. A general consensus emerged, nevertheless, that the original structure of the manual is now obsolete and ought to be modified in some major ways.

57. The Group of Experts reiterated the need to proceed with periodic revisions and updates of the United Nations Model Double Taxation Convention. It emphasized the need for such an important exercise particularly in view of the dynamic character of taxation and the need for the United Nations to continue to play the lead in this arena. The Group of Experts therefore agreed that these revisions in both the articles and commentary should be made at least once every two years.

58. The original manual was published prior to the publication of the United Nations Model Tax Convention and commentary. As a result, that manual included material later included in the commentary. The original manual also included an extensive discussion of the history of tax treaties and the role played by the League of Nations and the United Nations in promoting model conventions. This material may no longer be appropriate for inclusion in the manual.

59. Major changes in the manual were suggested. The objective of the revised manual should be to provide treaty negotiators with practical guidance for negotiating tax treaties that served national interests. To make the manual more useful to negotiators, the following changes were suggested: (a) the addition of a glossary of international tax terms; (b) a clear statement of the date of the current revision; (c) the use of more examples to illustrate particular points, with the examples displayed in indented format to draw the reader's attention and to separate them from textual material; and (d) a simplification of the current introductory section.

60. It was suggested that the manual might be published on the Internet and might include embedded links (hyperlinks) to background material, tax treaties and other references. Actual case studies might be included as well. A discussion of some additional topics might be added to the manual, including a discussion of capital flight and various anti-avoidance legislation.

61. There was a consensus that the manual should be produced in a more practical and useful format.

62. **On the basis of discussions the Group of Experts recommended revising the United Nations Model Double Taxation Convention between Developed and Developing Countries, which would involve the revision of articles: article 1 (Persons covered), article 5 (Permanent establishment), article 26 (Exchange of information) and the insertion of a new article 27 (Assistance in collection of taxes). The Group of Experts also recommended that the reformulation of the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* should focus on producing a document for use as a glossary for reference in international taxation, the United Nations Model Convention, tax treaties, negotiations and training.**

X. Institutional framework for strengthening international tax cooperation

63. As indicated earlier, a major issue on the agenda of the Group of Experts was the recommendation made in the Secretary-General's report on follow-up to and implementation of the outcome of the International Conference on Financing for Development[1] for strengthening the institutional framework for international cooperation on tax matters by converting the Group of Experts into an intergovernmental body within the subsidiary machinery of the Economic and Social Council of the United Nations. This recommendation was made in the context of implementation of the call in the Monterrey Consensus to strengthen international tax cooperation in support of development, through enhanced dialogue among national tax authorities and greater coordination of the work of the relevant multilateral bodies and regional entities. Subsequently, in its resolution 58/230 on follow-up to and implementation of the outcome of the International Conference on Financing for Development, the General Assembly requested the Economic and Social Council, in its examination of the report of the Ad Hoc Group of Experts on International Cooperation in Tax Matters at its 2004 substantive session, to give consideration to the institutional framework for international cooperation in tax matters.

64. The Group of Experts considered issues related to the upgrading of the Ad Hoc Group of Experts on International Cooperation in Tax Matters into an intergovernmental body, either in the form of a committee of governmental experts or a special new commission, as a subsidiary body of the Economic and Social Council. The Group of Experts felt that the members of any such body should be drawn from developed, developing and transition economy countries, as was the case with the Group itself.

65. It was suggested that an upgraded body should have a small technical staff adequate to support its activities, which might be established through redeployment of existing staff within the United Nations. Such a staff might include tax professionals in the fields of tax policy, tax administration, international tax matters, accountancy, law and economics. Though the technical secretariat could act as a clearinghouse for tax materials of interest to Member States and could also organize workshops to provide technical assistance on international tax matters, it should not duplicate functions now performed by other international bodies.

66. The body might draw some inspiration from the Fiscal Committee of the League of Nations, which had operated effectively in drafting some early model tax conventions. The objective would be to give Member States an enhanced opportunity for cooperation in the establishment of universally accepted international tax norms, building on the work and experience of the Group of Experts.

67. Comments were made by a large number of members and observers, many expressing strong support for the proposal, some raising issues that needed to be further addressed or clarified, others expressing various reservations, and a few indicating a preference for maintaining the status quo. Support was strongest from representatives of developing countries, civil society, professional organizations and those with university affiliations, whereas reservations or concerns were expressed primarily, but not exclusively, by representatives of various developed countries. The opinion of representatives of regional and international organizations was mixed. There was, however, nearly universal support for the goal of strengthening the capacity of the United Nations to provide leadership and assistance on international cooperation in tax matters.

68. There was a consensus on the following points: (a) the work of the Group of Experts ought to be strengthened; (b) developing and transition economy countries ought to have an effective forum for expressing their views on international tax issues; (c) any new or revised institutional arrangement ought to build on the work of the current Group of Experts and cooperate with other international activities to enhance tax cooperation; (d) an upgraded forum should convene more regularly than once every two years; (e) any new institutional arrangement should have a sufficiently limited number of members so that it could operate effectively; (f) the membership should include representatives from developed, developing and transition economy countries; and (g) Governments should select highly-qualified tax officials as their representatives.

69. The following major points were made in support of the proposal: (a) the United Nations is the main international organization within which it is possible to set universal norms relating to international cooperation in tax matters, and an enhanced forum would give greater legitimacy to the proposals coming from it; (b) an upgraded status for a forum within the United Nations would give the forum a greater opportunity to respond promptly to the ever-changing international tax environment; (c) the forum would provide an avenue for promoting more open disclosure of “reconciliation” tax records, which show inter-company transfers, and disclosure of those records would greatly facilitate audits and encourage consistent and fair treatment of taxpayers across national boundaries; (d) an enhanced arrangement and secretariat support staff would make it feasible for the United Nations to contribute more effectively to international and regional tax initiatives

and activities; (e) the need for an enhanced body with universally-drawn representation to address issues of international cooperation in tax matters is obvious, and critical in a globalizing world, and is going to be established sooner or later. Consequently, the real choice is whether the Ad Hoc Group of Experts is to be a part of, and help in, this inevitable development.

70. The following main reservations or objections were made to the proposal of upgrading the status of the Group of Experts: (a) a revised institutional arrangement, with members serving as representatives of their Governments might not work as smoothly or effectively as the current arrangement if the change caused the forum to become more “political”; (b) the forum would become unwieldy if it were to include representation from all 191 Member States of the Organization, while if it were to have limited membership, countries not represented might not be willing to have other countries “decide” matters affecting their tax policies; (c) the Group could become more effective within its current institutional arrangement by concentrating its agenda on problems particular to developing countries; and (d) a new “bureaucracy” would not be desirable and the Group should make better use of its existing resources and seek to complement its work with other international tax cooperation initiatives.

71. A number of steps that could be taken towards building an effective, enhanced forum on international tax cooperation were suggested to address the above reservations and objections. For example, to ensure smooth and effective functioning, the forum could establish internal procedures minimizing formality and offering substantial opportunities for free expression, since experience shows that many international bodies with professional membership act on a collegial basis in most of their activities and only on certain highly sensitive issues does it become necessary for members to act as “government representatives”. With regard to the “representativeness” of the forum, as with other United Nations subsidiary bodies, any policy recommended by the forum would need to be endorsed by the higher bodies of the United Nations, in this case by the Economic and Social Council and the General Assembly. It should be possible, therefore, to have a legitimate and fairly representative forum and to keep it small enough to operate effectively and economically. Moreover, in the transitional period, the forum could maintain its current membership. It was also noted that the Group of Experts has regularly invited observers to attend its meetings and to participate in its proceedings and that observers have made valuable contributions and could continue to do so under the proposed forum.

72. In light of the above, and pursuant to the General Assembly resolution 58/230, the following approach for a possible enhanced, intergovernmental forum might be taken into consideration by the Economic and Social Council when it gives consideration to the institutional framework for international cooperation in tax matters:

(a) *Size and composition*. The size and composition for an enhanced forum could remain generally unchanged from that of the present Group of Experts. As a transitional measure, the existing membership of the Group of Experts could be carried over to the meeting in 2005, with arrangements made after that for election/rotation of membership in accordance with the practices established by the Economic and Social Council for other similar subsidiary intergovernmental bodies;

(b) *Mandate and operations*. The forum should be expected to make recommendations to the Economic and Social Council on international tax matters, including the formulation of norms and the promotion of cooperative policies and practices as well as the provision of advisory services and technical assistance in this area. The forum would continue to be the custodian of the United Nations Model Tax Convention and Commentary, providing revisions to the model and commentary as warranted, and would cooperate with other international and regional organizations on international tax matters. It would meet at least once a year and would endeavour to hold technical, focused meetings at more frequent intervals;

(c) *Technical support*. The forum would require a small, competent and effective secretariat staff. Resources for the secretariat may be obtained through the reallocation of existing resources in the United Nations, which would remain part of the Department of Economic and Social Affairs. Among its duties, the staff could help organize technical assistance projects on international tax matters and collect and help disseminate information on tax policies and practices in collaboration with other relevant international entities.

XI. Agenda, time and venue for the next meeting

73. The proposed agenda for the twelfth meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters (or for the first meeting of an enhanced body) is:

(a) Treaty abuses and treaty shopping.

(b) Mutual assistance in collecting of tax debts.

(c) Earnings stripping.

(d) Modified permanent establishment definition.

(e) Taxation of income derived by participants in development projects.

(f) Revision of the United Nations Model Double Taxation Convention between Developed and Developing Countries.

(g) Review and adoption of the revised draft *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries*.

74. The twelfth meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters (or the first meeting of an enhanced body) should take place in the fourth quarter of 2005, at Geneva.

Notes

[1] A/58/216, para. 167.