

Options for Greater International Coordination and Cooperation in the Tax Treaty Area

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Prof. Michael J. McIntyre
Wayne State University Law School, Detroit, Michigan

1. INTRODUCTION

The point of a model tax convention is to promote cooperation and coordination among sovereign states with respect to certain fiscal matters. Some people may object to such cooperation and coordination, believing that governments should engage in a high level of tax competition and should eschew most cooperative efforts. This session of the seminar, however, is not the proper place for a discussion of those views. The issue addressed here is how to promote greater intergovernmental cooperation and coordination on the assumption that these twin goals are worthy ones for governments to pursue.

2. INSTITUTIONAL ISSUES

The most important model tax conventions have been developed by the OECD, beginning with its draft Model issued in 1963 and followed by its first full Model Tax Convention issued in 1977. Many previous models were developed, however, by other agencies, the most influential being the model developed by the League of Nations in 1928. The United Nations published a Model Convention in 1980 that drew heavily from the 1977 OECD Model. In 2001, the United Nations published a revised Model and has committed itself to periodical updates of the Model. The OECD issued a revision of its 1977 Model as a loose-leaf volume in 1992. Several amendments have been made to the 1992 Model, and the OECD has committed itself to periodical updates.

The OECD Model is ostensibly intended as a model to be used by an OECD Member country when it enters into a bilateral treaty with another OECD country. The influence of the OECD Model, however, extends far beyond the group of OECD Member countries. The issue arises as to whether the prominent role played by the OECD, through its Committee on Fiscal Affairs, in developing the text of the OECD Model can be considered appropriate in light of the practical use of the Model by non-members of the OECD. More generally, what is the proper institutional arrangement for developing and maintaining a model convention that will form the basis for the negotiation of treaties around the world over the next several decades?

The issue has various aspects, including: (1) political considerations and (2) technical adequacy.

2.1. Political considerations

Taxation is part of a political process and cannot be addressed with any hope of realism without reference to politics. The political considerations below are relevant in deciding (1) what organization should be in charge of the treaty process and (2) how that organization should function.

2.1.1. Fair representation

The OECD represents only 30 countries, all at relatively high levels of development. It may appear that a larger global organization would be a more appropriate forum for discussing and agreeing on model tax conventions, especially in light of the expectation that they would be used outside the OECD. The United Nations Ad Hoc Group of Experts on International Cooperation

in Tax Matters is substantially more representative, having members from 15 developing countries (or countries with economies in transition) and ten developed countries. Its membership is not determined, however, by a democratic process in which all countries participate.

The United Nations General Assembly, in collaboration with the governing bodies of the World Bank, the International Monetary Fund and the World Trade Organization, organized the International Conference on Financing for Development (held in Monterrey, Mexico on 18-22 March 2002) to find ways to strengthen the financing of development and the stability of the global financial system. One issue considered at the conference was the possible establishment of a world economic body, under the aegis of the United Nations, to address various economic issues of particular importance to developing countries. Presumably, an organization established by the United Nations would have some claim to being fairly representative of the nations of the world. Nothing of substance came of this proposal due to opposition from the developed countries. The Monterrey Consensus document merely recommended steps to "strengthen international tax cooperation ... giving special attention to the needs of developing countries and countries with economies in transition". In response to this call for dialogue, the technical staffs of the World Bank, IMF and OECD have agreed to coordinate their activities in the tax field. The United Nations, which might be expected to represent the position of the developing countries, is conspicuously absent from this dialogue.

The issue of fair representation cannot be divorced from the intended users of a model convention. If the convention is intended only for use by a limited group, then representation is properly limited to that group. In the case of the OECD, the original intent of its Model may have been for use only by its members. The UN Ad Hoc Group was formed when it became apparent that the OECD Model [*251] was having an influence beyond the members of the OECD. Because developed and developing countries frequently have different objectives in entering into tax treaties, the question of fair representation is a critical one.

(a) *Reform of existing organizations.* Can the OECD and the UN Ad Hoc Group be reformed in some ways to be more representative?

Is the OECD's effort to allow representatives from developing countries to participate in some aspects of treaty development an important step in the right direction, merely window dressing designed to preserve the hegemony of the OECD countries over tax treaty matters, or something in the middle?

Has the OECD been successful in enhancing fair representation by allowing selected countries outside the OECD to make comments and observations on certain provisions of the OECD Model? Is this enhanced openness a useful step or has it opened the OECD to lobbying by private interests? Has it been useful for the UN Ad Hoc Group to invite the OECD and other observers to participate in its meetings? What, if any, are the disadvantages?

(b) *Decision-making mechanism.* Should the organization responsible for treaty development operate under a consensus rule or by vote? If by vote, should a supermajority be required? Or should some weighted voting be required that would give increased influence to heavily populated countries or countries having a large share of the world's international trade?

Agreement by consensus legitimizes decisions and makes for a harmonious working atmosphere. It can give undue influence, however, to particular states, such as states that promote various harmful tax practices which they want protected, or at least not attacked, in tax treaties. This undue influence was apparent when the OECD prepared its first draft Model in 1963.

(c) *Size of treaty organization.* In principle, the organization responsible for drafting the text of a model convention should be small enough to be effective and large enough to be representative. What is the best size? Can a larger body be used for representational purposes with an executive committee to enhance effectiveness? What is the experience of the UN Ad Hoc Group with 25 members and the OECD with 30 members (with more members anticipated)? Are these bodies too large? Have they effectively addressed the size problem with steering committees, working groups, etc.?

(d) *Consultative efforts* An organization, such as the OECD, that is not widely representative of the countries of the world, may compensate to some degree by adopting procedures for consulting with other governments. Prior to the 1990s, the OECD did almost nothing to consult outside its core group. It has now opened up its procedures somewhat, offering opportunities for countries to sit as observers in some circumstances and inviting comments from outside tax specialists. These efforts, and other efforts that might be made in the future, may mitigate the lack of representation within the OECD itself. If an alternative organization were to take over the tax treaty work of the OECD, a similar issue would arise about the organization's proper use of consultative techniques.

2.1.2. Independence from inappropriate influences

Whatever organization is assigned responsibility for drafting the texts of a model tax convention should act in the public interest and in ways that promote world welfare rather than the welfare of powerful states or powerful interest groups. In looking at possible alternatives to the OECD as the major force in drafting these texts, it is useful to attempt a fair assessment of the OECD's successes and failures in promoting public welfare and resisting inappropriate influences. For example, do government representatives to the OECD use their position to obtain an unfair share of tax revenues from international operations for their country? Do they seek to protect some of their country's leading taxpayers from proper taxation? Has there been a similar pattern with the UN Ad Hoc Group? Would an alternative organization be better equipped to resist improper influences?

2.1.3. Legitimacy

A model tax convention has limited utility unless it is widely used by countries in negotiating tax treaties. A model convention cannot achieve wide acceptance, however, unless it enjoys some legitimacy. The OECD Model has obviously achieved a high level of legitimacy among developed countries but has far less legitimacy among other countries. An organization is more likely to get legitimacy for its model convention in the eyes of the world if it is fairly representative and is free from undue influences. Legitimacy also depends, however, on the quality of the work product and on other factors.

A search for legitimacy can have costs. For example, an organization may attempt to enhance the legitimacy of its model by avoiding certain difficult or controversial matters. At various times over the past several decades, the OECD might have been faulted in this regard. Or the organization may inhibit innovations in order to preserve the texts of a model convention, however outmoded, that has achieved legitimacy in the past.

2.2. Technical adequacy

An organization cannot function well as the developer and reviser of a model convention unless it is capable of doing the technical work required. In assessing technical adequacy, the issues discussed below are relevant.

2.2.1. Resources

Developing and revising a model tax convention and preparing relevant commentary on the model require significant resources. Although the OECD has been heard to complain of inadequate resources from time to time, it certainly devotes far more resources to the tax treaty process than any other international agency. Some of those resources come from contributions in money and services from the OECD Member countries, and some come from other sources, including contributions from the private sector in exchange for access to certain OECD procedures. [*252]

Relative to the OECD, the keepers of the UN Model have a minuscule budget and obviously are strapped for resources. It is unclear whether any new organization, such as the proposed World Tax Organization formed under the aegis of the United Nations or some consortium of organizations, would have a sufficient resource base to serve as the major developer of model tax conventions. Still, in absolute terms, the amounts involved in developing and maintaining a model tax convention are not large.

2.2.2. Professional staff

To develop and maintain a model tax convention, an organization requires an adequate professional staff, augmented perhaps by consultants engaged for special projects. Having a good professional staff obviously requires some resources. In addition, an organization must develop an appropriate working culture and must be free to select its staff based primarily on technical competence.

2.2.3. Making frequent revisions

Tax treaties must be revised almost constantly to keep abreast of the almost constant changes in national tax laws and in the ways that multinational companies and international financial institutions conduct their business affairs.

(a) *Major revisions.* A model tax convention should be revised periodically to deal with major new issues or to deal with old issues not addressed in the prior model. For example, over the past three decades, the OECD and UN Models might have been revised to deal with such issues as assistance in collection, new financial instruments, new forms of business, such as e-commerce and global trading, controlled foreign corporation regimes, corporate integration schemes, corporate mergers, dual-function entities, financial leases, and so forth.

Beginning in the 1990s, the OECD has made significant strides in updating its Model. The United Nations came out with a new Model in 2001. Still, neither Model addresses many important contemporary issues, including most of the issues mentioned above. The prospects of either Model doing so in the near future appear dim.

The question arises, therefore, as to whether some alternative arrangements can be developed, either within the current organizational framework or outside of it, for getting prompt and effective revision of model conventions and the accompanying commentaries.

(b) *Minor revisions.* A tax treaty needs to be revised frequently to deal with the unintended tax avoidance opportunities that taxpayers discover within it. Treaty negotiations, however, are slow, and many countries have been unwilling to revise a tax treaty to block tax avoidance when their own tax revenues are not implicated.

The OECD has attempted in some cases to close loopholes in treaties through amendment of its Commentary. That approach raises issues relating to the legal impact of the Commentary on

existing (and even future) treaties. Another approach followed by some governments has been to close the loophole through domestic legislation. That approach raises issues about the compliance of those governments with their treaty obligations, as set forth in the Vienna Convention on the Law of Treaties.

The question arises as to whether some alternative mechanisms might be developed for dealing effectively with the inevitable loopholes that are discovered in tax treaties. See the discussion of multilateral tax treaties in 3.

2.3. Assessment of past performance of organizations responsible for developing model conventions

A realistic assessment of the changes that might be made in managing and developing model tax conventions depends in part on an assessment of the past performance of the OECD and the United Nations with their Models. In making such an assessment, the following issues are relevant.

(a) Has there been significant progress over the past three decades in eliminating undesirable international double taxation and, if so, is that progress due primarily to the OECD or UN Model or, for example, to domestic legislation or international tax planning by multinational firms? Is it not at least a plausible hypothesis that most progress in eliminating double taxation has come from domestic efforts, with the treaty process mostly addressing fringe issues?

(b) Has there been significant progress over the past three decades in preventing fiscal fraud, tax evasion and tax avoidance, or have these harmful activities proliferated. If they have proliferated, how much, if any, of the blame is fairly placed on the OECD and UN Models and the organizations that promote them?

(c) Have the various articles of a tax treaty that provide for cooperative measures, such as exchange of information, been effective? In particular, have governments been meeting their obligations to exchange information freely or have they refused to do so or done so with such delays as to make the exchange provision nearly meaningless? Can a government generally rely on its treaty partner country to provide it with a full accounting of the investment income that its residents derive in that treaty country? If compliance by governments with their exchange of information obligations is exceedingly low, as some commentators allege, can it fairly be said that tax treaties, in practice, have promoted tax evasion and fiscal fraud.

(d) Has the OECD or UN Model promoted a fair sharing of tax revenues among governments, especially with respect to new forms of revenue, such as revenue from income generated through new financial instruments and income from e-commerce? Or has the treaty process resulted in less revenue going to developing countries?

(e) Has the success of the 1977 OECD Model inhibited reforms of the treaty process. Have some of the allegedly unworthy political compromises made in 1977 to accommodate the OECD countries involved in fostering harmful tax practices been institutionalized under the OECD Model?

3. DEVELOPMENT OF A MULTILATERAL TAX TREATY

3.1. Definition of the issue

A multilateral tax treaty might be considered (1) as a full or partial replacement for the series of bilateral treaties now used by many countries or (2) as a mechanism for amending (updating) existing bilateral treaties to reflect changes in or additions to the OECD Model or UN Model (or some other model), as approved by the body in charge of that model.

3.2. Political aspects

The political feasibility of a multilateral tax treaty as a replacement for bilateral treaties may depend significantly on the size of the group of countries that conclude such a treaty. For a small group of countries with similar tax systems (e.g. the Nordic countries), a multilateral treaty seems to be more feasible than a multilateral treaty applicable to all countries in the world that have tax treaties.

A multilateral tax treaty that is limited in scope also may be more acceptable politically. It may be possible, for example, to have a multilateral treaty that deals with many issues arising in a tax treaty but leaves a small number of sensitive issues for bilateral negotiations. A multilateral treaty among a small number of countries with closely integrated economies might also permit greater experimentation.

3.3. Possible advantages of a multilateral tax treaty

Some of the possible advantages of a multilateral tax treaty are listed below.

(a) *Mechanism for revising treaties promptly.* If a multilateral tax treaty is developed by an international organization, that organization could make periodical revisions of the treaty to deal with the inevitable emerging issues and the inevitable tax avoidance schemes. Presumably, some procedure would have to be established for ratifying the revised treaty because most countries would not forfeit their right to reject a revised treaty.

Currently, the OECD attempts to update and revise existing tax treaties based on the OECD Model by amending the OECD Commentary and treating the changes in the Commentary merely as interpretations of the OECD Model. In recent years, the OECD Commentary updates increasingly seem to some observers to strain an ordinary interpretation of the text of the OECD Model. As a result, the courts of some countries may refuse to read the updates of the OECD Commentary as improved interpretations of existing treaties. This problem is avoided if the updates of the Model are included in a multilateral treaty that is revised and then ratified.

(b) *Simplification.* A uniform tax treaty applicable to many countries may be easier to interpret and apply than the current non-uniform bilateral treaties. There is also likely to be increased consistency in interpretation and increased certainty in application. In some cases, novel rules inserted into a bilateral treaty can give rise to interpretation and/or application problems. In theory, the same degree of uniformity might be achieved through a series of identical bilateral treaties.

(c) *Solving triangular issues.* Some triangular issues that may arise as a result of the strict bilateral approach of the existing (bilateral) treaties can be solved more effectively by a multilateral treaty.

(d) *Reduced negotiating time.* Bilateral treaties take a year or more to negotiate. A multilateral treaty offers the prospect of avoiding the need for separate negotiations with each

country. This advantage is of particular importance to small countries that do not have an abundance of resources.

(e) *Reduced treaty shopping.* A multilateral treaty would provide for uniform treatment of all residents of the participating states. Treaty shopping to get the best deal among the applicable treaties would be eliminated. Of course, the problem of persons from non-treaty states improperly obtaining benefits would not be solved merely by having a multilateral treaty.

3.4. Possible disadvantages of a multilateral treaty

Some of the possible disadvantages of a multilateral treaty are indicated below.

(a) *Special provisions.* In some cases, a country may not be willing to enter into a multilateral treaty unless it retains the right to make special arrangements with some of its important trading partners. The simplification gains that might be obtained from a uniform multilateral treaty might be lost if many countries entered into side arrangements. Indeed, it is possible that a multilateral treaty, after its adornment with many side arrangements, could be more complex to interpret than the current set of bilateral treaties.

(b) *Ossification.* A multilateral treaty, in practice, may become difficult to amend. Bilateral treaties are already difficult to amend, and they involve only two parties. If a multilateral treaty ossifies, it is likely to do more harm than good.

(c) *Reduced flexibility.* By its nature, a multilateral treaty is less flexible in dealing with the particular circumstances of countries than a bilateral treaty. For example, it seems unlikely that a multilateral treaty could be used to define the taxes of particular countries which qualify as creditable income taxes for treaty purposes.

(d) *Capture by powerful countries or special interests.* There is an increased risk that a multilateral treaty would be written to protect the interests of the powerful -- powerful countries or powerful interest groups -- at the expense of others. Such a capture of an international tax treaty by the powerful may not be inevitable, but serious steps would need to be taken to prevent it from happening.