

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

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**Institutional framework for international tax cooperation\****Summary*

The Monterrey Consensus of the International Conference on Financing for Development (2002) committed the heads of State and Government to work towards the eradication of poverty, the achievement of sustained economic growth, and the promotion of sustainable development in the developing and transitional countries. To achieve this lofty goal, they recommended a variety of actions, including (a) international support for the mobilization of domestic resources for development and (b) the improvement of the institutional framework for international tax cooperation.

The present report presents a proposal that is designed to enhance the ability of developing and transitional countries to mobilize domestic resources through appropriate levels of taxation and to improve the institutional framework for international cooperation in tax matters. The central feature of the proposal is the establishment of a commission on international cooperation in tax matters within the Economic and Social Council of the United Nations. That commission would replace the current Ad Hoc Group of Experts on International Cooperation in Tax Matters. It would foster enhanced cooperation between the United Nations and other international organizations involved in economic development and would provide States Members of the United Nations with additional support when important international tax issues are under discussion by the international community.

The proposed intergovernmental commission would have a small but competent professional servicing staff. The staff would provide technical support for the commission, help organize technical assistance projects and events on international cooperation in tax matters for developing and transitional countries, and help collect information on international tax practices of importance to developing countries.

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## **I. An improved institutional framework for international tax cooperation**

1. At the International Conference on Financing for Development held in Monterrey, Mexico, from 18 to 22 March 2002, the heads of State and Government resolved to “address the challenges of financing for development around the world, particularly in developing countries”.<sup>1</sup> They committed themselves at that Conference “to eradicate poverty, achieve sustained economic growth and promote sustainable development ‘as they advanced’ to a fully inclusive and equitable global economic system”.<sup>2</sup>

2. No one, least of all the heads of State and Government assembled at Monterrey, believes that sustained economic development in the developing and transitional countries can be achieved easily or through any single initiative. What is required is a multi-front campaign. The heads of State and Government identified several major areas where successful action is critical. One area is the mobilization of domestic resources for development.<sup>3</sup> Another is the strengthening of international tax cooperation.<sup>4</sup>

### **The need for international cooperation**

3. In the global economy, the goals of mobilizing domestic resources and strengthening international tax cooperation are closely related. A key to mobilizing resources is an effective tax system. A tax system cannot operate well, however, if the government lacks the sovereign power to enforce its taxes. The forces of globalization have reduced the power to tax by increasing opportunities for international tax avoidance and evasion, by facilitating capital flight, and by encouraging tax competition among Governments. To regain the power to tax and thus the ability to mobilize domestic resources for development, countries need to cooperate among themselves to reduce unwelcome forms of tax competition and to reduce opportunities for tax evasion, tax avoidance and capital flight.

4. Developed and developing countries have long recognized the benefits accruing from cooperation on international tax matters. In the global economy, cross-border business and commerce are dominated by a relatively small number of powerful multinational enterprises. On the one hand, these enterprises may be subject to overlapping taxes in several countries which would create barriers to cross-border trade and investment. On the other hand, a multinational enterprise may be able to take advantage of its multinational status to avoid or evade taxes in all of the countries in which it operates. Section III below recounts the history of the involvement of the United Nations and its predecessor institution, the League of Nations, in fashioning international rules that would avoid the Scylla of international double taxation and the Charybdis of international tax evasion and avoidance.

### **Cooperation among developed countries**

5. The major industrialized countries have addressed their concerns about international taxation under the auspices of the Organisation for Economic Cooperation and Development (OECD). The predecessor of OECD was established

in 1948 for the purpose of revitalizing the economies of Europe in conjunction with the Marshall Plan. It had 16 members, all European countries outside the former Soviet bloc. Membership of OECD has been extended over the years to include all of the major industrialized countries of the world. It now has 30 members, only 2 of which — Mexico and the Republic of Korea — are developing or transitional countries. OECD began its work on international taxation in 1956, with the establishment of a Fiscal Committee. That Committee was charged with the task of developing a model tax convention.<sup>5</sup> It produced a draft convention in 1963 and its first model convention in 1977. That model convention remained unchanged until the early 1990s. Since then, it has been revised many times and is now issued in loose-leaf form.

6. OECD has a large professional staff devoted to the analysis of international tax issues and the collection of data useful for such analysis. It is the custodian of its highly successful model tax convention which has had a major influence on the contents of bilateral tax treaties. That influence has extended well beyond tax treaties between OECD members. OECD has also been influential in developing an international consensus on many international tax issues related only tangentially to tax conventions. For example, it has developed detailed guidelines on how transfer prices should be set on transactions between related parts of a multinational enterprise.

7. In recent years, OECD has sponsored various tax programmes for the benefit of developing and transitional countries, and it has occasionally invited some developing and transitional countries to participate in public discussions of international tax issues. The developing and transitional countries do not, however, have a seat at the table when OECD makes decisions on international tax issues. They are merely observers at a process that may affect their interests keenly but which they are powerless to influence. Similarly OECD has emphasized that “although it has extensive contacts with non-OECD countries and considerable awareness of developing-country issues through its non-member programmes, OECD does not represent the views of developing countries”.<sup>6</sup>

8. In many cases, the goals of the OECD member States are in harmony with the goals of the group of developing and transitional countries. Both groups of countries benefit, for example, from the development of international tax rules that promote cross-border economic activities or that block tax evasion; but the interests of the two groups are not always in harmony. Most of the OECD countries, for example, tend to favour restrictions on source jurisdiction, especially with respect to income from capital, whereas the developing and transitional countries typically favour an expansive exercise of source jurisdiction.

9. The conflict between the goals of the OECD member States and the developing countries has been evident in the recent efforts of OECD to establish an international consensus on the proper tax treatment of income derived from cross-border e-commerce. OECD has favoured a regime that would prevent the source State, in most situations, from taxing such income. Some developing and transitional countries were invited to participate in public forums on e-commerce. The basic decision to limit source jurisdiction apparently had been made by OECD before the public debate even began. The developing and transitional countries obviously did not have a seat at the table when that decision was made.

## **Providing a seat at the table for developing and transitional countries**

10. The United Nations has recognized for some time the need to give the developing and transitional countries a voice in the formulation of international tax norms. On 4 August 1967, the Economic and Social Council adopted resolution 1273 (XLIII) requesting the Secretary-General to set up an ad hoc working group consisting of experts and tax administrators nominated by Governments, but acting in their personal capacity, both from developed and from developing countries and adequately representing different regions and tax systems, with the task of exploring, in consultation with interested international agencies, ways and means for facilitating the conclusion of tax treaties between developed and developing countries, including the formulation, as appropriate, of possible guidelines and techniques for use in such tax treaties which would be acceptable to both groups of countries and would fully safeguard their respective revenue interests.

11. Pursuant to that resolution, in 1968 the Secretary-General established the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries. The group was composed of tax officials and experts from 20 countries. The useful work of the Ad Hoc Group is discussed in section III below. In 1980, the name of the Expert Group was changed to the Ad Hoc Group of Experts on International Cooperation in Tax Matters, and its membership was increased to 25, pursuant to Economic and Social Council resolution 1980/13 of 28 April 1980. Ten of the members come from developed countries and the remaining 15 come from developing and transitional countries.

12. An ad hoc group of experts, however, does not provide an adequate institutional framework for international cooperation among developed countries and developing and transitional countries. What is needed is a permanent institutional arrangement with the status necessary to give all countries, including the developing and transitional countries, an effective voice in the establishment of international tax norms. Only a structure within the United Nations is likely to provide the necessary status and legitimacy under current international circumstances.

13. The need for a new institutional framework for addressing international tax issues has been recognized by the United Nations and other international institutions on many occasions. In the United Nations Millennium Declaration (see General Assembly resolution 55/2 of 8 September 2000) heads of State and Government: declared that efforts to make globalization benefit all the world's people "must include policies and measures, at the global level, that correspond to the needs of developing countries and economies in transition and are formulated and implemented with their effective participation" (para. 5); resolved "therefore to create an environment — at the national and global levels alike — that is conducive to development and to the elimination of poverty" (para. 12); and noted that "(s)uccess in meeting these objectives depends, inter alia, on good governance within each country" and "also depends on good governance at the international level and on transparency in the financial, monetary and trading systems" (para. 13).

14. The key question is how to provide an appropriate institutional framework for cooperation on international tax matters. The report of the Secretary-General to the Preparatory Committee for the High-level International Intergovernmental Event on

Financing for Development (A/AC.257/12) of 18 December 2000 identified the need “to further strengthen the current structure of international institutions and networks, particularly as they relate to the objective of increased and more equitable world economic growth”. With respect to achieving the “good governance at the international level” called for in the United Nations Millennium Declaration, that report stated the following:

“There is a growing need to improve arrangements for cooperation between national tax authorities. Increasing international economic and financial interdependence is constraining national capacity to set and enforce various tax instruments. Governments are increasingly limited by international competition in both the forms of tax and the tax rates they can apply. Improved international cooperation between taxing authorities would serve, inter alia, to reduce opportunities for tax evasion and avoidance, contribute to mitigating the capital-flow instability to which developing countries are sometimes subject, and deploy tax incentives and disincentives in support of public goods, such as avoiding depletion of the global commons” (para. 140).

“These goals require major improvements in international cooperation on taxation matters. Forums exist in limited-membership organizations to treat these issues from the viewpoints of their members, in particular OECD. In addition, taxation is addressed at the level of experts in United Nations forums, notably the Ad Hoc Group of Experts on International Cooperation in Tax Matters and certain expert groups on accounting and other related matters that are convened by the United Nations Conference on Trade and Development (UNCTAD). But, although OECD, for instance, has undertaken a number of outreach activities with non-member countries, there is today no global intergovernmental forum that considers tax questions on an ongoing basis or that can adequately put the tax debate in a wider — including a developmental — context” (para. 141).

15. To address the current institutional deficiencies in addressing international tax matters, the Secretary-General’s report recommended that various options be given careful study. One option was to merge the existing international organizations dealing with tax matters into a single entity, tentatively referred to as the international tax organization. A “less ambitious” option was to strengthen the ability of the United Nations to deal with international tax matters by building on the successes of the Ad Hoc Group of Experts on International Cooperation in Tax Matters (para. 142).

16. To advance discussion of options for fixing the flaws in the existing institutional arrangements for international tax cooperation, the Secretary-General appointed a High-level Panel on Financing for Development, chaired by Mr. Ernesto Zedillo, former President of Mexico. That Panel issued a report (the Zedillo report) on 26 June 2001 (see document A/55/1000). One of the key recommendations of the Zedillo report was “that the international community consider the potential benefits of an international tax organization” (executive summary, recommendation 12). The panel members left little doubt that they believed those benefits to be considerable (sect. 5 entitled “Systemic issues”, subsect. entitled “Creating new institutions”).

17. The implicit recommendation of the Zedillo report regarding the establishment of an international tax organization provoked considerable discussion among the international tax community. Much of the reaction was critical. At one extreme,

critics suggested that a new international organization was unnecessary and would duplicate, but with less effectiveness, the activities of existing international organizations, most notably OECD. At the other extreme, some critics expressed concerns that the proposed international tax organization would be too successful and might morph over time into a super-agency that would control the fiscal policies of national Governments.

18. Notwithstanding the criticisms, some commentators responded positively to the international tax organization proposal. In their view, the existing international arrangements do not give the developing and transitional countries an effective voice in establishing international tax norms, and the norms promoted by limited-membership organizations lack universal legitimacy.

19. Whatever its objective merits, the international tax organization proposal was not endorsed in the Monterrey Consensus of the International Conference on Financing for Development. Political changes in certain countries and the strong opposition of some international organizations sealed its fate. The Monterrey Consensus acknowledged, nevertheless, that international cooperation on tax matters is important and that the existing institutional arrangements need to be adapted to give voice to the concerns of the developing and transitional countries. It endorsed actions to “(s)trenghen international tax cooperation, through enhanced dialogue among national tax authorities and greater coordination of the work of the concerned multilateral bodies and relevant regional organizations, giving special attention to the needs of developing countries and countries with economies in transition” (para. 64).

## **Lessons learned**

20. Several lessons can be drawn from the public discussion of the international tax organization proposal and the endorsement of enhanced international cooperation in the Monterrey Consensus:

- First, a broad consensus appears to have emerged that the existing institutional arrangements are defective because they do not provide a seat at the table for the developing and transitional countries when international norms are being addressed.
- Second, any international tax norms that emerge from the existing international arrangements lack the legitimacy that can come only from their endorsement by an international organization with universal representation.
- Third, any proposed reform of the existing institutional framework for international tax cooperation cannot attract wide support unless it builds on the existing international institutions and is respectful of their traditional areas of operation.
- Fourth, the most promising avenue of reform for the United Nations to pursue is a strengthening of its own capacity to engage in international dialogue on international tax matters.

21. Section IV sets forth a detailed proposal for enhancing the capacity of the United Nations to deal with international tax matters. In accordance with the lessons set forth above, the proposal builds upon an existing arrangement, namely, the United Nations Ad Hoc Group of Experts on International Cooperation in Tax Matters. The proposal is not an attempt to promote an international tax organization

through the back door. On the contrary, it does not call for any new international organization. It fully recognizes the legitimate functions performed by other international organizations in the field of international taxation, and it provides a means for fuller cooperation between those organizations and the United Nations. Although it has some ancillary objectives consistent with the current practices of the Ad Hoc Group, its overriding objective is to give voice to the developing and transitional countries in the formulation of international tax norms.

## **II. Mobilization of domestic resources for development: the need to mitigate international tax evasion, excessive tax competition and capital flight**

22. Developing and transitional countries cannot hope to “eradicate poverty, achieve sustained economic growth and promote sustainable development” unless they are successful in mobilizing domestic resources for development. A well-functioning tax system is an essential element of any realistic programme for mobilizing domestic resources.

23. A key requirement for mobilizing domestic resources is what the Monterrey Consensus characterizes as “an enabling domestic environment”. According to the Monterrey Consensus:

“An enabling domestic environment is vital for mobilizing domestic resources, increasing productivity, reducing capital flight, encouraging the private sector, and attracting and making effective use of international investment and assistance. Efforts to create such an environment should be supported by the international community” (para. 10).

24. Virtually all of the developing and transitional countries face serious problems in administering an effective tax system, owing to the forces of globalization outside their control. They face serious problems of international tax evasion and avoidance. They frequently find that much of the capital needed for domestic investment has fled to offshore tax havens and to various developed countries that offer tax-free investment opportunities for foreign capital. They also face problems from excessive tax competition — tax-incentive bidding wars often stimulated by the multinational enterprises. In short, most developing and transitional countries do not enjoy the enabling domestic environment that the Monterrey Consensus states is essential for sustained economic development and poverty eradication.

25. The problems that the developing countries face from excessive tax competition have been recounted in the tax literature and will not be addressed in detail here. It is enough to note that the existing institutional framework for international cooperation has not been adequate with respect to addressing this issue effectively. OECD, primarily through the efforts of the major European countries, has sought to prevent what it characterizes as “harmful tax competition” from undermining the tax systems of Europe. No comparable effort has been made to address the problems of tax competition in developing and transitional countries.

26. To a limited extent, international tax evasion has been addressed through the exchange-of-information provision of bilateral and multilateral tax treaties. Exchange of information has been successful in some cases in combating evasion, but the success rate is at best disappointing. Most developed countries do not

provide information to developing and transitional countries on a routine basis, and some developing countries provide only limited assistance when a particular individual or company is the target of a fraud investigation. Many developed countries decline to exchange information when that information is protected from discovery under bank secrecy laws. A few tax treaties provide for assistance in the collection of delinquent taxes, and many more are likely to do so in future years. For now, however, the developed countries provide almost no assistance to developing and transitional countries in collecting taxes due from tax evaders.

27. Developing and transitional countries receive little or no help from developed countries in combating tax avoidance. On the contrary, many developed countries have adopted domestic legislation that facilitates tax avoidance. For example, some developed countries have adopted laws or regulations that effectively allow taxpayers to treat a legal entity as a pass-through entity in one country and a taxable entity in another country. These so-called hybrid entities are frequently used for tax avoidance purposes — to obtain, for example, a deduction for the same expenditure in more than one country. Many of the tax treaty rules that are promoted by developed countries facilitate tax avoidance by giving priority to legal form over economic substance.

28. Some developed countries also undermine the enabling domestic environment necessary for domestic resource mobilization by facilitating capital flight from developing and transitional countries. The two most important financial centres in the world are in the United States of America and Europe. The United States provides an exemption from its income tax for interest earned by foreign persons on bank deposits. This exemption has the effect of drawing funds out of developing and transitional countries for deposit in United States banks. The United States tax code also provides that interest on most types of corporate debt held by foreign persons is exempt from United States tax.

29. The United States declines to provide developing and transitional countries with information on the United States bank-deposit interest income earned by their residents, although an exchange of such information would appear to be required under many United States bilateral tax treaties. In early 2001, the United States Department of the Treasury issued a proposed regulation that would have required United States banks to provide United States treaty partners with information on the United States bank deposits of their residents. That regulation was modified, however, to exclude from its scope the residents of many countries, including all developing and transitional countries. It is estimated that over US\$ 1 trillion of bank deposits are held in United States banks by foreign tax cheats.<sup>7</sup> The portion of those deposits originating in developing and transitional countries is unknown.

30. Members of the European Union (EU) have become quite concerned in recent years about the problem of capital flight and have adopted measures to curb it. In general, the EU Directive on the Taxation of Savings requires member countries to adopt and enforce rules that establish the identity of depositors and other persons receiving interest payments. That information must be shared with the member State where the person earning the interest is resident. Alternatively, certain countries that have historically used bank secrecy to attract foreign investors are permitted to avoid the exchange of information about depositors by withholding taxes at the source and paying over a portion of the withheld taxes to the member country where the depositor is resident. No information need be exchanged and no withhold tax

need be imposed, however, when the foreign investor is resident in a country outside the EU. As a result, the EU will continue to attract investment by tax evaders resident in developing and transitional countries.

31. What makes the problem of capital flight difficult to control in a global economy is that capital is allowed to flow freely without any border restrictions or information flows. As a result, the income from the fleeing capital is difficult to trace to a particular person. Countries in Europe and North America have some concern that if they take effective measures to prevent tax evasion and capital flight, the fleeing capital will simply relocate in a country that has not adopted these measures. In theory, the solution to this dilemma is international tax cooperation on a broad scale that includes the major developed countries and the developing and transitional countries as well. Unfortunately, it is unlikely that the countries of the world can achieve that ambitious goal under the existing institutional framework for international tax cooperation.

32. The Monterrey Consensus has imposed on the developed countries an obligation to assist developing and transitional countries in establishing the enabling domestic environment necessary for resource mobilization. As discussed above, that obligation is not being met. It is unlikely to be met any time soon under the existing institutional framework for international tax cooperation.

### **III. Involvement of the United Nations and the League of Nations in international tax matters**

33. As mentioned above, in 1967, the Economic and Social Council adopted resolution 1273 (XLIII) requesting the Secretary-General to set up an ad hoc working group of tax experts and tax administrators. This ad hoc group was expected to represent the interests of both developed and developing countries as well as the different regions and tax systems of the world. The ad hoc group was asked to formulate guidelines and techniques for use in tax treaties between developed and developing countries. In accordance with that resolution, the Secretary-General established the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries (see paras. 10-11).

34. Notwithstanding the interest of the United Nations in international tax matters, the driving force in developing international tax norms during the post-Second World War period was OECD. In 1963, OECD published its draft model tax convention.<sup>8</sup> In form, the 1963 draft recognized the importance of sharing of tax revenue between the source and residence countries. Its practical effect, however, was to erect substantial barriers to the exercise of source jurisdiction, to the detriment of the developing countries. The model convention also afforded major opportunities to multinational enterprises to adopt tax minimizing strategies through its emphasis on legal form over economic substance. The 1963 draft was revised slightly over the next decade and a half. It was published in final form in 1977.<sup>9</sup> It became the basis for a very large number of bilateral tax conventions.

35. The widespread success of the OECD model convention in the 1970s provoked some reaction from developing countries. Many of those countries, being outside of OECD, felt excluded from effective participation in the design of the OECD model. They had been disenfranchised at a time when the number of developing countries

was increasing markedly, owing in large part to the collapse of colonialism in Africa and Asia after the Second World War.

### **Development of a United Nations model tax convention**

36. The developing countries responded to the adoption of the OECD model convention by developing their own model convention under the auspices of the United Nations. The first step in developing a United Nations model was the production in 1979 of a manual that gave guidance to the developing countries on the process of treaty negotiation and on the important issues to be addressed in the negotiation process.<sup>10</sup> The manual was prepared by the Ad Hoc Group of Experts and the United Nations Secretariat. The following year, the United Nations published the *United Nations Model Double Taxation Convention between Developed and Developing Countries*.<sup>11</sup> That publication included a model convention and commentaries on the articles therein, both of which had been prepared and approved by the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries. The United Nations model was based in significant part on the OECD model, although it departed from the latter model on some key points. In particular, it modified the definition of a permanent establishment to allow some additional taxation of business income by the source country, and it provided that any reduction in a country's statutory withholding rates would be effected through bilateral negotiations. No specific target withholding rates were established in the model. The obvious expectation was that tax treaties based on the United Nations model would include a positive withholding rate on royalties and that the withholding rates on dividends and interest generally would exceed the rates recommended in the OECD model.

37. The United Nations model has been effective in influencing the content of bilateral tax treaties between developed and developing countries. In particular, virtually all of the treaties between developed and developing countries provide for a positive withholding rate on royalty income, and the modifications proposed in the article on the permanent establishment by the United Nations model have been adopted widely. The core of the United Nations model, however, is taken from the OECD model. As a result, the United Nations model permits companies to engage in tax-avoidance strategies to minimize their exposure to taxation in the source country. The United Nations model does have a somewhat broader exchange-of-information article than does the OECD model convention. Unfortunately, developing countries have had mixed success in obtaining information from the developed countries through that article. For example, the developing countries have not been able to use that article to prevent capital flight by their residents who seek to avoid tax in their home country by taking advantage of tax-free investment opportunities available in the developed countries.

38. Both the OECD model and the United Nations model were not modified during the 1980s, despite the increased globalization of the world economy. OECD finally began making some amendments to its model in the 1990s; it now publishes its model in loose-leaf form. The United Nations published a new model tax convention in 2001 — the first revision in two decades.<sup>12</sup> In the revisions to the OECD and United Nations models, many useful changes were made, mostly of a technical nature. The revised models, however, have continued the emphasis on formalisms. For example, both model conventions continue to permit various tax-

avoidance techniques by treating the corporations constituting a multinational enterprise as if they were independent entities, notwithstanding their economic integration in most cases.

39. Although the OECD and United Nations models have addressed many international tax issues, they have not addressed all the important international tax issues that have emerged in the 1980s and thereafter. For example, neither model convention addresses cross-border mergers, aggressive tax avoidance schemes, treaty-shopping, hybrid entities, overlapping controlled-foreign-corporation regimes, and global trading of financial instruments.

40. Over the past several years, OECD has attempted to involve developing and transitional countries in its various activities relating to tax treaties and international taxation in general. It has invited representatives of developing and transitional countries as observers to some of its meetings, particularly with respect to e-commerce. It has also invited a selected group of developing countries to register objections to positions taken by OECD in the commentary to the OECD model convention. The United Nations Ad Hoc Group has been equally hospitable in inviting the OECD staff to participate as observers in its activities. The OECD outreach activities, although certainly welcome, seem unlikely to result in the developing and transitional countries' influencing the core decisions made by OECD on tax treaty matters or on any other matters of importance to the OECD member States.

### **Tax cooperation under the League of Nations**

41. Much of the important work on the development of a consensus on international tax matters actually began with the activities of the League of Nations following the First World War. The League published the first internationally important model tax convention in 1928. That model was the culmination of work that had begun in 1920. The convention recognized the importance of some sharing of taxing power between the source country and the residence country. It did not attempt to limit the methods the contracting States might use to prevent double taxation. Instead, it offered alternative means of achieving a reasonable sharing of tax revenues from cross-border activities.

42. The League of Nations model tax convention of 1928 was prepared by a group of government experts on double taxation and tax evasion. The initial group, formed in 1922, had seven members, all officials from European countries. In 1925, the committee was expanded to include two more European representatives and three additional representatives from outside Europe. Beginning in 1927, the United States, which was not a member of the League, participated on an informal basis. The expanded committee produced a report and draft convention in 1927, which was circulated to League members and some non-member States. In 1928, the Secretary-General of the League convened a meeting of government experts in Geneva, Switzerland, to consider the draft convention. The drafters of the convention relied in part on a 1923 League of Nations report on double taxation prepared by a group of four economists from Great Britain (Sir Josiah Stamp), Italy (Professor Einaudi), the Netherlands (Professor Bruins) and the United States (Professor Seligman).

43. The 1928 convention addressed only a small subset of the international tax issues of importance to the taxation of cross-border activities. Recognizing the need

for additional work, the League of Nations established a Fiscal Committee in 1929. The Fiscal Committee engaged in activities before, during and after the Second World War. It ceased operations when the League was supplanted by the United Nations.

44. During the 1930s, much of the work of the League's Fiscal Committee was in the area of formulating rules and standards for allocating the income of industrial and commercial enterprises operating in more than one country. In 1933, it prepared a draft multilateral convention on the allocation of profits. That model convention was revised in 1935 but never formally adopted.

45. The League's Fiscal Committee continued its work on a model tax convention during the war years. In 1940 and again in 1943, the League's Fiscal Committee convened a regional conference in Mexico City to revise the 1928 convention. The meeting included representatives from countries of the western hemisphere, both developed and developing. The regional conference produced a draft model convention, popularly known as the Mexico Draft.

46. In general, the Mexico Draft took the position that the primary jurisdiction in tax income should be assigned to the source country — the position favoured by the developing countries. In this respect, the Mexico Draft was a major refinement of the League's 1928 model convention. The basic structure of the 1928 convention, however, remained unchanged. The Mexico Draft clarified an ambiguity in the 1928 convention by providing that all of the business income derived in a country would be taxable there unless the activities were "isolated or occasional" and the enterprise earning the income did not have a permanent establishment in that country. A protocol to the convention provided rules for attributing income to a permanent establishment. These rules, in general, followed the Fiscal Committee's 1935 draft convention for the allocation of profits.

47. The work of the League of Nations on tax matters continued for a short time even after the founding of the United Nations in 1945. In 1946, the League's Fiscal Committee, with a full complement of members, met in London to review the Mexico Draft. A new draft, popularly referred to as the London Draft, was produced. The London Draft was similar in some respects to the Mexico Draft in the treatment of business profits. It differed from the Mexico Draft, however, in stipulating that an enterprise resident in one contracting State would need to have a permanent establishment in the other contracting State in order for that latter State to be authorized to tax the enterprise on any portion of its business profits. The London Draft also imposed significant limitations on the taxation of investment income in the source country, contrary to the position favoured by the developing countries and adopted in the Mexico Draft. For example, the Mexico Draft had provided that royalties paid for the right to use a patent or secret process would be taxable only in the State where the right was exploited. In contrast, the London Draft provided for the right to tax such royalties in the country of residence.

48. Neither the London Draft nor the Mexico Draft was ever adopted by the League or its successor institution as model conventions. The Fiscal Committee disbanded with the termination of the League, and the United Nations did not form a successor body to continue its work. Only in 1967 did the United Nations act to establish the Ad Hoc Group of Experts to address international tax matters. The Ad Hoc Group was given far less institutional support and status than the Fiscal Committee had enjoyed under the League of Nations. Unsurprisingly, the Ad Hoc

Group has not been able to play the important role in establishing an international consensus on tax matters that was played by the Fiscal Committee of the League of Nations. The surprise is that the Ad Hoc Group, notwithstanding this lack of institutional support, has enjoyed some meaningful successes.

#### **IV. Proposed new institutional framework**

49. The Zedillo report is certainly correct in its assertion that the existing institutional arrangements for dealing with international tax matters are unsatisfactory from the perspective of the developing and transitional countries. The question is what modifications can be made in those arrangements to enhance the institutional framework for international tax cooperation.

50. At the minimum, the developing and transitional countries need to have at their disposal a centre on international cooperation in tax matters that has competent and adequate staffing and that is responsive to their agendas. This institutional arrangement is needed to assist them in coping with the great fiscal pressures that they face both domestically and in the global context. The most promising approach is to build upon the existing programme already in place in the United Nations, namely, the Ad Hoc Group of Experts on International Cooperation in Tax Matters. As discussed in section III above, that body has done important work over the past two decades in developing and promoting the United Nations model tax convention. It has also conducted a few workshops to assist in the training of tax officials in developing countries. It is woefully underfunded, however, and does not have the institutional structure within the United Nations that is necessary to project and defend its work adequately in the international context. Significant restructuring of that body is needed for it to serve the needs of developing and transitional countries for assistance and support on international tax matters.

51. In terms of status, the model to be followed in reconstituting the Ad Hoc Group of Experts could be the Fiscal Committee that operated so successfully under the League of Nations. The Ad Hoc Group currently has the status of an “expert body” within the Economic and Social Council of the United Nations. It should be given the status of an intergovernmental commission and should have a budget adequate to meet its expanded responsibilities. Members of this new commission for international cooperation in tax matters should be elected under the procedures generally followed by the Council for other subsidiary commissions and bodies. It should continue to have representation from developed, developing and transitional countries, although the members of the commission should serve in a governmental representative capacity.

52. The commission should have a small support staff of full-time tax professionals, ideally drawn from the accounting, economics and legal professions, headed by an official with experience in international tax matters, with a budget adequate to permit, for example, occasional meetings with representatives of member States and to permit the professional staff members to represent the United Nations Secretariat at other forums. For example, the staff of the commission might participate in the “international tax dialogue” that has been proposed by the World Bank, the International Monetary Fund and OECD.

53. The central goal of the proposed commission for international cooperation in tax matters is to give the developing and transitional countries an effective voice

when issues of cooperation on tax matters are being decided by the international community. To that end, the commission should take over the tax treaty work of the Ad Hoc Group of Experts on International Cooperation in Tax Matters. As the Ad Hoc Group of Experts has done in recent years, the commission should include in its agenda the consideration of all of the major international tax issues of importance to developed and developing countries. The professional staff should help organize meetings of the commission and prepare the supporting documents for those meetings.

54. The commission would not duplicate the work being accomplished by other international organizations. It would not attempt, for example, to collect statistical data on tax systems, as is done by OECD, or collect data on economic development, as is done by the World Bank. Similarly, it would not attempt to provide technical assistance on the design of domestic tax rules or on the introduction of new forms of taxation.

55. In addition to its central goal, the commission might pursue several ancillary goals. For example, it might serve as a clearing house for information about tax techniques that have been used successfully in developing and transitional countries to deal with international tax matters. It also might maintain a list of international tax experts of an independent stature who could serve, at the request of the host Government, as advisers to developing and transitional countries on certain types of international tax reform. As the Ad Hoc Group of Experts has done from time to time, the commission might offer workshops on international tax matters for the benefit of developing and transitional countries.

### Notes

<sup>1</sup> See Monterrey Consensus of the International Conference on Financing for Development (*Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7), chap. I, resolution 1, annex), para. 1.

<sup>2</sup> Ibid.

<sup>3</sup> Ibid., para. 10.

<sup>4</sup> Ibid., para. 64.

<sup>5</sup> OECD, *Model Double Taxation Convention on Income and on Capital: Report of the Committee on Fiscal Affairs* (Paris, 1977); p. 2.

<sup>6</sup> “Developing the International Dialogue on Taxation: A Joint Proposal by the Staffs of the International Monetary Fund, OECD and the World Bank”, para. 7. Available at <http://www.imf.org/external/nplfad/itd/2002/031302.htm>. Accessed on 16 September 2003.

<sup>7</sup> Marshall Langer, “New E.U., U.K., and U.S. reporting rules on bank deposit interest paid to non-residents”, *Tax Notes International* (28 January 2002), pp. 403-411.

<sup>8</sup> See OECD, *Draft Double Taxation Convention on Income and Capital: Report of the OECD Fiscal Committee* (Paris, 1963).

<sup>9</sup> See OECD, *Model Double Taxation Convention on Income and on Capital: Report of the Fiscal Committee* (Paris, 1977).

<sup>10</sup> *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (United Nations publication, Sales No. E.79.XVI.3).

<sup>11</sup> United Nations publication, Sales No. E.80.XVI.3 and corrigendum.

<sup>12</sup> *United Nations Model Double Taxation Convention between Developed and Developing Countries* (United Nations publication, Sales No. E.01.XVI.2).

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