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Third Annual Developing Country Forum

South-South Cooperation in International Tax Matters

9-10 December 2019
Pravasi Bhartiya Kendra, New Delhi

REPORT

Third Annual Developing Country Forum on South- South Cooperation in International Tax Matters

Geneva, 23 January 2020



<https://taxinitiative.southcentre.int/>



*Third Edition of the Annual Forum organized by the South Centre, the Government of India
and the Research and Information System for Developing Countries*

New Delhi, 9 – 10 December 2019

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Executive Summary

The South Centre organized, in cooperation with the Research and Information System for Developing Countries (RIS), the Ministry of External Affairs and the Ministry of Finance of India, the Third Annual Developing Country Forum on South-South Cooperation in International Tax Matters (the Forum).

The Forum is an activity of the South Centre Tax Initiative (SCTI) which serves as a platform owned by developing countries to facilitate the networking and access to their officials to technical and academic resources, as well as to provide a venue for discussion among developing countries to identify collective efforts towards their participation in international tax fora and negotiations on matters of global economic governance.

The inaugural address of the Third Forum was given by India's Minister of State for External Affairs, H.E. V. Muraleedharan, who emphasized the need for developing countries to work together to counter illicit financing and tax evasion, and to tackle the issue of fugitive economic offenders (FEOs). Minister Muraleedharan also mentioned that effective international taxation was essential to ensure that foreign and domestic companies pay the same taxes and, hence, compete on a level playing field.

The keynote address was delivered by Mr. Pramod Chandra Mody, Chairman of India's Central Board of Direct Taxes. He raised the importance of source taxation of capital gains from movable assets, challenges faced in the extractives sector and the G24's response to the OECD's proposal on a Unified Approach. He urged developing countries to work closely together on capacity building and offered India's services on the matter.

On the digital economy, panel discussions covered the G24's proposal of fractional apportionment, the complexity of the OECD's Unified Approach and the challenges posed through the distinction between routine and non-routine profits, the possibility of a services Permanent Establishment (PE) through Article 5(3)(b) of the UN Model Convention and new forms of virtual PE evolving through judicial precedent such as the use of (digital) cookies in a server. Panelists also covered political aspects, such as the critical importance of developing countries to "speak up" and no longer remain passive observers, the OECD's growing influence over regional tax organisations and the possibility of working through the UN system to strengthen the voice of developing countries in the debates. There were strong

objections to the way the OECD Secretariat unilaterally shaped the discussion on international taxation by bringing out the Unified Approach which effectively removed the G24's proposal from consideration. One panelist said a resolution could be introduced in the UN General Assembly on the G24 proposal and hence bring it back into the debate. Other panelists also called into question the entire legitimacy of the OECD process and reiterated that developing countries did not need to adhere to the Unified Approach as a basis for future negotiations.

On offshore indirect transfers, panelists spoke of the need to allocate all residual rights of taxation of capital gains to the country of source, rather than the country of residence as currently provided for in Article 13(6) of the UN Model Convention. They stressed that the capital gains on transfers of movable and immovable property should be treated at par. Stringent reporting requirements were suggested as a practical first step developing countries could take in taxing offshore indirect transfers. Developing countries were also urged to make written responses to policy proposals such as those put out by the Platform for Collaboration on Tax on capital gains, which had the potential to become international standards. Panelists also shared their country practices in this area.

On extractive industries, panelists shared their country experiences and innovations regarding issues such as tax collection at source, transfer pricing involving technical services, the use of the sixth method, the need for interest deduction caps, designing effective fiscal systems and managing decommissioning effectively, to name a few.

The session on tax risk assessment was of high interest to the participants, who shared their country experiences in using data obtained from country by country reporting and exchange of information agreements. Panelists also shared the institutional mechanisms used and processes implemented for risk assessment.

The last session, on Fugitive Economic Offenders (FEOs), went beyond the consideration of the conventional international taxation framework and entered the realm of criminal law, covering topics such as extradition, the various multilateral instruments involved in handling the proceeds of transnational crime and whether new ones were necessary. It was stressed that FEOs constituted a serious threat to the economic health of developing countries. A view was expressed that neo-colonial links were drawn with some of the countries which are popular destinations for such offenders. Panelists also examined various lists of tax havens, which often double as sanctuaries for FEOs.

The Third Forum saw the participation of high level officials coming from 19 countries namely Argentina, Bangladesh, Burkina Faso, Ecuador, Germany, India, Indonesia, Jamaica, Malawi, Mauritius, Mozambique, Nepal, Nigeria, Philippines, Samoa, Seychelles, Uganda, United Kingdom and Switzerland. It had the highest participation thus far of the Annual Forum series. Discussions during the forum addressed the most relevant tax issues that may impact developing countries currently being discussed at the international level, especially in the OECD. The Forum also allowed the exchange of expertise among developing countries coming from Asia and the Pacific, Latin America and the Caribbean, and Africa, which consolidated this space as a necessary mechanism to identify coordinated positions among developing countries towards the consolidation of a network of tax officials from developing countries and strengthening their voice in the international fora. This was highly appreciated by the participants.

Participants also recognized the South Centre's role in supporting developing countries' engagement with and negotiations in international tax cooperation fora, such as in the OECD/G20 Inclusive Framework on BEPS, the UN tax cooperation work, and other regional cooperation initiatives. The South Centre was requested to carry out capacity building programs and exchange of expertise among the network of country officials. All the presentations and conference materials can be accessed on the South Centre Tax Initiative website.¹

¹ <https://taxinitiative.southcentre.int/event/upcoming-third-annual-developing-country-forum/>

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Background



Participants during discussions on Breakout Group Sessions

The South Centre organized, in cooperation with the Research and Information System for Developing Countries (RIS), the Ministry of External Affairs and the Ministry of Finance of India, the Third Annual Developing Country Forum on South-South Cooperation in International Tax Matters (the Forum).

The Forum is an activity part of the South Centre Tax Initiative (SCTI) which serves as a platform owned by developing countries to facilitate access of developing country officials to technical and academic resources, as well as to provide a venue for discussion among developing countries to identify collective efforts towards their participation in international tax fora and negotiations on matters of global economic governance.

This space serves as an opportunity to boost South-South cooperation in international tax matters and to increase the collective efforts of developing countries to raise their voices and become full participants in international norm-setting. During discussions in the Forum, participants have the opportunity to share technical innovations and identify capacity building activities and exchange of expertise among their peers, for promoting better coordination in tax policy reform among developing countries and strengthening the spaces for consultation and coordination in negotiations in international fora.

The First Annual Forum was held from 30 November to 2 December 2016 in Surabaya, Indonesia.² The First Forum created enormous interest and offered support from developing countries for its continuation, expansion and strengthening. The Second Annual Forum³, held from 25 to 27 April 2018, continued where the first annual forum had left off, and expanded its repertoire to further appreciation from developing countries.

² <https://taxinitiative.southcentre.int/event/the-inaugural-annual-forum-on-developing-country-tax-policies-and-cooperation-for-agenda-2030/>

³ <https://taxinitiative.southcentre.int/event/second-annual-developing-country-forum-for-cooperation-in-international-tax-matters/>

The Third Forum built upon the previous two and achieved the highest number of participants and included high level officials coming from 19 countries namely Argentina, Bangladesh, Burkina Faso, Ecuador, Germany, India, Indonesia, Jamaica, Malawi, Mauritius, Mozambique, Nepal, Nigeria, Philippines, Samoa, Seychelles, Uganda, United Kingdom and Switzerland.

1. Opening Session

The Third Annual Developing Country Forum on South-South Cooperation in International Tax Matters opened with welcoming remarks from Prof. Sachin Chaturvedi, Director General, Research and Information System for Developing countries. He explained that currently, USD 2.5 trillion per year are required by developing countries to fulfil the Sustainable



Opening Session

Development Goals and Agenda 2030, but that the total amount achieved through global tax collection is much less than this, as around USD 500 billion are lost due to tax avoidance.

For Prof. Chaturvedi, this scenario further complicates if one considers the required finance to cope with the effects of climate change. Therefore, there is a need to provide a platform for developing countries to promote global tax cooperation. The Forum is one of such mechanisms, while other proposals also identify the need to revitalize UNCTAD as a space to discuss issues of concern for developing countries, including the effect of bilateral taxation treaties, taxation of extractives industries and BEPS.

Following the welcoming remarks, Prof. Carlos Correa, Executive Director of the South Centre, shared with participants his introductory remarks and emphasized that the Third Forum is a continuation of the South Centre's efforts to ensure that the voices of developing countries are heard in setting global tax policies. For Prof. Correa, the mobilization of domestic resources is crucial to reach the goals set out in the 2030 Agenda and, therefore, ensuring effective and sustained revenue collection is critical to generate the much needed resources. The Forum provides a "safe space" for participants to forge common negotiating positions and work out an appropriate response that safeguards their interests while contributing to consolidating a network of tax experts that help developing countries to work together in future multilateral negotiations. Finally, Prof Correa thanked the Steering Group of the South Centre Tax Initiative and launched the book⁴ "*International Tax Cooperation: Perspectives from the South*," which serves as a specific contribution by and for developing

⁴ <https://www.southcentre.int/book-by-the-south-centre-2019-3/#more-13265>

countries to the international discussion on tax reform. The topics covered by the book include illicit financial flows, transfer pricing, profit attribution, exchange of information, tax havens and the role of gender in taxation.

Finally, the keynote speech was delivered by Mr. Pramod Chandra Mody, Chairman, Central Board of Direct Taxes (CBDT) of India. For Mr. Mody, the initiative taken by the South Centre was useful for starting a discussion on the issues included in the agenda, such as the digital economy, extractive industries and capital gains. He said it will also serve as an opportunity to identify the inputs and feedback necessary for international negotiations on these matters. Similarly, the Forum could be a space to share good practices and experiences in the development of model rules and samples of tax designs based on developing countries' interests, to boost shared prosperity. One of the issues that require significant attention according to Mr. Mody, is the identification of risk assessment in a way that will enable tax authorities to develop appropriate indicators that will help them meet revenue targets.

2. Technical Session I: Taxation of the Digital Economy– Conceptual Issues



Technical Session I: Panel of Discussants

Substantive discussions started with the taxation of the digital economy, which bring new challenges for tax administrations. The discussion centered on the OECD’s Inclusive Framework of the Base Erosion and Profit Shifting proposal to redefine “economic nexus” along with its corresponding benchmarks. Similarly, discussants also considered the Group

of 24 (G-24) proposal on the same matter.

One discussant noted that the League of Nations had discussed the issue of taxing rights since 1921 and that the United Nations (UN) took over the discussion of the League of Nations. In this process, discussion about taxing the digital economy started 20 years ago; nonetheless they were discontinued at the time. Discussants considered that the current state-of-play of the world economy showed the enormous challenges that global markets are facing for harvesting taxing rights on large digital corporations which currently are not paying taxes due to the lack of physical presence. On the subject, one discussant considered that the traditional understanding and application of the arms-length principle and permanent establishment is not enough and that if physical presence is not required, then in-depth discussion on methodologies to define the allocation of profits was required. On this subject, some panelists highlighted that developing countries have engaged in different modalities of implementation of Article 5 and Article 5(3)(b) of the United Nations Model Convention on Double Taxation, but noted that digitalization had exceeded their capacities.

Members of the panel considered the current efforts made by the OECD’s Inclusive Framework of the Base Erosion and Profit Shifting (BEPS) and the G-24. On the first one, discussants observed that the BEPS project was not designed by developing countries and that the work agenda has not considered developing countries' interest. They also mentioned that two principles could serve as the basis for the allocation of profits, the economic nexus and the residence nexus. The second one is a priority for the OECD. Such an approach will imply that those market jurisdictions will only receive benefits from residual profits, which will not

consider the rights of the place where the value is created nor the factors that tend to generate profit (production, consumption and labor). Another discussant stated that so far no agreed formula has been developed for a fair formula-based apportionment approach, and that the current proposal by OECD is problematic because it will imply recognizing only non-routine profits for developing countries and it is also a methodology prone to dispute among jurisdictions. Participants considered that a more straightforward proposal is necessary and that more support should be given to the Group of 77 (G-77) and the G-24 to promote its proposal on Significant Economic Presence (SEP) and fractional apportionment.

Panelists also covered political aspects, such as the critical importance of developing countries to “speak up” and no longer remain passive observers, the OECD’s growing influence over regional tax organisations and the possibility of working through the UN system to strengthen the voice of developing countries in the discussion. There were strong objections to the way the OECD Secretariat unilaterally shaped the discussion by bringing out the Unified Approach which effectively removed the G24’s proposal from consideration. One panelist said a resolution could be introduced in the UN General Assembly on the G24 proposal and hence bring it back into the debate. Other panelists also called into question the entire legitimacy of the OECD process and reiterated that developing countries did not need to adhere to the Unified Approach as a basis for future negotiations.

3. Technical Session II: Taxation of the Digital Economy– Practical Issues and Evolving Practice

The second session focused on the practical experiences developing countries are implementing to cope with the challenges raised from the taxation of the digital economy. One discussant stressed the need for multinational corporations to stop using harmful tax practices, but also considered the need for reaching a compromised unified approach for taxing the digital economy. The



Participants of the Forum during the discussion on practical issues on taxation of the digital economy.

adoption of an intergovernmental declaration in the United Nations was proposed on the basis that the United Nations is already working on the issue at that it has the constituency of 134 countries. Similarly, participants stated the fact that OECD does not have a mandate to be in the driving seat of the global tax reform.

Participants also came to know about the experience of India in the application of the equalization levy that operates as a withholding tax of 6% on business-to-business transactions in the digital advertising space. It was explained that the nexus in this levy is not based on significant economic presence, but the sphere of economic nexus (provision of good and services). The case of Ecuador was also cited, where discussion on the application of value-added tax to services rendered over digital platforms was under consideration. For such an approach, a discussant identifies that one of the challenges is how to design a mechanism to determine the number of users and services a particular digital platform has. One way of coping with such a situation, as contained in the proposal by Ecuador, is to make the service provider the actor withholding the tax and using their databases as an advantage. Nevertheless, for this, the registration of platforms is a priority.

Participants also discussed how the traditional requirement of physical presence undermines the ability to charge a large amount of income from the digital economy, and that efforts should be taken by the international community to set up the mechanisms to define the tax liability of a foreign company. The case of Nigeria was discussed, where a new digital tax will be applied in April 2020. Participants learned that the concept of significant economic

presence will be operationalized. Nevertheless, participants questioned how such a principle would be applicable given the ongoing phase of the OECD discussions.

4. Technical Session III: Combating Tax Avoidance: Offshore Indirect Transfer of Assets

Tax administrations around the world face various challenges in the fight against the avoidance of taxes on the capital gains realized on the offshore transfer of assets located within their territory. The session considered the legal issues that developing countries have faced and the developments in domestic law to restrict such tax avoidance strategies.



Technical Discussion III: Panel of Discussants

Participants considered the evolution of abusive tax practices on the indirect transfer of assets, mainly how they have been applied in cases of movable property. For another discussant, capital gains must be payable in the source jurisdiction as they respond to value creation in such jurisdiction. It was also highlighted that ideally, all residual rights of taxation of capital gains should be given to the country of source rather than the country of residence, as is currently the case in the UN Model Convention. Panelists called on developing countries to try and amend Article 13 (6) of the UN Convention accordingly.

On this basis, participants were of the view that income arising from the transfer of an asset, even capital, should be taxable. For achieving such an objective, there is a need to clarify the nexus between the taxing right and the transfer of the asset. One discussant considered that States have a space to develop these doctrines at the international level, yet they are not using it. Discussants considered that a network of double taxation treaties and investment treaties also poses a risk to developing countries, as both processes allow potentially harmful dispute settlement procedures such as binding arbitration. This overlap between investment agreements and international taxation, should be considered during negotiations and ponder the impacts that signing an agreement can bring in other areas of discussion.

It was also mentioned that developing countries should be proactive in the ongoing discussions on monitoring Action 12 of the BEPS initiative, as other issues have effects on indirect transfer of assets, for example, the question of beneficial ownership. Participants explained that state practice has been developed on the matter and that some countries require

companies to ask for permission or provide mandatory notification before a company can be sold to foreigners. Developing countries were also urged to make written responses to policy proposals such as those put out by the Platform for Collaboration on Tax on capital gains, which had the potential to become international standards.

5. Technical Session IV: Extractive Industries



Participants of the Forum during discussion on taxation in the extractive industries

Many developing countries have a wealth of natural resources that can be harnessed as a potential revenue base for fulfilling their development needs. This requires creating appropriate tax and broader fiscal systems to ensure that they obtain a proper share of the benefits from the extraction and use of such resources. The session considered the recent innovations in the determination of profits or

royalties in the extractives industry and attempts to implement policies on the treatment of technical services.

Discussants and participants considered the main challenges their jurisdictions face when dealing with transfer pricing issues in the extractive industry. One discussant observed that the current sixth method, as applied by the OECD-BEPS initiative, is still similar to the arms-length principle and allows the establishment of the commodity price on a different date than the one in which the transaction was made. Another discussant observed that there is a need to have a reference to quoted prices, as extractives industries might artificially shift profits to jurisdictions which apply little to no taxes, and where there is little or no economic activity being undertaken by that entity. Specific initiatives were discussed, in particular, *Publish what you⁵ Pay* a global campaign intended to support countries to adopt policy tools and legislation requiring companies in extractive industries to publicly publish their real payments.

One discussant explained the experience of India, in particular, the implementation of the concession regime and the contract regime. In the first case, it is a front end loaded regime but not progressive as it is not related to the profit of the investor. In this case, countries can impose higher tax or windfall tax or can have a separate regime for the extraction industry. In the second case, the contract regime applies a payment or royalty to the company which may vary depending on the services required, but profits from production are shared by the country and the company as a joint venture.

⁵ <https://www.pwyp.org/>

Participants recognized that natural resources are critical for attaining sustainable development in developing countries. Nevertheless, a discussant observed that such operations are capital intensive and imply risk, and therefore, some companies might be induced to employ abusive tax practices to reduce their tax liability and increase revenues while minimizing risks. Some of these practices include splitting of intra-firm transactions and using those to maximise profit shifting through transfer mispricing; thin capitalization by indebting the subsidiaries to reduce its equity capital and allowing the allocation of excessive tax deductions on interest payments; intra-group charges allocating technical service fees to other companies in the corporate groups; and the use of offshore marketing companies to shift profits out of the countries where they are made.

6. Technical Session V: Tax Risk Assessment



Technical Session V: Panel of discussants

This session looked at the experience that developing countries have had to date with the exchange of information for tax purposes, in particular, Country by Country Reporting (CbCR) that can be a useful tool for developing countries conducting tax risk assessments. It considered the upgrades made to risk assessment methodologies by

developing countries, as well as innovations in domestic law, which would be of interest to other developing countries.

Participants had the opportunity to listen to the experiences of various developing countries. One discussant observed that developing countries generally have higher tax rates and are prone to BEPS. It was mentioned that large size multinational enterprises (MNEs) must file country-by-country reporting, including detailed financial and tax information relating to the global allocation of their income and taxes. This information helps to identify the jurisdictions where profits are generated, value is added, and risk is taken. One discussant commented on how the identification of foreign MNE groups with large revenue footprint in India based on inbound CbCR data, from this point tax authorities can identify high risk jurisdictions of each MNE Group and the local firm in India.

7. Technical Session VI: Fugitive Economic Offenders and Asset Recovery

The final session considered the matter on how tax havens that offer secrecy facilities and citizenship for sale undermine the integrity of tax administration and prosecution in many countries. These facilities have allowed fugitive economic offenders (FEOs) to evade prosecution by domestic courts. Participants considered the need for negotiating a global convention that



Technical Session VI : Panel of discussants

allows the strengthening of international cooperation towards developing tax intelligence on tax crimes and other crimes. One discussant observed that the Group of 20 had dealt with these issues in the framework of corruption, but several gaps still exist for achieving the successful extradition of offenders.

One such barrier is the high threshold required for assessing cases for criminal activity, which discourages countries in their jurisdictions. One discussant brought to the attention of participants the existence of the Financial Secrecy Index, which is a mechanism that ranks tax havens. Participants also expressed the view that there seemed to be an overlap between former colonial countries, tax havens and the destination of many economic offenders. Another shared details of a beneficial ownership public registry being developed by their country. Finally, participants considered that tax avoidance has enormous consequences for the implementation of SDGs and that the digital economy is changing the way we are looking at these issues, creating much space for innovating in cyber security. Similarly, the formulation of development-oriented tax policies should not be focused only on incentives for attracting foreign direct investment. It is still questionable to what extent such incentives are solely responsible for drawing investment, but what is indisputable is that states offering such incentives are losing revenue.

Way Forward and Closing Session



Closing Ceremony

economic offenders.

Participants recognised that developing countries are gaining space in the international discussion on tax matters. As mobilization of resources for achieving Agenda 2030 is becoming one of the primary concerns of the international community, participants concluded that developing a fair global tax system is crucial and can only be achieved through the sharing of experiences and good practices among developing countries.

The South Centre and the Research and Information System for Developing Countries thanked all participants for sharing their views and knowledge and were grateful with the Ministry of External Affairs of India and the Ministry of Finance for sharing their expertise and hospitality to all during the third edition of the Annual Developing Country Forum on South-South Cooperation in International Tax Matters.

The ultimate goal of the forum was to provide a platform for different countries to discuss topical issues related to international tax governance that ultimately contributes towards the achievement of sustainable development through mobilizing resources that would help countries to implement their national development plans and objectives, in line with 2030 Agenda for Sustainable Development. Participants recommended the South Centre to strengthen and promote the work of the South Centre Tax Initiative, in particular:

The Third Annual Developing Country Forum on South-South Cooperation in International Tax Matters concluded after two days in which experts from developing countries discussed taxation of the digital economy, offshore indirect transfers of assets, extractive industries, tax risk assessment, and fugitive

- a. Continue building strong partnerships with participant States;
- b. Take necessary steps for the South Centre to become a 'hub' of exchange of expertise and capacity building among developing countries, including through the design of training programs for national tax officers and the implementation of peer exchange programs;
- c. Strengthen the South Centre Tax Initiative as a platform for developing countries to arrive at common positions on tax matters; and,
- d. Develop innovative methods to increase participation in the Forum, including through 1) more breakout groups; 2) better inclusion of francophone countries; 3) share the presentations from all panelists with participants to act as reference materials, and; 4) invite more countries to the Forum to enrich the discussions and experiences.

Finally, it was mentioned that the current State of play in the international tax reform movement requires the strengthening of tax diplomacy, which implies building the capacity not only of experts but negotiations and policy makers. The South Centre stands ready to facilitate building partnerships among developing countries to promote shared positions in the international fora and produce research outcomes that could cover part of the demand of thematic priorities identified by developing countries.
