

## The Entitlement to Tax - A critical commentary to the development of the international tax regime

Yvette Lind<sup>1</sup>

*Copenhagen Business School, Denmark*

As a result of the significant need for additional discussions on the inequality which currently shape international tax matters, Copenhagen Business School hosted a conference concerning inequality within the international tax regime in September 2020. The conference brought together researchers at the forefront of their respective fields to identify, discuss, and to underline future challenges associated to inequality in the international tax context. This special issue is an outcome of papers presented at the conference and concerns the relationship between developing and developed states with an emphasis on present shortcomings when allocating taxing rights in a fair and sustainable manner.

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### Background

The OECD model tax convention on income and capital (OECD MTC)<sup>2</sup> is considered normative within the international tax regime, and consequently also shapes large parts of individual states' tax treaty networks (Steenkamp 2017; Whitaker 1982-83). As the OECD and G20 countries are currently shaping the international tax regime through the ongoing Base Erosion and Profit Shifting (BEPS) project, concerns regarding the equality, or more accurately: inequality between developing states and developed states have been raised. There is a tangible unequal relationship between developing and developed states, as the OECD MTC is generally perceived to advantage the global north, compared to the global south, when considering the allocation of taxing rights as well as the political influencing powers behind the design of the OECD MTC.

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<sup>1</sup> E-mail: [yl.law@cbs.dk](mailto:yl.law@cbs.dk)

<sup>2</sup> OECD Model Tax Convention on Income and on Capital of 2017.



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### **The historical background**

At the end of the colonisation era, developing states accepted to conclude tax treaties with their former subjugators as a part of their process to independence. These tax treaties were mostly based upon the prevalent OECD MTC. Research has shown that the former unequal power relationship between negotiating states was passed on in the tax treaty negotiation process. For instance, Martin Hearson has uncovered that tax experts from the UK dictated the terms of the tax treaties by insisting on source-restricting tax treaty provisions based upon the OECD MTC (Hearson 2016, 2017, 2018).

Provisions that evidently harmed the possibilities for developing states to establish and protect tax bases of their own as well as to raise sufficient revenues to prosper<sup>3</sup>. Tax treaty provisions such as these enable multinational enterprises (MNEs) and foreign companies to set up shops in developing states and harvest their natural resources while paying their taxes in the residence state (UK for instance) rather than paying in the source state (the developing state).

But why would developing states accept tax treaty provisions that harm their tax bases? The legal doctrine dealing with this issue indicates that there is no easy answer (Ring 2009, 2010; Hearson 2018), but some more general reasons are often touched upon. Without concluding any tax treaties at all they would not be able to attract foreign direct investment (FDI), and additionally be locked out of any influencing outside of their own domestic

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<sup>3</sup> Prosper in this context should be put in relationship with the fact that most African states currently suffer from extreme poverty.

arena. Furthermore, the OECDs blacklist of non-cooperative jurisdictions (the so-called tax haven blacklist) has also influenced developing states to agree more easily to tax treaty provisions that are not in their best interest, as they otherwise would be in the risk of being blacklisted.

The papers included in this special issue provide comprehensive analyses of the above-described development. In “*A Different Unified Approach to Global Tax Policy: Addressing the Challenges of Underdevelopment*” Ozai and Magalhães contribute with a commendable introduction to the historical development of international tax policies. Illustrating how the global north has taken to foster the global south and aided through the implementation of legal transplants gathered from the north. And as with the case of legal transplants in general, many of these tax mechanisms have failed to factually assist the tax systems and the financial development of the south as they have been implemented without any consideration to differing legal cultures, nor the specific prerequisites within these individual states. International tax policy enforces the perception of developing states being a homogenous group rather than individual states and perpetuate that the challenges imposed on these states are of a purely domestic nature rather than acknowledging the unequal relationship stemming from, for instance, past colonialism.

Emblad eloquently links into this reasoning when exploring the relationship between states in the north and the south in his paper “*Power and Sovereignty - How economic-ideological forces constrain sovereignty to tax*”. Through the inclusion of the term ‘economic-ideological forces’ he explores the currently unequal relationship through the lens of tax sovereignty. This critical analysis concludes that the concept of sovereignty has become a tool for maintaining established power relations in-between states. As a conclusion, the author advises states in the south to break free from this understanding of sovereignty in the hope of revising the international tax order. Moreover, proposing alternatives on how states may allocate taxing rights between themselves in the hope of a fairer outcome between the north and the south.

### **Critical review of the BEPS project**

One of the most prevalent tax policy challenges that the global south face today, is to establish and maintain sustainable revenue sources to fund their domestic expenditures (Ault and Arnold 2017). While this problem is highly

complex, a central aspect is the protection of the domestic tax base. Below are some general examples of why it is difficult for developing states to build and protect their tax bases.

Initially, hybrid mismatches<sup>4</sup> play a central part within the BEPS project (Ault and Arnold 2017), and it has been argued that developing states should unquestionably be included in this work as source taxation is key when attempting to neutralize these tax arrangements (Harris 2017). When combatting hybrid mismatches it is key to interpret other state's domestic tax laws to eliminate these mismatches. However, developing states may, due to various reasons, be less inclined to do so. One reason is the lack of expertise and funding regarding the administrative capacity. Another reason may also be that many developing states are less concerned about scrutinizing the incomes (FDI for instance), and this includes tax haven-based sources as they are in more dire need to attract it and cannot afford to be selective (Harris 2017). This situation, in combination with an underdeveloped and/or underfinanced tax administration, make it challenging and occasionally undesirable to investigate the origin of inflowing capital. The same reasoning applies to the withholding of taxes on outflowing sources of income.

Moreover, permanent establishment (PE)<sup>5</sup> does, not unexpectedly, pose a problem for developing states when dealing with MNEs. There are multiple ways in which a MNE (or any other non-resident) can circumventer the creation of a PE. To exemplify, a non-resident may offer services in various locations, each for less than six months at a time, thereby bypassing the 183 days-rule.<sup>6</sup> The BEPS project, specifically Action Plan 7, does not provide the best solutions when considering developing states, partially a result of the predominance of tax principles that favour residence states within the OECD MTC. It has further been argued that the proposals set out in BEPS Action Plans 7-10 (combination of PE and transfer pricing rules) will continue to promote residence taxation over source taxation, and thus also promote developed states compared to developing states (Jiménez 2017).

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<sup>4</sup> Hybrid mismatch arrangements occur when two, or more, jurisdictions characterize an entity or transaction in differing ways. Resulting in differing tax outcomes that can be exploited by the taxpayer in question.

<sup>5</sup> A permanent establishment is a fixed place of business where work is performed or from where the business is managed and gives rise to income or value-added tax liability in a particular jurisdiction.

<sup>6</sup> Regulated in Article 5(3b) in the UN MTC.

Additionally, country-by-country reporting (CBCR)<sup>7</sup> is also problematic from a developing state perspective. Many states are not equipped to implement, or execute, this type of information exchange. The obvious hurdles are, as already mentioned, the lack in expertise, funding, and technical updating of local tax administrations. Developing states have already flagged for the difficulties in withholding taxes due to these reasons.

Riccardi Sacchi analyses the ongoing work at international level in her paper “Implementing a (global?) minimum corporate income tax: an assessment of the so-called “Pillar Two” from the perspective of developing countries”. With the objective to focus on the BEPS project, Pillar Two in particular, she assesses the Global Anti-Base Erosion (GloBE) proposal from the perspective of developing states. This analysis comprises not only the international tax context in which the GloBE proposal have emerged but also the policy rationale and mechanics behind the rules constituting the GloBE package. Her insightful analysis concentrates in particular on the income inclusion rule, the ordering criterion and the introduction of substance carve-outs. She concludes that the ambition of the GloBE proposal to foster economic development is at the very least doubtful and poses the question of whether Pillar Two is necessary at all.

### **Case study of Latin-American tax jurisdictions”**

Navarro Ibarrola analyses the practise of granting of corporate income tax incentives as a means of attracting FDI from a Latin-American perspective in his paper “*Tax sparing clauses and their descent: evidence from the Latin-American tax treaty network*”. The paper examines the rationale of tax sparing, as well as the relevance of this policy instrument in the Latin-American tax treaty network, by analyzing all clauses adopted in it. The paper contributes with additional insights concerning the decline and plausible collapse of tax sparing clauses in Latin-American tax treaties due to the enforcement of CFC rules and the possible adoption of an income inclusion rule as proposed in the OECD GloBE proposal (Pillar 2) and should be of great interest to international tax scholars in general.

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<sup>7</sup> BEPS Action Plan 13.

## Some final words

The ongoing pandemic has had a significant (economic) impact on most states, yet it has had a devastating impact on developing states considering their pre-existing vulnerability and hardships. How this will affect future developments of the international tax regime, e.g. if there will be more concessions made to the developing states or if there will be introduced some compensation/transferring functions, remains to be seen.

This special issue aims to highlight tax issues specifically targeting the global south, yet there is still great need for additional research in these matters. The majority of these papers concern corporate taxation, as this is central for ongoing developments at the international level. However, it should be mentioned that corporate taxation is less prevalent to tax systems in developing states compared to those in developed states. Highlighting an additional discrepancy which is in a dire need for the attention of international tax scholarship.

The terminology of developing states has been used in this editorial, yet it should be emphasised that this does not indicate an ignorance to the complexity of the meaning and application of the terminology. Instead, it should be underlined that this in itself is a matter worthy of more attention and acknowledgement as the global south consists of a multitude of differing jurisdictions with differing backgrounds and needs.

In conclusion, the contributions of this special issue can assist in some of the described matters in addition to adding valuable insights through these differing research topics.

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### Notes on contributor

Jur.dr. Yvette Lind is an Assistant Professor in Tax Law at Copenhagen Business School. Associate editor at the Nordic Journal of Law and Society. Her areas of expertise primarily concern various aspects of international taxation, social insurance law, EU state aid provisions, environmental taxation, and constitutional law. TaxCOOP 35 Leaders of the Future Laureate in 2020. Member and coordinator for the CBS Interdisciplinary research group on Taxation and Fiscal Policy (CBS Tax Group).