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Lessons from EU-third country Tax agreements: effects on money laundering, tax evasion and avoidance

Good afternoon. I wish to thank the chairman and the TAX3 Committee for the opportunity to share my views on the lessons learnt from EU-third countryTax agreements and their effects on money laundering, tax evasion and avoidance.

Due to time and my not too wide experience I will be speaking from the lessons learnt from the African perspective. In this presentation I am presuming that Tax Agreements basically refer to bilateral and in particular contexts to multilateral tax treaties.

Tax agreements which basically take the form of Double Taxation Agreements have a long history and they have had tremendous effect on international trade and investments and led to the development of international treaty practice all over the world. Many developing countries especially African countries however are now developing rules, procedures and capacity in this area. As a result of the increasing importance of tax treaties a model tax treaty has been developed by the African Tax Administrators forum as an alternative to the two main international model tax treaties: the UN Model Tax treaty and the OECD Tax treaty model. There are wide areas of convergence among these models as their aim is to encourage investments in source countries but at the same time eliminate double taxation and prevent tax evasion and abuse. However significant differences exists between them especially between the UN and OECD Models.

The original aim of tax treaties was to eliminate double taxation and address tax avoidance and evasion. The 2003 updated commentary to Article 1 of the OECD Model provides that "*the principal purpose of double taxation conventions is to promote, by eliminating international* *double taxation, exchanges of goods and services, and the movement of capital and persons. It is also a purpose of tax conventions to prevent tax avoidance and evasion*."[1]

Suffice it to say that the world of international tax has moved on beyond this original purpose and the current 2017 OECD Model Tax Convention with the inclusion of the BEPS provisions has radically changed the complexion of Tax Treaties.

The question to ask is whether these early Tax Agreements between EU and third countries did achieve their aim of avoiding double taxation and prevented tax evasion and avoidance. My experience with implementing some of these treaties in Ghana(Ghana has nine treaties currently in force and apart from the Republic of South Africa the rest are all with EU countries) and I presume some other countries in Africa was that theses tax treaties substantially achieved their aim of eliminating double taxation especially for the residents of EU countries. Research and practice did however show that these treaties did not adequately address the issue of tax evasion and avoidance and possibly may have facilitated money laundering in some cases.

Some of the old treaties between EU countries and developing countries enabled big multinational enterprises to develop tax avoidance strategies that exploited the gaps and mismatches in tax rules especially that of developing countries to artificially shift profits to low or no no-tax jurisdictions. The net effect was a reduction in viable tax revenues available to low income governments for investments in physical and social infrastructure that would have aided in economic growth and development.

Developing countries lack of capacity in negotiating and administering tax agreements were exploited to the maximum by actors in the international tax arena with the requisite expertise and financial muscle. An example can be found from the research study by the international charity ACTION AID which detailed the elaborate tax planning that multinational enterprises employed to avoid paying low or no taxes in the countries they operated through the exploitation of the provisions of tax treaties in five different countries.

It has been noted that advances in technology and communication which made physical presence no longer a relevant consideration in the operations of multinational enterprises created scenarios

[1] Commentary to OECD 2017, art 1, Para 54.

where an enterprise could have substantial economic presence in a jurisdiction without that jurisdiction having a legally recognized taxing right. Such a situation created fertile grounds for tax avoidance schemes to flourish.

The development of the OECD BEPS Action plan and its implementation is a clear admission of the failure of tax treaties in combating tax evasion, avoidance and money laundering. In fact previous UN Tax Committees in discussing updates to the UN Model Tax Treaty had raised concerns of the erosion of the tax base of developing countries with the prevailing OECD and UN models at the time and sought albeit not too successfully to put it on the international tax agenda.

So now the world has a new global tax outlook with the advent of the OECD BEPS project. This project was developed to tackle multinational enterprises' ability to use the existing international tax rules to generate non-taxed or low-taxed income. So new international tax rules were developed and are being implemented. Are these sufficient to tackle the issues of tax evasion, avoidance and money laundering? For developed countries and by extension EU countries the answer may be yes. But I do not believe that third countries not originally part of the development of the new rules would have their problems with the old tax rules sufficiently addressed. Why am I not convinced ?

The BEPS Action plan states unequivocally that: *" while actions to address BEPS will restore both source and residence taxation in a number of cases where cross border income would otherwise go untaxed or would be taxed at very low rates, these actions are not aimed at changing the existing international standards on the allocation of taxing rights on cross border income."*

According to the "*United Nations Handbook on Protecting the Tax Base of Developing Countries"2nd Edition:* developing countries are primarily (though not exclusively) concerned with the reduction in source based income taxation rather than the shifting of domestic income of locally owned companies to low or no tax jurisdictions. And the UN Model Tax Convention generally favors retention of greater "source country" rights under a treaty as compared to those of the "residence country" of the investor. This position is crucial to developing countries in their treaty negotiations. The interesting conundrum we are faced with is a new international tax order developed by developed countries for developed countries with indirect benefits for developing countries if they have the capacity to assess the benefits(which they do not have) but being implemented as the new global standard applicable to all countries.

The UN identified the following issues as of particular concern to developing countries not directly addressed in the BEPS project:

1. The taxation of capital gains by source countries on the indirect transfer of assets located in their countries
2. The taxation of fees for technical services by source countries
3. The taxation of rents and royalties(payments for the right to use tangible or intangible property) by source countries
4. Use of statutory general anti avoidance rules in domestic law to stop taxpayers from using abusive tax avoidance arrangements and their relationship with the provisions of tax treaties
5. Tax incentives(the availability of harmful preferential tax regimes) identified as a BEPS issue but not considered in the Action plan.

In seeking to implement the new international rules to combat base erosion developing countries must balance the need to attract investment against the necessity of protecting the tax base. In addition considerations of practical implementation should be taken into account to avoid measures that would complicate tax collection and result in raising costs for the source country residents. This might end up making tax evasion and avoidance more lucrative and worth the risk of engaging in it.

CONCLUSION

What lessons do we pick from EU third party agreements?

The Addis Agenda calls for improving the fairness, transparency, efficiency and effectiveness of tax systems including through broadening the tax base and fighting tax avoidance and evasion. This cannot be achieved unilaterally given the globalized nature of trade, investment and finance. The Addis Agenda emphasizes the importance of international tax cooperation which should be universal in approach and scope and should fully take into account the different needs and capacities of all countries.

I would be the first to admit that developing countries have in the past been unable or incapable(and are still severely handicapped) of engagement and effective participation in international tax policy discussions. But to efficiently tackle the issues of tax evasion, avoidance and money laundering not only must their capacity be enhanced but they must be equal participants in the development of the rules of international taxation and not mere consumers whose views are sought merely for the appearance of broad consultation.

Thank you

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