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Special meeting on international cooperation in tax matters

Summary record of the 16th meeting
Held at Headquarters, New York, on Friday, 7 April 2017, at 10 a.m.

President: Mr. Shava . . . . (Zimbabwe)

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The meeting was called to order at 10.10 a.m.

Agenda item 13: Implementation of General Assembly resolutions 50/227, 52/12 B, 57/270 B, 60/265, 61/16, 67/290 and 68/1

Agenda item 18: Economic and environmental questions

(h) International cooperation in tax matters

Opening remarks by the President and the Under-Secretary-General for Economic and Social Affairs

1. **The President** said that the Addis Ababa Action Agenda of the Third International Conference on Financing for Development, which provided a holistic and coherent framework for financing the 2030 Agenda for Sustainable Development, recognized taxation as one of the most important ways for developing countries to mobilize domestic resources for investment in sustainable development, and contained a commitment to improve the transparency, efficiency and effectiveness of tax systems. The current meeting would serve to highlight national, regional and international efforts to improve international tax cooperation, combat illicit financial flows and strengthen the institutional arrangements for promoting cooperation. It would also provide an opportunity to highlight the major accomplishments of the current members of the Committee of Experts on International Cooperation in Tax Matters, whose term would expire in June.

2. **Mr. Wu Hongbo** (Under-Secretary-General for Economic and Social Affairs) said that the current meeting would allow Member States to be updated on the most recent developments in international cooperation in tax matters before they delved into negotiations at the second Economic and Social Council forum on financing for development follow-up, to be held in May.

3. The current members of the Committee would leave an impressive legacy. They had reviewed and updated the United Nations Model Double Taxation Convention between Developed and Developing Countries, which would be issued in its revised form by the end of 2017. To complement the United Nations Model Convention, the Committee had produced the *United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries*, a compact training tool designed to provide guidance for tax treaty negotiators in developing countries. It focused on the stages of capacity development of developing countries and was particularly useful for developing countries that negotiated on the basis of the United Nations model. The Committee had completed its revision of the *United Nations Practical Manual on Transfer Pricing for Developing Countries*, which assisted policymakers and administrators in dealing with complex transfer pricing issues, as well as taxpayers in dealing with tax administrations. Lastly, the Committee had approved the guidelines contained in the forthcoming handbook on taxation of the extractive industries in developing countries, which would be launched in October. Natural resource extraction was a key factor in countries' ability to mobilize domestic resources. The handbook was designed to correct the asymmetry in specialist information and expertise in that area between multinational companies and developing countries, as well as between developed and developing countries.

4. Capacity development was needed for normative changes to have an impact. Implemented by a broad range of stakeholders, the United Nations capacity development programme in international tax cooperation was aimed at strengthening developing countries' capacity to build more effective and efficient tax systems, in accordance with Economic and Social Council resolution 2017/2. With a focus on double taxation treaties, transfer pricing and tax base protection for developing countries, the programme largely drew on the outputs of the Committee, operationalizing them for the benefit of developing countries.

5. The Platform for Collaboration on Tax, launched jointly by the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD), the United Nations and the World Bank Group in 2016, was designed to strengthen those organizations' cooperation on tax issues, as well as their ability to provide capacity-building support to developing countries. The Platform had made progress on several fronts, including preparations for a global conference to be held in February 2018 at United Nations Headquarters on the theme of taxation and the Sustainable Development Goals.

6. Since the term of the current membership of the Committee would come to an end in June, the process of selecting new members was under way, in accordance with the provisions of Economic and Social Council resolution 2004/69.

Keynote address

7. **Ms. Rubagumya** (Commissioner of Legal Services and Board Affairs of Uganda), delivering the keynote address and accompanying her statement with a digital

slide presentation, said that development financing in Uganda and most other African countries relied heavily on taxes. Ideally, 100 per cent of taxes should be collected from domestic resources, but currently the figure for African countries overall was approximately 70 per cent. Domestic resource mobilization was therefore focused on international taxation, in particular, enhancing compliance with transfer pricing regulations, preventing treaty abuse, and redesigning policies, which were frequently out-of-date and did not meet the demands of international taxation.

8. Various challenges hindered developing countries' efforts to make the most of taxation. Treaty abuse was widespread; since many tax treaties were outdated and did not reflect the work done by the United Nations and OECD, treaty shopping was prevalent. Another problem was the lack of information about the global activities and operations of multinational entities and the difficulty in finding comparable data for use in transfer pricing cases. Multinational enterprises created cash boxes in preferential tax jurisdictions, collecting interest and royalties without having a substantial presence or creating value there, thus eroding developing countries' tax bases.

9. Domestic resource mobilization was also undermined by limited financing for capacity-building, and developing countries lacked sufficiently expert staff. Owing to the complexity of international taxation, it took approximately four years to build tax officials' expertise to the requisite level. While better systems for taxation of income from extractive activities could potentially transform the revenues of developing countries with significant oil reserves and other natural resources, those taxing rights were often an area of dispute that ended up in costly international arbitration cases, such as *Uganda v. Heritage Oil*.

10. Online transactions, which were accounting for ever higher proportions of sales, could become another source of international tax revenue. Currently, entities that conducted business online, such as Amazon, could not be taxed by the Governments of the countries where they sold their products. News, entertainment and e-commerce websites, as well as YouTube channels, should be paying taxes to national Governments. However, neither domestic tax laws nor tax treaties contained provisions dealing explicitly with e-commerce. Even if provisions were established, enforcing compliance would present administrative challenges, especially with regard to emerging technologies, such as cloud computing, and hard-to-track intangibles.

11. The way forward was increased dialogue between developing countries, which must speak out in unison in order to resolve their common challenges. Policies and treaties must strike the right balance between maintaining source taxing rights to protect revenue and reducing tax barriers to encourage investment. Guidelines on contract negotiation and policy design for the extractive and other natural resource-based industries were especially vital. In addition, a common approach to the imposition of capital gains tax on transfers of interests in the extractive sector would benefit developing countries with natural resources. Treaties should be renegotiated to include robust limitation of benefits clauses, and clear language on the prevention of treaty shopping should be incorporated into developing countries' legal systems.

12. The United Nations should play a leading role in providing much-needed capacity-building support to national tax authorities of developing countries. She stressed the need for a framework to ensure that revenue authorities benefited from the Committee's work and recommendations on policy design and administrative reform, and for more timely and effective exchanges of information. Toolkits on various tax-related subjects should be widely circulated. She urged the United Nations to increase its capacity-building collaboration with the African Tax Administration Forum.

13. In conclusion, she said that domestic resource mobilization was crucial to transforming developing countries' economies. While that entailed many challenges, efforts to find solutions were under way.

Interactive dialogue: "United Nations Model Double Taxation Convention between Developed and Developing Countries (UN Model)"

14. **Mr. Lennard** (Secretary of the Committee of Experts on International Cooperation in Tax Matters), moderator, opening the dialogue, said that both the country where a company made its profit and the country where the company was resident were entitled to tax its profits. However, double taxation was problematic because it deterred investors. One of the countries had to relinquish some of its rights to tax in order to achieve the right balance between promoting investment and supporting development in developing countries, many of which used the tax revenue from foreign investment to build such essential facilities as hospitals and schools. The Committee of Experts on International Cooperation in Tax Matters, through the United Nations Model Convention, sought to provide guidance on determining that balance.

15. **Mr. Lara Yaffar** (Chair of the Committee of Experts on International Cooperation in Tax Matters), panellist, said that the work of the Committee over the past year had focused on revising the United Nations Model Convention to ensure that countries' ability to raise revenue for development was not hindered, and that double taxation treaties did not result in the reduction of their tax bases. Changes were going to be introduced to the United Nations Model Convention to establish when a company had the right to the benefits of a double taxation treaty, and to enable tax authorities to deny that right to a company when the primary purpose of its operations was to obtain a tax benefit, as opposed to a commercial benefit. Under the revised Model Convention, States could also choose not to grant tax benefits originally provided for by a treaty if they changed their tax system or tax benefits in order to obtain revenue beyond what had been negotiated or agreed at the outset.

16. The Committee would begin to strengthen the criteria, contained in various double taxation treaties, for determining when countries where wealth was generated had the right to tax. One such criterion was "permanent establishment", however, companies often avoided becoming permanently established through falsification or fragmentation of activities. The Committee was considering the extent to which the United Nations Model Convention should address that issue.

17. In order to increase the tax bases of developing countries, the Committee had decided to establish clear criteria for collecting taxes on payments for technical services; although not covered by the OECD Model Tax Convention on Income and on Capital, 2014, such criteria would provide developing countries with a valuable tool.

18. There were other problems that contributed to tax base erosion. The primary problem was companies opting to be based in one country for tax purposes, but actually having their centres of operations in another, in order to choose the more favourable of the tax systems. The Committee had put in place provisions that enabled tax authorities to analyse such situations and determine whether they could consider companies resident for tax purposes in order to obtain the benefits of double taxation treaties.

19. Companies used hybrid mismatch arrangements to exploit differences in different countries' tax systems. There was currently no equation to ensure that for each deductible in one country, there was a corresponding taxable amount in the other. The Committee had therefore added certain provisions to the United Nations Model Convention to prevent erosion of the tax base in that way.

20. In addition to its work on base erosion and profit shifting and transfer pricing, the Committee had worked to strengthen cooperation mechanisms for combating tax avoidance and evasion through the exchange of information. It had established the necessary parameters to achieve international cooperation in diverse areas, and had proposed to the Economic and Social Council that it could issue a code of conduct. The proposed code of conduct would establish commitments, which countries could incorporate into their national legislation, regarding the primacy of exchange of information and the development of mechanisms to make it effective. Above all, legislation should provide for the automatic exchange of financial information. Information should be shared when tax authorities requested it, but there should also be a mechanism for the automatic distribution of information that might be useful to other tax authorities, even when those authorities had not specifically requested it.

21. **Ms. Peters** (Coordinator of the Subcommittee on Base Erosion and Profit Shifting Issues for Developing Countries, Committee of Experts on International Cooperation in Tax Matters; and Policy Manager at Inland Revenue, New Zealand), panellist, accompanying her statement with a digital slide presentation, said that "base erosion and profit shifting" referred to strategies used by multinational enterprises to exploit gaps in tax legislation to artificially shift profits to no-tax or low-tax jurisdictions.

22. The United Nations Model Convention provided a blueprint for bilateral arrangements between countries under which each country gave up some of its taxing rights in the spirit of reciprocity. One of the issues that the Subcommittee on Base Erosion and Profit Shifting Issues for Developing Countries sought to address was "treaty shopping", which occurred when a third party took advantage of a bilateral tax treaty to which it was not a party. She provided a practical example of treaty shopping: "Company T", based in "State T", had an investment in "State S", which, under its domestic law, applied a 25 per cent tax on dividends. There was no treaty between State T and State S. Not wishing to pay the 25 per cent withholding tax, Company T developed an arrangement with a party resident in a third country, "State R", which did have a bilateral agreement with State S, in order to access the benefits of the bilateral treaty between States S and R.

23. Through the Addis Ababa Action Agenda, Member States had committed to improving the fairness, transparency, efficiency and effectiveness of tax systems; reducing opportunities for tax avoidance; and considering the insertion of anti-abuse clauses in all double tax treaties (paras. 22 and 23). The Subcommittee had issued a questionnaire to developing countries in order to find out what problems they faced with regard to taxation; the results showed that they faced the same problems as developed countries, with treaty abuse a major concern. In response to the expansion of the Subcommittee's mandate to include revising the United Nations Model Convention to prevent treaty abuse, it had proposed changes to the Convention which it expected to be incorporated into the 2017 update. The major changes it had proposed were a new preamble that established that treaties were not to be misused, and that specifically addressed the issue of treaty shopping; new articles to address specific types of treaty abuse; and the expansion of taxing rights to ensure that tax could be collected in the source State, where income was earned.

24. **Mr. Gomes Sambo** (Head of the International Cooperation Department, General Tax Administration, Angola), panellist, accompanying his remarks with a digital slide presentation and speaking about technical services covered by the United Nations Model Convention, said that Angolan domestic legislation provided for a withholding tax on fees for technical services; the rate was 6.5 per cent of the total value of the service. The tax was a major source of revenue for Angola, which attached great importance to foreign investment. Application of article 7 of the Model Convention to technical services would pose an administrative challenge, making it difficult to accurately tax payments. Capacity-building support must be provided to the tax administrations of developing countries if they were to combat tax avoidance. For instance, under the current United Nations Model Convention taxpayers, on the basis of the country's double tax treaties, could avoid the domestic withholding tax simply by avoiding permanent establishment in Angola.

25. The inclusion of a specific provision in the United Nations Model Convention to prevent taxpayers from avoiding permanent establishment status would provide countries such as Angola with a valuable tool to protect their tax bases. Such a rule would also be in line with most of the recent transfer pricing and base erosion and profit shifting recommendations designed to preserve source State taxing rights. Most countries that based their treaty policy on the United Nations Model Convention continued to face challenges in developing their tax administrations to be able to handle complex tax situations; often they had to cope with taxpayers who were able to avoid source State taxation through the use of international structures that allowed them to dodge permanent establishment.

26. The mismatch between the range of services covered by the withholding tax in Angola and those covered by the technical services fees provision to be included in the United Nations Model Convention would leave Angola in a difficult situation. The Convention should cover services such as maintenance, installation, specialized technical assistance and consultancy in a wide range of areas in order to ensure that payment for them was subject to the withholding tax rather than article 7.

27. **Mr. Romano** (Deputy Director General of the General Tax Directorate, Uruguay), panellist, accompanying his statement with a digital slide presentation and speaking about the impact of the United Nations Model Convention on developing countries, said that his Government had been actively working to develop tax policy in recent years, including by adopting a number of new tax treaties. International tax systems were important for Uruguay because it depended exclusively on tax revenue to fund its public policies.

28. The United Nations Model Convention, which was central to the development of tax policy for developing countries, differed from the OECD Model Tax Convention on Income and on Capital, 2014 in various ways. For instance, it defined "permanent establishment" more broadly, and its article 7, on business profits, attributed more revenue to permanent establishments, meaning that more of their income was taxable. Article 7 also contained an anti-abuse clause known as the limited force-of-attraction rule, which was useful for small tax authorities because it was often difficult to determine where business actually took place. Article 12 on royalties, which allowed for shared taxation on royalties, as well as articles 13 and 14 on capital gains and independent personal services, respectively, were also valuable for developing countries.

29. The new article 12A, on technical services, was a welcome addition: it would address harmful practices by allowing for shared taxation in the source country without requiring any threshold to be met by the service provider. The importance of ensuring that fees for technical services were taxable was illustrated by the following example: If a country had a 25 per cent tax rate and a company made a profit of 100 pesos, it would pay 25 pesos in taxes. However, if a

multinational company chose to purchase technical services through one of its outposts located in a low-tax jurisdiction, but where it did not have permanent establishment, and spent 75 pesos on those services, its taxable revenue would be only 25 pesos, meaning that it would only pay 6.25 pesos in taxes.

30. The problem was even more severe if consolidated taxation on dividends was factored in. To use the same example, if the first company paid dividends of 75 pesos to its shareholders, taxed at the rate of 7 per cent, the tax authority would receive 5.25 pesos in tax on the dividends, and would therefore receive a total of 25 plus 5.25 pesos, or 30.25 pesos. However, the second company's dividends would only amount to 18.75 pesos (its taxable revenue of 25 minus 6.25 in taxes) because the rest of its profit had been artificially transferred to a lower tax jurisdiction under the label of technical services. At the 7 per cent rate, the Government would receive 1.31 pesos in tax on the dividends, and would therefore receive a total of only 6.25 plus 1.31, or 7.56 pesos. The Government's inability to tax expenditure on technical services would result in base erosion of 30.25 minus 7.56, or 22.69. Given that many developing countries used tax revenue to fund their public policies and development programmes, it was extremely important to combat practices that led to tax base erosion; article 12A was therefore a valuable addition.

31. **Mr. Lennard** (Secretary of the Committee of Experts on International Cooperation in Tax Matters) said that the new article 12A was important because it was a step towards finding the right balance between encouraging investment and ensuring that investment provided revenue for developing countries. He asked the panellists what was on their wish list for an up-to-date future United Nations Model Convention.

32. **Mr. Lara Yaffar** (Chair of the Committee of Experts on International Cooperation in Tax Matters) said that it was important to monitor the effects of introducing the radical changes in article 12A into tax treaties. Changing the language of treaties would be only the first step; the real challenge lay in administration. Developing countries frequently adopted innovative policies but failed to apply them properly because their tax auditors did not have the requisite experience, expertise or qualifications. The United Nations Model Convention must be accompanied by a strong capacity-building programme and technical assistance. Above all, capacity-building should focus on the criteria considered in audits. It might be useful to organize forums in which tax authorities could collaborate and share their experiences in applying the new measures.

33. **Ms. Peters** (Coordinator of the Subcommittee on Base Erosion and Profit Shifting Issues for Developing Countries, Committee of Experts on International Cooperation in Tax Matters; and Policy Manager at Inland Revenue, New Zealand) said that it was important to maintain the balance between encouraging investment and preserving countries', particularly developing countries', legitimate rights to tax investment. It was necessary to continue to make changes in order to keep pace with the way multinationals operated globally, and with the best tax and treaty policies.

34. **Mr. Gomes Sambo** (Head of the International Cooperation Department, General Tax Administration, Angola) said that administrating tax treaties was the next challenge. The tax administrations of developing countries were much less prepared than those of developed countries and needed strengthened staff capacity in order to apply the new rules. The United Nations should provide that support.

35. **Mr. Romano** (Deputy Director General of the General Tax Directorate, Uruguay) said that a tax system was only as good as its administration. It was difficult for developing countries' tax administrations to contend with multinational groups, which often had much greater expertise in tax matters than they did. Therefore, he supported the establishment of a programme to support developing countries' efforts to build capacity in that critical area.

36. **Mr. Picciotto** (Emeritus Professor at Lancaster University and Senior Fellow at the International Centre for Tax and Development) said that the Committee was hampered by a lack of resources, despite the commitments made in the Addis Ababa Action Agenda. Although it had been agreed that it could meet twice per year, its full-time staff had only increased from one to 1.5 and there were no resources at all for its subcommittees, which were essential to the Committee's substantive work, and to preparations for its biannual meetings. The OECD Centre for Tax Policy and Administration, which did excellent work, had enormous resources by comparison. The imbalance between the organizations' resource levels must be addressed.

Interactive dialogue: "United Nations Practical Manual on Transfer Pricing for Developing Countries"

37. **Mr. Lennard** (Secretary of the Committee of Experts on International Cooperation in Tax Matters), moderator, said that transfer pricing was not a bad practice in itself but rather something that multinational enterprises had to do. What was bad, however — and what could be corrosive to development — was mispricing, or a shifting of profits

that prevented a developing country from achieving taxation on the profits created there because those profits appeared to have been made elsewhere, for example, in a tax haven. It was therefore vital to strike a balance between understanding that multinational enterprises did business among themselves in a very special way and ensuring that transfer pricing did not become mispricing to the detriment of developing countries and development.

38. **Mr. Sollund** (Coordinator of the Subcommittee on Transfer Pricing; and Director-General of the Tax Law Department, Ministry of Finance, Norway), panellist, accompanying his statement with a digital slide presentation, said that the *United Nations Practical Manual on Transfer Pricing for Developing Countries* had been launched in 2013 as a practical tool designed to assist the tax administrations of developing countries in tackling the difficult issue of transfer pricing. Since the Committee of Experts was not a body of Governments, the *Manual* was not a piece of legislation, or even soft law; instead, it was a response to the needs expressed by developing countries for clearer guidance on the policy and administrative aspects of applying transfer pricing analysis to some of the transactions of multinational enterprises.

39. Transfer pricing was not in itself an indication that there was something wrong or that there was abuse or mispricing; rather, it was a neutral term. In a globalized world, trade within multinational enterprises accounted for a substantial proportion of economic transactions, and the terms, conditions and prices of those intra-group transactions had a direct impact on the tax bases of the countries in which the various entities of multinational enterprises conducted their business. Consequently, it was very important for tax administrations to deal with those terms and conditions in a way that did not distort the allocation of tax bases among countries.

40. When companies traded in the market, they were exposed to market forces and to the different, and often opposing, interests of the parties to a transaction. But when the parties shared common interests because they belonged to the same group of companies, countries then needed tax rules to repair and adjust the distortive effects of the special relationships between the parties to a transaction. Article 9 of the United Nations Model Convention had established the arm’s length principle, under which transactions within a group were compared to transactions between unrelated entities, and the transactions between unrelated entities were used as a benchmark for adjusting profits where profits were reduced in a specific jurisdiction.

41. The existing *Manual* from 2013 contained chapters describing how international and multinational companies operated and what legal framework countries needed within their domestic law and in international treaties to deal with transfer pricing. It provided guidance on the practical aspects of operating the arm’s length principle, including price comparisons between controlled transactions and uncontrolled transactions, and measures to avoid and deal with disputes. It also described different methodologies that could be applied to the various situations and types of transactions that tax administrations might encounter. The 2017 update had a new four-part format, which comprised an introductory chapter putting transfer pricing and the arm’s length principle in an economic context; a second part containing substantive explanations on the application of the arm’s length principle; a third part on the administrative aspects; and a fourth part containing the special country practices. The new format would make it easier to add new elements, especially new sections in part four on the transfer pricing practices of different countries, especially less developed countries.

42. The updated *Manual* contained additional chapters on services, intangible assets, cost-sharing and business restructuring, and it took into account the outputs of the OECD Base Erosion and Profit Shifting Project, including the need to ensure that the allocation of taxation rights between jurisdictions reflected where the value was being created. It also contained revised guidance on comparability analysis and documentation, as well as an additional section on commodity transactions. With regard to documentation, country-by-country reporting had been added as a new element and the *Manual* described the legislation and practices of different countries in a neutral manner. In particular, the update contained information on the “sixth method” used by some countries in Latin America in dealing with commodity exports.

43. The *Manual* was linked to article 9 of the United Nations Model Convention concerning the taxation of associated enterprises. It explained the content of article 9 and was consistent with the commentary on that article. The commentary on article 9 would be amended in the 2017 update of the Model Convention to acknowledge the importance of the OECD transfer pricing guidelines. Since both the OECD model and the United Nations model established the same principle, the framework for dealing with transfer pricing should be the same regardless of whether a tax treaty was based on the OECD model or the United Nations model.

44. **Ms. Abdul Hamid** (Director of the Multinational Tax Department of the Inland Revenue Board, Malaysia), panellist, accompanying her statement with a digital slide presentation, said that the Manual's chapter on intra-group services was important for Malaysia, which faced many challenges as a service-recipient, rather than a service-providing, country, and as a country with many subsidiaries that paid management fees. Over the years Malaysia had been working to address those challenges and, to that end, it had embarked on transfer pricing in 2003. At that time, the Government's point of reference had been the OECD guidelines.

45. The benefit test was one of many hurdles faced by Malaysia owing to a lack of information and documentation, which meant that companies there found it difficult to demonstrate the test. Recipients were only able to submit claims that were relevant to them and there was no information on allocation keys. Malaysian subsidiary companies were also not privy to the methodologies applied in other jurisdictions. However, Malaysia was a signatory to the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports, which should help Malaysian companies to overcome those difficulties by facilitating information sharing. Other challenges were related to the fact that intra-group services were based on the percentage or proportion of sales and did not take into account the Malaysian efforts in actually acquiring those sales. Furthermore, as in most developing countries, there was a lack of publicly available information on service comparables such as labour costs. Lastly, Malaysia might consider safe harbour options in the future but, for the time being, it was unable to do so because it did not have published industry rates to use as a benchmark. As a result, data gathering would be required to determine what was an appropriate safe harbour.

46. **Mr. Lennard** (Secretary of the Committee of Experts on International Cooperation in Tax Matters) said that there were many legislative, information, skills and other gaps between developing and developed countries and between developing countries and multinational enterprises. The *Manual* was aimed at addressing those gaps.

47. **Mr. Obell** (Chief Manager of the Transfer Pricing Audits for Large Taxpayers, Revenue Authority, Kenya), panellist, accompanying his statement with a digital slide presentation, said that multinationals played a key role in the Kenyan economy as in other developing countries. In Kenya, a number of trends had been noted with regard to those enterprises, including the fact that they were reporting consistent business and tax losses year on year even though their businesses were undergoing sustained capital expenditure expansion. Capital deduction claims were high, as were tax refund claims. Many multinationals within Kenyan jurisdiction had offshore entities in low-tax jurisdictions, and tax yields in the extractive sector were low.

48. Legislative gaps were a key challenge for Kenya, which had lost cases in the past owing to a lack of effective transfer pricing legislation. It was also grappling with a lack of available data on multinationals, including information on how they were structured and where they reported profits, and a lack of comparable data. Moreover, the country lacked the technical capacity to deal with transfer pricing and did not have the resources for testing benchmarking. To address those challenges, the Government had improved its legislation and, in 2009, had formed a team of 24 experts to deal with cases of transfer pricing.

49. However, additional measures were needed to address the challenges facing the country. Further strengthening of transfer pricing legislation would be critical; to that end, the Government was working closely with OECD and was using the *United Nations Manual*. In particular, it was focusing on proper risk identification and risk analysis. A member of the Global Forum on Transparency and Exchange of Information for Tax Purposes, Kenya was working with the United Nations, OECD and development partners to build capacity through training and workshops, and was investing in benchmarking tools.

50. **Mr. García Balda** (Coordinator of International Taxation, International Tax Service, Ecuador), panellist, said that, as a developing country and capital importer, Ecuador faced many risks, including those relating to the overvaluing of payments, intangible assets, intra-group services and financial services, all of which were causing tax base erosion. A raw material producer, Ecuador was the victim of undervalued prices, failure to apply the arm's length principle and triangulation. The latter did not occur purely in relation to tax havens; in some cases, countries with which Ecuador had concluded taxation treaties were using those treaties not as protection against double taxation but to avoid paying taxes in either country. All of that was causing further erosion of the national tax base.

51. Like many developing countries, Ecuador suffered from capacity gaps. To tackle that problem, it had reformed its taxation system and had amended its tax regulations and transfer pricing rules to make it easier for the tax authorities to impose the correct

taxes. It had also been offering training to increase the number of transfer pricing experts in the tax authorities. However, limited access to international databases continued to act as an obstacle and Ecuador had few comparables in the Latin American region. It was difficult for the authorities to make the necessary profit adjustments when they lacked information about companies in other countries. In addition, there was no defined risk matrix for transfer pricing as the country lacked the required technical data and accurate values. The tax authorities in Ecuador were using the *United Nations Manual* to improve their control processes and deepen their knowledge of transfer pricing issues.

52. **Mr. Paul** (World Health Organization) said that tobacco multinationals were among the most profitable companies in the world and tobacco usage was the single most preventable cause of death worldwide. Tobacco multinationals used transfer pricing as a tax avoidance scheme to reduce profits, which essentially represented lost revenue that could have been used for health. He wondered whether there was a way to help countries to use the *United Nations Manual* to look into that issue, given that tobacco multinationals operated across the world and the global economic cost of smoking was approaching $1.4 trillion per year.

53. **Mr. Lennard** (Secretary of the Committee of Experts on International Cooperation in Tax Matters) said that the *Manual* had not been drafted on the basis of an industry-by-industry approach but rather focused on how business was organized.

54. **Mr. Sollund** (Coordinator of the Subcommittee on Transfer Pricing; and Director-General of the Tax Law Department, Ministry of Finance, Norway) said that transfer pricing was a very important area in taxation for many industries, including the tobacco industry. The *Manual* should provide some general guidance for tax administrations as they addressed the issues that arose in dealing with the tobacco industry.

Interactive dialogue: "Handbook on the taxation of extractive industries in developing countries"

55. **Mr. Lennard** (Secretary of the Committee of Experts on International Cooperation in Tax Matters), moderator, said that a handbook on the taxation of extractive industries in developing countries would be released in October. The Subcommittee on Extractive Industries Taxation Issues for Developing Countries was the engine room of much of the work on extractive industries, as it was able to work intersessionally. In addition, its work had included the participation of non-governmental organizations and business.

56. **Mr. Mensah** (Coordinator of the Subcommittee on Extractive Industries Taxation Issues for Developing Countries; and Assistant Commissioner, Revenue Authority, Ghana), panellist, accompanying his statement with a digital slide presentation, said that extractive industries were a very important source of revenue for developing countries but many of those countries were unable to reap the benefits of having such rich resources, especially in the area of taxation. The Subcommittee on Extractive Industries Taxation Issues for Developing Countries had been established to assist developing countries in generating the necessary revenue. Specifically, it had been mandated to consider, report on and propose draft guidance on extractive industry taxation issues for developing countries. To that end, it had produced an overview note and eight guidance notes on various topics approved by the Tax Committee, all of which would be incorporated into the handbook on extractive industries taxation issues for developing countries, to be released in October.

57. The overview note drew attention to some of the taxation issues affecting the extractive industries in developing countries and gave information on the options available according to the particular circumstances in a given country. The note was designed to build awareness of the issues, assist policymakers and administrators in developing countries and provide information to other stakeholders. It gave an overview of mining and oil and gas industry structures to provide context for designing and administering a tax regime. Above all, the tax and fiscal system should ensure that the Government obtained an adequate and appropriate share of the benefits from the country's resources while providing a return commensurate with the risks borne and functions carried out by the parties.

58. **Mr. de la Rey** (Senior Specialist, Revenue Service, South Africa), panellist, said that the guidance note on fiscal take in the extractive industries would constitute a separate chapter in the handbook. The note provided context on how value derived from natural resources could be shared between Government and investors, and gave an overview of the issues arising for the types of Government take available. Fiscal payments by the extractive industry played a critical role in resource-rich countries; those payments could be in the form of income taxes, royalties, infrastructure development or the funding of projects for the benefit of local communities. Relevant aspects when designing and implementing a fiscal regime included risk and return, predictability, long-term perspective, flexibility and timing of tax revenue collection. The note also

addressed important considerations from the perspective of both resource holders and investors, and covered implementation aspects such as a dedicated tax office focusing on the extractive industry and the importance of early-stage monitoring and auditing.

59. The guidance note on tax aspects of negotiation and renegotiation of contracts pointed out that, in many developing countries without laws governing investment and the fiscal terms of natural resource activities, the terms were negotiated and reflected in a contractual agreement between investor and Government. The note gave an overview of the tax and fiscal issues faced by developing countries in negotiating and renegotiating long-term natural resource contracts. It also highlighted country and investor perspectives and the practical aspects of successfully negotiating contracts. It explained the need for contracts to be flexible enough to self-adjust as circumstances changed and the need for tax authorities to be involved to ensure consistency with sound tax policy and administration.

60. The guidance note on transfer pricing issues in extractive industries identified issues that could arise during the entire life cycle of an extractive project and suggested solutions for addressing those issues. Generic case examples were given and the note described the value chains of mining and mineral extraction, and production of oil and natural gas. The note also gave mining-specific case examples which covered issues such as price fluctuations, inter-company financing and the sale and leaseback of equipment.

61. **Mr. Mensah** (Coordinator of the Subcommittee on Extractive Industries Taxation Issues for Developing Countries; and Assistant Commissioner, Revenue Authority, Ghana) said that the guidance note on selected tax treaty issues for the extractive industries drew on material from both the United Nations and OECD models, and provided guidance on the international tax issues that could arise given that extractive activities often included cross-border elements affecting the taxes payable by those industries. The guidance note on permanent establishment issues for extractive industries provided an overview of permanent establishment tax aspects and dealt mainly with the oil and gas industry. The other guidance notes covered value-added tax issues (which could have an impact on attracting investment), the taxation of indirect asset transfers, and tax treatment of decommissioning in the extractive industries.

62. **Mr. Lennard** (Secretary of the Committee of Experts on International Cooperation in Tax Matters) said that decommissioning was important because it addressed the role that the tax system played in protecting the local area and community when the life of a mine or oil and gas facility came to an end.

63. **Mr. Pérez-Gómez Serrano** (Director of Transfer Pricing Audits, Tax Administration Services, Mexico), panellist, accompanying his statement with a digital slide presentation, said that there was only one time to correctly tax non-renewable resources, and Mexico was not alone in facing challenges in ensuring that taxes were paid in the right amount and at the right time. The national mining industry accounted for 8.5 per cent of the country's gross domestic product and was a key component in the national tax base. The industry was also a source of concern because it was a high-profit business and there was evidence of mispricing, in terms of both underpricing of commodities and overpayments of services and intangibles among related parties.

64. Mexico faced a number of difficulties in tackling taxation issues in the extractive industry, including challenges related to the definition of related parties, subjectivity in the application of transfer pricing methods, financial transactions and low-tax jurisdictions. To address those issues, the Government was working with the United Nations to establish clearer legal definitions and streamline its legislation and rules. In addition, Governments should not insist on transfer pricing methods that were not applicable and were highly subjective, such as the transactional net margin method. Transfer pricing was becoming more complex. As a result, training was needed but, in addition, risk assessment was vital, and countries needed to use all available tools including country-by-country reporting. Lastly, revenue from the industry should be used wisely because it would not last forever.

65. **Ms. Chatel** (Associate Chief, Tax Treaties and International Tax, Revenue Agency, Canada), panellist, accompanying her statement with a digital slide presentation, said that the oil and gas sector was a very important source of revenue for the Canadian authorities and generated income tax, indirect taxes, royalties and land sales. Royalty taxation in the Canadian provinces had changed and royalties were now based on net earnings instead of gross earnings, which was seen by the industry as a positive change.

66. Over the years, Canada had designed a tax system that recognized the specificities of the oil and gas industry, including its price volatility, cyclical nature and the fact that it was capital intensive. Recently, there had been a shift away from tax incentives in the

non-renewable sector in order to place the emphasis on neutrality and to have the market focus on where it was most productive. By contrast, there was increasing pressure to develop incentives for the renewable energy sector, which had been announced in the most recent national budget. Canada had suffered significant tax revenue losses as a result of loopholes in the taxation of gains that derived their value from mineral rights and oil and gas rights. However, the forthcoming handbook addressed that issue through the indirect taxation of assets.

67. A number of strengths had been identified in the Canadian taxation system. In particular, the country had many auditors and other experts specialized in the taxation of natural resources, and taxpayers appreciated being able to deal with tax auditors who understood the business. Canada had also adjusted its tax system to the business. The system was complex, given that both the provinces and the national Government were taxing resources. However, complexity went hand in hand with a comprehensive system.

The meeting rose at 1.05 p.m.