UN, OECD, IMF, U.S. Treasury and IFA International Tax Projects

Mitchell B. Carroll

MITCHELL B. CARROLL*

UN, OECD, IMF, U.S. Treasury and IFA International Tax Projects

Relief by treaties from conflicting claims of national tax jurisdictions to income from international business and investments is a goal of the United Nations (UN), the organization for Economic Cooperation and Development (OECD) and the International Monetary Fund (IMF), as well as of the U.S. Treasury. Their respective activities in promoting international tax law are followed assiduously by the International Fiscal Association (IFA) which has its seat in the Netherlands School of Economics in Rotterdam. It includes some 4,000 members in over 70 countries. The ramifications of the activities of these groups are so extensive, it is opportune to take a brief look at them.

Through its consultative status, IFA is participating in the meeting at Geneva, which began on October 25, 1971 of the *ad hoc* group of experts on tax treaties between developed and developing countries. Its purpose is to formulate a new model which balances the respective interests of the two categories of countries. Hitherto, about 600 general tax treaties have been listed in the U.N. collection, and they have been for the most part between developed countries. An increasing number of treaties have been concluded by such countries as Germany, Japan and Sweden with less industrialized nations that are striving to progress economically. However, the U.N. hopes to augment the number by having officials of governments in the two categories meet to learn how to reconcile their conflicting interests through jointly framing a new model convention.

Concurrently, the OECD which brought forth its "Paris model" in 1963 is revising it, in the light of improvements in recent bilateral treaties. The new model is expected in 1973.

The present OECD text resulted from bringing up to date the League of

*Honorary President, International Fiscal Association Rotterdam, of Counsel, Coudert Bros., New York. This 25th Congress will, I also understand, mark the close of an era of some thirty years during which Dr. Mitchell Carroll, one of our distinguished citizens, has served with such devotion and ability as your International President. Both as a public servant and as a private citizen, Dr. Carroll has given bountifully of his time and energies in the development of tax treaties and in numerous other aspects of international taxation. He has been a pioneer in an area which grows in importance with each passing year. From an address by Secretary of the Treasury, John B. Connally, before the International Fiscal Association, Washington, D.C., October 4, 1971.

Nations Fiscal Committee's London model of 1946, which was intended to be conducive to encouraging developed countries to supply capital to less developed countries. This text emerged from the same Committee's Mexico model of 1943, and the prior Geneva model of 1935 for the allocation of taxable income, as well as the earlier Geneva models of the Meeting of Governmental Experts in 1928.[1]

Members of IFA are watching with keen interest the race between the tax groups respectively of the UN and the OECD, which are supposed to reach their goals in 1973.

At the same time, the U.S. Treasury, which is administering general tax conventions between the U.S. and 22 countries, and estate tax conventions with a dozen countries, is participating in these international groups through Nathan N. Gordon, director of International Tax Affairs. He is a member of the UN group and is Chairman of the OECD Committee on Fiscal Affairs.

Purpose of Committee on Fiscal Affairs

The OECD Committee's scope was recently enlarged to cover a reappraisal and diversification of its work. The Committee recognized that taxation is now one of the principal means which governments can use to influence overall demand, the long-term direction of resources, and the distribution of national income.

Cognizance is taken of the international repercussions of taxation on international flows of capital in the form of purchases of securities, or investments made by large international corporations. This may result from government policy or the interaction of different national tax systems.

Up until the present, the OECD has worked, not only on the avoidance of double taxation, but also on other subjects including adjustments of border taxes, and the tax on value-added (TVA).

Subjects Selected for Study

To bring its activities up-to-date, a group of tax experts selected subjects relevant to current policy and appropriate for the combined attention of fiscal experts and economists generally occupied with fiscal policy.

The new Committee on Fiscal Affairs, would, in addition to continuing work on avoidance of double taxation and related questions, give attention primarily to: (i) taxation affecting international flows of capital; (ii) the international impact of company taxation; and (iii) standard classification of tax revenues.

[1]The story of the development of these models, and the author's part in shaping them is published by the American Bar Ass'n, The INT'L LAWY. July 1968, Vol. 2 No. 4, CARROLL, INT'L TAX LAW pp. 692–728.

Flows of Capital

Decisions of lenders and borrowers, investors and companies are affected by tax considerations which, in turn, influence the direction of international flows of capital. The Committee will seek to identify areas where decisions are likely to be taken exclusively or primarily as the result of tax factors.

Governments may deliberately use taxation to shape decisions in order to achieve objectives of domestic policy, such as growth stabilization and income distribution.

In the second place, a government may regard taxation in certain cases as an alternative or supplement to exchange controls, multiple exchange rates, administrative controls over international flows of capital, or other techniques.

The Committee on Fiscal Affairs has taken note of the fact that it is possible in some cases to receive interest on Euro-issues without deduction of a withholding tax in the country of the borrower which fact stimulates international mobility of capital. It also influences the decisions of lenders, who might prefer Euro-issues to domestic or customary foreign bonds, and of borrowers who may place their issues in countries which do not withhold a tax on interest.

Lenders may, of course, prefer to avoid a tax on interest through receiving it abroad where no tax is due, rather than bear tax at home on interest paid on domestic bonds.

The Committee has appointed a Working Party to look into the advantages and disadvantages for financial flows resulting from the difference in the fiscal treatment of interest on international issues.

Investment Companies, Funds and the Like

Investment companies, mutual funds and pension funds affecting international transactions, have tax problems which are not resolved by existing double taxation conventions. This occurs particularly when the shareholder resides in one country, the investing company is in a second country, and the investment is made in a company in a third country. The Committee is seeking an international solution.

Taxes on the Issue and Negotiation of Securities

Taxes on the issuing and negotiating of securities do not produce much revenue, but are considered to be obstacles to the international flow of capital. They augment the cost of borrowing. Hence, the Committee will consider whether it is possible to reach an agreement on the reduction or even elimination of such a tax, or on reducing differences in their rates as between member countries.

International Effect of Company Taxes

In view of the increase in the international operations of domestic corporations, or so-called multi-national corporations, corporate taxation becomes increasingly important. A government may seek to insulate the domestic situation from foreign influences, and choices of investments may be affected by sharp differences in levels of company taxation.

Where the investment choice relates to facilities for production, it has implications for employment and growth. The investment has implications for the balance of payments and the policy of exchange control.

The relative levels of taxes on companies may be difficult to compute, because of the differences between taxes on profits and other levies, allowances for depreciation, and losses, tax-free holidays, and efficiency in tax collections.

Because of the importance of allowances for depreciation, the Committee is making a special study of them.

Dividend Taxation

In general, dividends are subject first to the company tax on profits and, secondly, to a withholding tax. Interest income of the shareholder is usually taxed by withholding at source, and cumulative taxation is frequently not alleviated. In some cases, it is mitigated by a reduced rate of company tax on distributed income. In still other cases, the company tax pertaining to the dividend is credited against the tax borne by the shareholder on his entire net income inclusive of dividends.

The co-existence of these different systems naturally affects the choice of the country in which to invest. A number of governments are presently studying which system to adopt. Hence the Committee has appointed a Working Party to examine the advantages, disadvantages of the different forms of taxing company dividends from national and international, economic and technical points of view—especially in the light of the experience of recent changes in some countries.

Tax on Trans-Border Mergers

In view of the policy of encouraging integration in the EEC and other areas, the ascertainment of tax discrimination against mergers across frontiers, which does not apply in the case of domestic mergers, has been assigned to another group. The study will also include the remedies, such as tax treaties, which could remove such discrimination.

Standards for Classifying Tax Revenues

In view of the circumstances in comparing tax burdens, a Working Party is to prepare a list of taxes drawn up in accordance with standard definitions of various types of levies. There will follow global comparisons of tax receipts between member countries, and taxes on particular classes of enterprises or goods, or on individuals or income groups.

Double Taxation and Related Questions

In furthering the work on prevention of double taxation initiated by League of Nations' committees in the 1920s which evolved into the OECD Draft Convention on Income and Capital published in 1963, that draft is being revised in the light of bilateral conventions since concluded.

During the next two years, the Working Party is to report on methods of protecting taxpayers and combatting abuse of tax conventions. Another aim is to formulate a draft Convention on Mutual Assistance for the Assessment and Collection of Taxes, which recalls the text of the meeting of government experts at Geneva in 1928. Clauses on this subject are found in most bilateral general tax treaties.

Insurance Against Nuclear Risks

So great is the concern in European countries about the risk of damage from the use of nuclear weapons, that consideration is being given by a Working Party to special treatment for the reserves of companies insuring against nuclear damage in view of the possibly heavy payments that such companies might have to face.

Tax Incentives and Environment Problems

Empirical research into the effect of taxation on the work supply (overtime, retiring age, number of married women seeking work, risk taking, migration of executives, etc.) are to be looked into, as well as methods to stimulate savings.

Another research subject is how taxation might be and has been used to influence urban and regional development, and to finance anti-pollution measures, and to combat traffic congestion.

IMF Aid to Developing Nations

The principal work of the large IMF staff (of around 40 experts) is to help less advanced members of the Fund improve their methods of budgeting and administering their tax laws.

Proposal of Secretary of the Treasury

In his inaugural address at the Congress of the International Fiscal

Association in Washington, October 4–8, 1971, the Secretary of the Treasury, the Honorable John B. Connally, outlined work to be done in the international fiscal field which reflects the foregoing program of the OECD. This coincidence may be due to the fact that the President of the OECD Committee on Fiscal Affairs is the Honorable Nathan N. Gordon, Director of International Tax Affairs, the U.S. Treasury.

Mr. Connally mentions the work of the OECD Fiscal Committee on developing standards for classifying taxes and measuring burdens. He contemplates agreement on border-tax adjustments and distinctions between "direct" and "indirect" taxes. A third subject is the scope of tax holidays, and tax incentives for plant investment designed primarily to produce goods for export. A fourth subject involves principles of non-discrimination against foreign direct investment and foreign nationals.

A fifth and important point is the effect of various structures of taxation of corporate income upon the international business community.

A sixth point, reminiscent of subpart F of the U.S. Internal Revenue Code enacted in 1962, is the impact of the conduct of trade through foreign base companies and other affiliates, which enable exporters of some countries to enjoy advantages over others.

Another Treasury proposal is to examine the effect of withholding taxes and exemptions for investment payments upon international capital markets and the flow of funds.

An eighth subject is expediting mutual administrative assistance to dispose of cases that might produce double taxation, or permit escape from taxation in any country. Mr. Connally says that the Treasury has taken steps to improve its competent-authority procedures and to encourage U.S. citizens and corporations to make use of them. He adds that the Treasury has actively pursued understandings with other nations regarding exchange of fiscal information to combat tax evasion.

Mr. Connally suggested that international codes of conduct should be developed and enforced with respect to international fiscal matters. If agreement can be reached on acceptable fiscal norms which affect trade and capital flows, "we shall have taken giant steps across mountains of misunderstanding and across crevices of tax avoidance."

To accomplish these objectives, Mr. Connally suggested exploring the feasibility of creating a continuing secretariat with a staff of experienced fiscal experts, and more frequent discussions among representatives of participating nations. This might be accomplished, he says, under the aegis of an existing international organization or through the creation of a new organization, perhaps affiliated with an existing body.

Mr. Connally expressed belief in the need of "a more active forum for multilateral study, debates and agreement on international fiscal affairs to match those that exist with respect to monetary and trade matters." He declared that the "United States stands ready in the future, as it has in the past, to participate in this essential work." He hopes "that the organizational structure can be created or extended to facilitate and expand these efforts."

Implementation of Secretary Connally's Propoal

Mr. Connally's challenging design for further development of international tax law has provoked keen expectations in all interested groups. The IMF has funds to spend on rendering technical assistance, especially in the fields of budgeting and tax administration in the less developed countries. Possibly they might be made available for projects envisaged by Secretary Connally that fit as well within the scope of the IMF.

The OECD's Committee on Fiscal Affairs, being composed mainly of European nations which benefited from the Marshall Plan, plus Canada, Japan and the United States (21 in all), has carried on the work of avoiding double taxation. It still endeavors to attain the goals of The Fiscal Committee of The League of Nations and that of the UN which, after several meetings, adjourned *sine die*.

Now the UN is active again with its *ad hoc* group of experts on Tax Treaties between Developed and Developing countries, which took the 1963 draft of the OECD as its starting point. The OECD Committee on Fiscal Affairs is reviewing the latest of the general tax conventions registered with the UN in order to bring its model convention up to date as of 1973. By that time the UN *ad hoc* group hopes to have a model for negotiations between the capital-exporting and capital-wanting countries. Because of its consultative status vis-à-vis the UN ECOSOC, members of the International Fiscal Association are contributing studies to the UN Group; and are following the activities of all these organizations.

Hence, it is gratifying that Secretary Connally chose the inaugural session of IFA's 25th Congress in Washington, as the occasion to make his pronouncement that should give a real impetus to the further development of international tax law by treaties or otherwise.

Responses have been favorable to the suggestion that the interested organizations follow the example of European companies in the EEC, and enter into a cooperation agreement to cross the frontiers of their respective jurisdictions and accomplish their common objective.