

Recent Developments at the OECD

Presentation to BMA Conference
Mumbai, India
5 – 6 December 2003

David Partington
OECD Secretariat
Paris

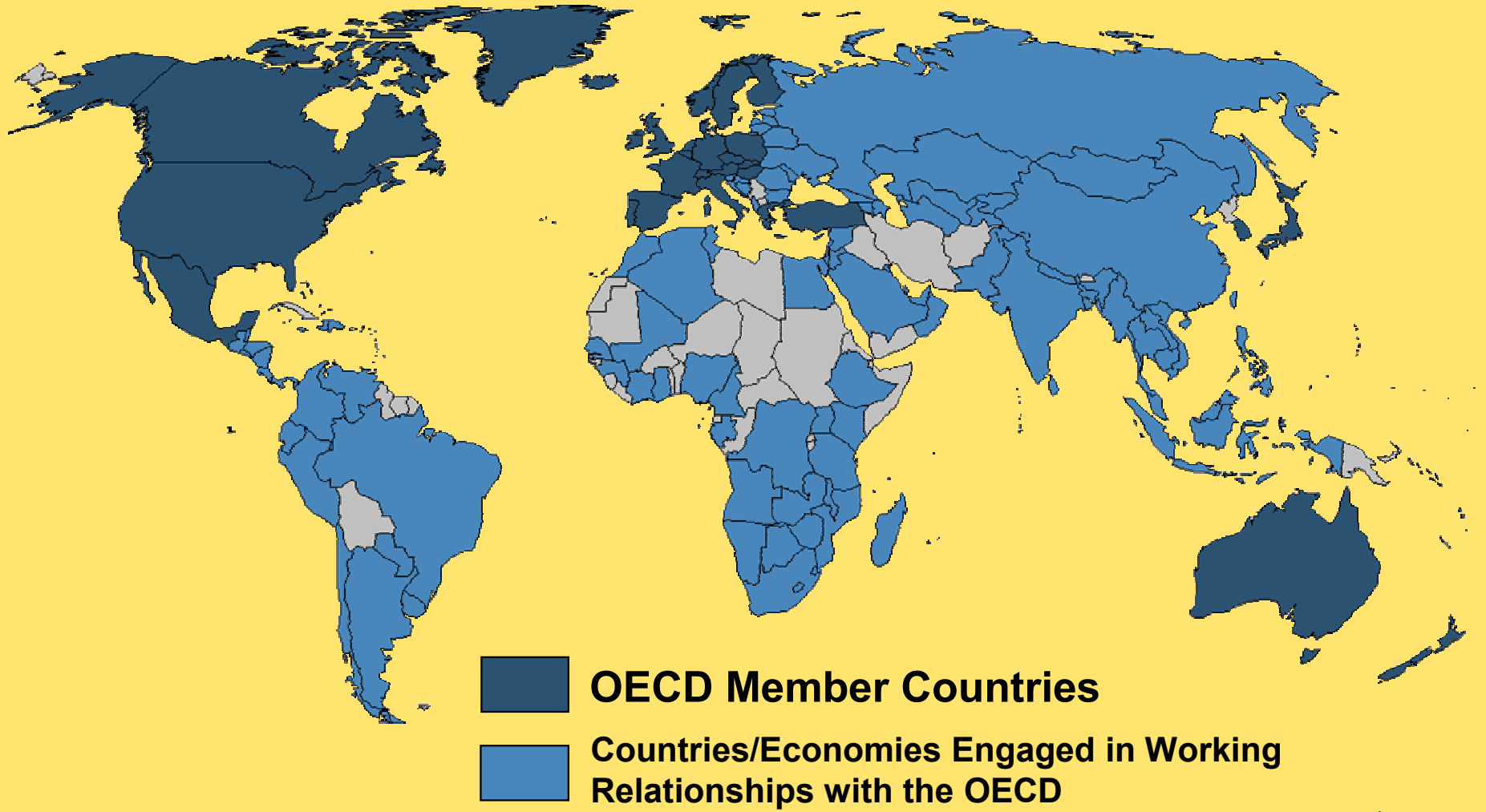
Outline of Presentation

- What is the O.E.C.D?
- Transfer Pricing Update
- Tax Treaties Update
- Promoting fair tax competition
- Emerging issues.

What is the OECD

- Organization of Economic Co-operation and Development
- A forum for economic and social challenges of interdependence and globalisation
- A provider of comparative data, analysis and forecasts to underpin multilateral co-operation
- Setter of “soft” and occasionally “hard” rules in which governments work together to address

Limited membership but global reach



Membership

- 30 industrialized countries:
 - 15 European Union
 - Switzerland, Norway, Iceland, Turkey
 - Poland, Hungary, Czech Republic, Slovak Republic
 - Japan, Korea, Australia, New Zealand
 - Canada, United States, Mexico
- Taxation work includes over 60 non-member countries

OECD's Work in Taxation

- OECD sets the international taxation guidelines in areas where international co-ordination is desirable:
 - tax treaties (OECD Model Tax Convention)
 - transfer pricing
 - e-commerce
 - exchange of information
 - harmful tax practices
 - consumption tax
- Guidelines developed through expert committees and consensus approach
- Can't issue directives

Current Approach

- Globalisation has required a refocus of OECD's tax work:
 - global solutions to tax problems
 - expansion of dialogue to include:
 - Non-OECD economies
 - business community
 - expanded work programme

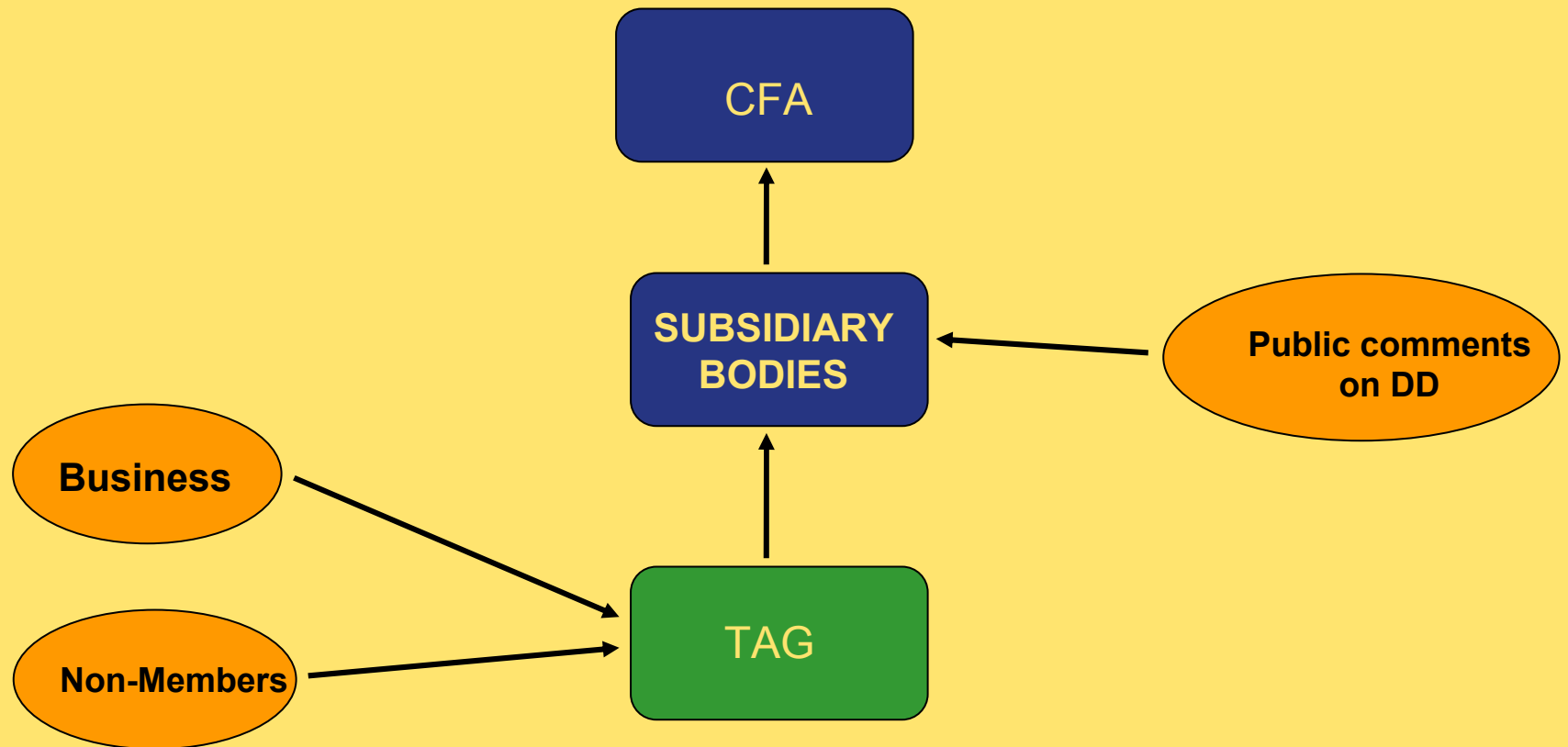
Working with Non-OECD Economies

- Key part of OECD's work on taxation
- Can't regulate international tax rules - need to develop an international consensus
- The rules we develop must be fair and sound
- Strong dialogue through:
 - network of multi-lateral centres
 - regional training
 - country specific events
 - participation in process
- Desired outcomes:
 - Consensus on rules
 - conventional application of existing rules
 - sound fiscal policy

Working with Business

- Becoming more common and takes various forms:
 - BIAC (Business & Industry Advisory Committee)
 - Technical experts on working groups (e.g., e-com TAGs)
 - Approaches on specific problems
 - Consultation on discussion drafts (<http://www.oecd.org>)

E – Commerce Model



Part II – Transfer Pricing Update

Transfer Pricing Issues

- Can the arm's length principle as set out in the 1995 Transfer Pricing Guidelines remain the basis for taxing MNEs?
- Requires consistency in application and responsiveness to emerging issues:
 - **Monitoring :**
 - Practical examples; peer reviews; review of comparability issues; and Review of profit methods
 - **Extending the Guidelines :**
 - Attribution of profits to PEs
 - Thin capitalisation and other financial transactions
 - Stock options
 - E-commerce

Attribution of profits to PEs

- Starting point : lack of consensus
 - no common interpretation or application
- Problems e.g. with global trading and e-commerce
- Development of Working Hypothesis (WH):
 - How far can PE be treated as if it were a separate enterprise?
 - How far can guidance in TP Guidelines be applied, *by analogy*, to attribute profits under Article 7(2)?
- Test the application of WH in practice: does it make sense?
 - banks, insurance, global trading and server PEs

Attribution of profits to PEs

Discussion Papers:

- Discussion Draft on the Attribution of Profits to Permanent Establishments
- Part I: General Considerations
- Part II: Special Considerations for Applying the Working Hypothesis to Banks
- Consultation with commentators April 2002
- Release of revised Parts II and III March 2003
- Still to come: revised Parts I (and IV (Insurance))

Working Hypothesis

Profits to be attributed to a PE are the profits that the PE would have earned at arm's length as if it were a separate enterprise performing the same functions under the same or similar conditions, determined by applying the arm's length principle under Article 7(2)

Attribution Approaches

- Purpose: Towards achieving a consensus position on the attribution of profit to a PE under Article 7.
- Working Hypothesis: the preferred approach:
 - Two step approach
 - Functional and factual analysis to hypothesise the PE as a distinct and separate enterprise
 - Application of the arm's length principle to the hypothetical enterprise in accordance with the 1995 Guidelines

Specific Issues on Part I

- Identify dealings and apply ALP
 - Same as transactions?
 - Transfer of risks without functions?
- Intangible property
 - Who is economic owner/developer
 - Use of intangible in comparability analysis
- Internal services: has a service been provided?
 - Arm's length price - yes!
- Capital allocation and funding
 - capital allocation, thin (or quasi thin) capitalisation
 - internal “interest” dealings

Stock Options

Identified as a “hot issue” under monitoring:

- Parent grants options to employees of affiliate in another country
 - Is a charge justified?
 - Has a service been performed?
 - What if no cost to parent (issues new shares)?
 - Timing: grant? exercise?
- Impact on methods sensitive to wage costs
 - comparables don't account for stock options
- Stock options and CCAs

Cross-border loans and thin capitalisation

Extension of TP Guidelines to cover these issues

- Interest rate
 - how to apply the ALP
- Thin capitalisation
 - can the ALP be applied (even indirectly)?
- Possible approaches:
 - comparable arm's length structure
 - earnings stripping
 - debt/equity ratio of group (NZ approach)
 - independent banker (UK approach)
 - safe harbours

Improving Dispute Resolution Mechanisms

- Major priority over next 2 years
 - Transfer pricing and treaty issues
- Questionnaire to OECD, non-OECD and business
 - Identify best (and worst) practices
 - Examine why Mutual Agreement Procedures (MAPs) is not used more by business
- Why doesn't Mutual Agreement Procedures (MAPs) work better?
 - Operational issue
 - Substantive issues
- Supplementary dispute resolution
 - Arbitration and mediation

Part III Tax Treaty Update

Main Treaty issues under study (1)

- Pensions (draft issued November 2003)
- Employee Stock Option Plans*
- Application of tax treaties to specific entities (e.g. trusts and collective investment funds)
- Issues related to the application of Article 8 (on international shipping and air transport)
- Permanent establishments
- Dispute resolution

* (see slides below)²²

Main Treaty issues under study (1)

- Residence tie breaker for legal entities
- On-going technical amendments from the catalogue of issues
- Development of a background document on the practical application of tax treaties
- On-going work with non-OECD economies

Stock Options – Main issues in report

- Mismatch in taxing event/time
- Capital gain or employment income
- Identifying services to which the option relates
- Multiple residence taxation
- Replacement of options
- Options granted to directors

Stock Options – Content of July 2003 draft

- Basically follows the approaches put forward in the first discussion draft:
 - exercise is generally the dividing line between employment income and capital gains
 - vesting is generally the dividing line for determining to which employment services an option relates (bias towards future services but this is a case by case determination)
 - residence country must provide relief regardless of when the source country tax the employment benefit
- Clarification of the concept of vesting
- No suggestion for a special stock-option provision in the OECD Model

2003 Update - Main Items

- Clarification of the treatment of E-Commerce:
 - application of the permanent establishment definition
 - treaty characterization of e-commerce payments
- Permanent establishment interpretation issues
- New Article on Assistance in the Collection of Taxes (Article 27)
- Restriction of entitlement to treaty benefits
- Clarification of domestic anti-avoidance rules

2003 Update - Main Items (2)

- A number of technical changes to the Commentary
- Changes and additions to reservations and observations of OECD members, and positions of 24 Non-OECD economies

Part IV Harmful tax practices & bank secrecy

Impact of globalisation

- Today's more open environment has increased living standards globally.
- But also raised challenges for governments to ensure that:
 - Tax competition is « fair »
 - Tax rules are fairly enforced.
- OECD is assisting governments in meeting these challenges.

The Response of OECD Governments

- 1998: Launch of project to eliminate harmful tax practices
- 2000: Issuing of a report on improving access to bank information
- 2002: Initiate a Review of Article 26
- All aimed at promoting fair tax competition and helping governments to enforce their tax legislation.

The 1998 Harmful Tax Practices Initiative

Current Status

Harmful Preferential Tax Regimes in OECD countries

- 47 identified as potentially harmful in 2000;
- Almost all now redesigned/eliminated

Tax Havens

- 32 Offshore Financial Centers (OFC's) become OECD's participating partners;
- Six OFC's remain unco-operative tax havens.
- Dialogue on implementation of commitments continues.

State of Play: Tax Haven Work

- 32 offshore jurisdictions committed to transparency and effective exchange of information

Aruba	Cyprus	Neth. Antilles	US Virgin Is
Antigua	Dominica	Niue	Vanuatu
Anguilla	Guernsey	Panama	
Bahamas	Grenada	Samoa	
Bahrain	Gibraltar	San Marino	
Belize	Isle of Man	Seychelles	
Bermuda	Jersey	St. Kitts & Nevis	
British V.I	Malta	St. Vincent	
Cayman Is	Mauritius	St. Lucia	
Cooks Islands	Montserrat	Turks & Caicos	

State of Play : Tax Haven Work

Only 6 offshore jurisdictions now listed as un-cooperative tax havens:

- Marshall Islands
- Liechtenstein
- Andorra
- Nauru
- Liberia
- Monaco

From Tax Haven to Participating Partner

- Jurisdictions have engaged constructively with OECD
 - Leading to greater understanding of offshore
- 32 jurisdictions are our participating partners in further developing standards.
 - Model Agreement on Effective Exchange of Information
 - Accounts Requirement
 - Trust Sub-group
- Change since 1998 has been remarkable

2000 Report on Improving Access to Bank Information - Current Status

- Established a standard on access to bank information
- Identified 5 measures to help achieve standard:
 - Removal of anonymous accounts
 - Know your customer rules
 - Removal of domestic tax interest requirements
 - Establish a common understanding of tax fraud
 - Improving access to information on civil tax matters
- Article 26 will be updated to reflect these and other developments

Improving Access to Bank Information

- Considerable progress has been made.
 - Abolition of anonymous accounts Yes
 - Abolition of Domestic Tax Interest Yes
 - Improved access for criminal tax purposes Yes
 - Improved access for civil tax purposes Con't

The end game

- Increased international tax cooperation
- Tax authorities have better access to the information needed to apply the tax laws.
- Countries compete on basis of service not secrecy.
- Reduced incidence of non-compliance with the tax laws.
- Fairness in taxation becomes the norm.
- Tax rates can be lowered.
- Integrity of international financial systems enhanced.
- Business gets level playing field

Part V Emerging Issues

International taxation : Future Challenges

- The balance between source and residence taxation
- Pressure from financial markets and new financial instruments.
- Greater use of environmental taxes without impeding business competitiveness
- Reconciling privacy/confidentiality issues with the need for access to information.
- Clarifying the role of tax administrations.
- Financing the demands of an ageing population.
- Minimising the adverse impact of labour taxation on labour market performance
- Taxation of highly mobile high income individuals

Following and engaging in our work

- OECD web site: www.oecd.org