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Protecting the Tax Base of Developing Countries: An Overview

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Hugh J. Ault and Brian J. Arnold

1. Introduction

1.1 General background. One of the most significant policy challenges facing developing countries is establishing and maintaining a sustainable source of revenues to fund domestic expenditures. While this problem has many facets, one of the most important is protecting the domestic tax base. In recent years, increasing attention has been paid to the fact that many multinational companies ("MNE") appear to have been able to pay effective tax rates well below what one would expect from the headline rates in the countries in which they are operating. Several widely publicized cases of low or no taxes on well-known companies highlighted these issues and brought the questions of tax avoidance and evasion into the public political debate. In response to these developments, the OECD began analytical work to try to determine what exactly were the techniques through which corporations were able to dramatically reduce their effective tax rates. This work was supported by the G-20 and the G-8, where the particular problems facing developing countries were emphasized. The results of this work were the OECD Report "Addressing Base Erosion and Profit Shifting" and the subsequent "Action Plan on Base Erosion and Profit Shifting" which are discussed below in more detail. (see 1.4.1)

While the work of the OECD is important, and made substantial efforts to take the viewpoints of developing countries into account in formulating its analysis, it was clear from the beginning that some kind of independent examination of the problems of tax avoidance and the resulting profit shifting and base erosion from the perspective of developing countries was required. This is true for a number of reasons. In the first place, most developing countries are primarily (though not exclusively) concerned with the reduction in source-based taxation, rather than the shifting of the domestic income of locally-owned companies to low or no tax jurisdictions. Secondly, the corporate tax on inward investment typically plays a larger role in total revenue in developing countries than in countries with more developed tax systems. In addition, the potential responses to base erosion and profit shifting are limited to some extent by the administrative capacity of developing country tax administrations.

For all of these reasons, it was clear that work on these questions which focused on the issues and needs of developing countries in particular should be developed. As a result, the United Nations Committee of Experts on International Cooperation established a Subcommittee charged with informing developing country tax officials on these issues and facilitating the input of developing country views and experience into the work of the Committee and in the wider work of the OECD Action Plan. In addition, the UN Financing for Development Office (FfDO) undertook a project to supplement and complement the OECD work by focusing on a number of issues which are of particular interest to developing countries which will include but not be limited to the matters covered by the OECD work

1.2 Scope of the FfDO work on base erosion and profit shifting.

There is no single cause or explanation for the increasing level of base erosion and profit shifting. The various issues are not new and have been discussed in the past. They involve questions of domestic tax law of individual countries, the interaction between domestic tax systems and the role of tax treaties in facilitating base erosion. Some of these issues are of concern for all countries, while others are of greater importance to some than to others. Thus some of the issues covered in the OECD/G-20 BEPS project discussed below are of interest to both OECD countries and to developing countries and some are primarily the concern of OECD countries. In addition some issues have been identified which are not included in the OECD-G20 BEPS work but are still important to tax base protection from the perspective of developing countries. Thus the FfDO project has decided to focus its efforts on the following topics[1]:

Neutralizing the Effects of Hybrid Mismatch Arrangements
Limiting the Deduction of Interest and other Financing Expenses
Preventing the avoidance of Permanent Establishment status
Protecting the tax base in the Digital Economy
Transparency and Disclosure
Preventing Tax Treaty Abuse
Preserving the Taxation of Capital Gains by Source Countries
Taxation of Services

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[1] This project does not deal with the base erosion and profit shifting aspects of transfer pricing as those matters are being considered by the UN work on the revision of the UN Practical Manual on Transfer Pricing for Developing Countries.

Tax Incentives

These issues were the ones which seemed on an initial examination to be of most importance to developing countries. In some situations, the erosion of the tax base results in income avoiding taxation altogether, so-called “double non-taxation.” Typically, these cases involve the interaction of technical tax rules in several countries which combine to have the effect of avoiding the taxing jurisdiction of both countries. In other cases, the base erosion arises from the fact that economic activities which formerly were subject to the local taxing jurisdiction can be restructured, often as the result of advances in technology and communication, into situs where the existing jurisdictional rules no longer reach them. Here, the question is of one of reestablishing the tax base which has been lost and reformulating tax rules to better fit the current structures of business activities. In some cases, countries have intentionally allowed their companies to reduce or avoid tax on their foreign income and in other cases, countries have failed to tax companies doing business in their jurisdiction in order to encourage inward investment. In still other cases, it is a lack of information concerning the overall activities of the corporation which results in the avoidance of tax in the jurisdictions concerned. This is especially the case where third-country intermediary companies are concerned.

Countries can of course deal with some of these issues unilaterally and a number have already begun to do so. But to respond effectively to some of the challenges which base erosion and profits shifting pose, it is essential that actions be taken forward in a coordinated manner. Countries must be more aware both of how their tax systems affect other countries’ systems and how their domestic system is impacted by another country’s tax rules. This is important both for the development of domestic tax legislation and for determining tax treaty policy. These results can only be achieved through increased international dialogue and cooperation.

1.3. Goals and Methodology of the FfDO project on base erosion and profit shifting.

The basic goal of the FfDO project is to complement and supplement the work done in the OECD BEPS project. It will complement the work by providing additional insight into the issues identified in the OECD project when viewed from the perspective of developing countries. It will also supplement the OECD work by considering issues which involve base erosion and profit shifting of particular importance to developing countries which are not included within the OECD focus. In addition, the OECD work has quite short deadlines for its initial assessments and recommendations.

comprehensive changes in international tax rules. As noted subsequently, the OECD explicitly takes the position that the BEPS project is not intended to alter the fundamental allocation of the international tax base between residence and source countries.

The final outcome of the FfDO project will be a collection of papers on the selected topics listed above. The papers will be developed by individual authors, informed by the OECD work on the topics and a review of the existing literature. Most importantly, it will reflect the input of developing countries both through the Subcommittee-sponsored activities and through the workshops held specifically to catalogue the experience and concerns of developing countries with the overall problem of base erosion and profit shifting.

1.4 History of the OECD/G-20 work on BEPS

1.4.1 Background of the OECD Report "Addressing Base Erosion and Profit Shifting" In November, 2012, the G-20, meeting in Mexico, in its final communique, "welcomed the work that the OECD is undertaking into the problem of base erosion and profit shifting and look forward to a report about progress of the work at our next meeting." The G-20 request to the OECD was triggered by well-publicized reports of important multinationals reporting very low effective rates of tax on their worldwide profits. Prior to the G-20 endorsement, the OECD had been examining various related issues in its work on aggressive tax planning, transfer pricing, exchange of information and harmful tax competition. The G-20 requested a "diagnosis" of the extent of and the causes of profit shifting and the accompanying base erosion. The OECD Report was ph tmit4cs1e6srtnd traomOEheic y2-4onentfm

International mismatches in entity and instrument characterization, so-called hybrid arrangements which take advantage of differences in domestic law to create income which escapes taxation altogether or is taxed at an artificially low rate;

The use of treaty concepts limiting taxing jurisdiction to prevent the taxation of digital goods and services

The use of debt financing and other intra-group financial structures

Various aspects of transfer pricing dealing with risk, intangibles, and the splitting of ownership within a group which allow the separation of economic activates from taxing jurisdiction

The lack of effective anti-avoidance measures such as General Anti-

As a result of this “diagnosis”, the Report concludes that what is needed is a comprehensive “global action plan” to deal with the many interrelated strands which lead to base erosion and profit shifting. While countries can and will take unilateral action, if those actions are not coordinated, the resulting potential double taxation can generate double taxation. The Report was endorsed by the G-20 at its meeting in February, 2013 and the OECD was instructed to develop the Action Plan . The Action Plan was presented to the G20 leaders at their meeting in July, 2013 where it was fully endorsed:

“Tax avoidance, harmful practices and aggressive tax planning have to be tackled. The growth of the digital economy also poses challenges for international taxation. We fully endorse the ambitious and comprehensive Action Plan – originated in the OECD – aimed at addressing base erosion and profit shifting with mechanism to enrich the Plan as appropriate. We welcome the establishment of the G20/OECD BEPS project and we encourage all interested countries to participate. Profits should be taxed where economic activities deriving the profits are performed and where value is created. In order to minimize BEPS, we call on member countries to examine how our own domestic laws contribute to BEPS and to ensure that international and our own tax rules do not allow or encourage multinational enterprises to reduce overall taxes paid by artificially shifting profits to low-tax jurisdictions. We acknowledge that effective taxation of mobile income is one of the key challenges. We look forward to regular reporting on the development of proposals and recommendations to tackle the 15 issues identified in the Action Plan and commit to take the necessary individual and collective action with the paradigm of sovereignty taken into consideration.”

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necessary or longer necessary at all. Or it may come about because of the technical requirements of existing rules in domestic tax law or tax treaties as to taxing jurisdiction.

In addition to the importance of reassessing the applicable substantive rules, the Action Plan stress the need for transparency and sharing of information among jurisdictions. Thus, one of the action items calls for the development of better mechanisms for information sharing to implement the substantive rules.

The basic focus in the OECD/G20 Plan calls for adjustments to current international tax rules which would reduce the ability of companies to generate untaxed or low-taxed income by modifying existing rules. However, the Plan states that "[w]hile 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 directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income".

1.5.2. The Role of Developing Countries in the OECD/G20 Action Plan At several points, the Action Plan recognizes the special situation of developing countries as regards the issues identified in the Plan. Thus the Plan observes that as a result of base erosion and profit shifting, "[i]n developing countries, the lack of tax revenue leads to critical under-funding of public investment that could help promote economic growth." As to input from developing countries, the OECD organized various regional meetings to obtain information as to developing country views as to the issues discussed in the Report and the Plan. In addition, the Plan recognizes that "[d]eveloping countries also face issues related to BEPS, though the issues may manifest differently given the specificities of their legal and administrative frameworks. The UN participates in the tax work of the OECD and will certainly provide useful insights regarding the particular concerns of developing countries." Nonetheless, it is clear that, while developing country interests have been to some extent taken into account, there is a need for an independent examination of

project has tentative selected the following Action Plan items for further analysis for the developing country perspective.

2.1 Neutralizing the Effects of Hybrid Transactions

2.1.1 What are hybrid transactions? In many cases, the same cross border transaction may be treated differed differently in two jurisdictions. Domestic tax rules are typically developed without significant consideration given as to how the transaction may be treated in another jurisdiction when a foreign party is involved. This “hybrid” nature of the transaction may result in income escaping taxation in both jurisdictions. As a result, the overall tax revenues which the two countries were expecting from the transaction are reduced. The tax base of one of the countries has been reduced but there has been no corresponding increase in the tax revenue of the other country. The transaction has resulted in “stateless” income which is not taxed in any jurisdiction. In other situations, differences in the treatment of a legal entity can result in the same amount being deducted twice. These “hybrid” results can come about because of differences in domestic law or differences in the application of tax treaties and has been identified as a source of base erosion in the OECD/G20 Action Plan.

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Example. Company A resident in Country A transfers shares to Company B resident in Country B under an arrangement in which Company A agrees to repurchase the shares at some point in the future for a fixed price (a stock “repo”). Under Country A’s tax law, the formal sale is treated as a secured loan and the difference in the two prices is treated as interest that is deductible by Company A. Country B follows the legal form of the transaction and treats Company B as the purchaser of the shares and the payments received on the shares by Company B as dividends. When the shares are repurchased by Company A, Company B may realize a gain. Both the dividends and the gain on the sale of the shares may qualify for the participation exemption under Country B’s tax system.

Hybrid entities can be used to obtain the benefits of the allocative rules in tax treaties in circumstances where it is unlikely that the parties to the treaty intended such benefits to be available.

> Example: Organization P of Country P is owned by X1 and X2, residents of Country X. Organization P is treated as an entity by Country S but is fiscally transparent under the laws of Country P. The tax treaty between Country P and Country S prevents Country S's taxing righ

As this example shows, there are a number of connected issues involved in determining the appropriate treatment of cross border interest. First of all, since there is no external debt anywhere in the Company P group, the only effect of allowing the interest deduction is to shift profits from Company DC to Company F. That is, the combination of the deduction in Country DC and the exemption from tax of the interest receipt has resulted in part of the profits of Company DC and the Company P Group from being taxed anywhere. If Company P had instead financed the investment in Country DC though a direct equity investment, Company DC would have been taxed on the profits which would be transferred to Company P as a dividend which might be subject to withholding tax by

2.2.2.4

2.3 Preventing the Avoidance of PE status. One way in which a developing country's tax base can be eroded is for the taxpayer to arrange its operations in a manner which technically avoids the rules for the assertion of taxing jurisdiction. One of the basic principles of the domestic law of many countries and of tax treaties based on both the UN and OECD Models is that the source country's right to tax business activities requires the existence of a Permanent Establishment ("PE") in the country. In some situations, it has been possible for taxpayers to arrange their affairs to avoid the definition of PE while at the same time having a substantial penetration in the jurisdiction which might be seen to justify taxation by that country. These issues are related to the PE issues discussed here, the taxation of the digital economy, discussed in the materials in Section 4, and the materials on the taxation of services, discussed in Section 8.

2.3.1 Commissionaire arrangements. In recent years, a number of companies have reorganized their international structures. This process has involved centralizing a number of functions dealing with intangibles, product promotion, inventory management and the like in individual companies, often located in low tax jurisdictions and converting sales subsidiaries who previously handled all aspects of the purchase and sale of goods in the source country, into so-called "low risk" distributors. In many cases these business restructurings had the effect of reducing substantially the amount of revenue attributed to the source jurisdiction. Under the prior structure where the "full-fledged" subsidiary bought the goods from a related party and sold them in the source jurisdiction, the full amount of the sales profit would be taxed in the source country. However, where the operations are rearranged with the local company only acting as an sales agent, it is possible to argue that only a small sales commission would be taxable in the source state. This position relies on the requirement of Article 5(5) of the OECD and UN Model Conventions which requires that, for a PE to be present in these circumstances, the agent must have "authority to conclude contracts" in the name of the related person supplying the goods. This requirement has been interpreted to require that the authority must include the legal authority to bind the supplier, that is, at the end of the contract negotiations, the agent must have the legal authority to create binding obligations on the supplier for a PE to exist, regardless of the extent of the agent's activity in the market jurisdiction.

Under the laws of many countries, the agency relationship can be structured as a so-called "commissionaire" under which the agent concludes contracts which are only binding on the agent itself and do not create any obligations on the part of the supplier, even though it is clear that the supplier will be supplying the goods on the terms agreed to by the agent. In such a case, the only amount taxable in the country of sale would be the "low risk" sales commission and not the real profit on the sale of the goods which would be attributed to the supplier who in these circumstance would

not technically have a PE in the country of sale. The OECD Action Plan No. 6 proposes to examine this kind of "artificial" avoidance of PE status and make it clear that the source country's taxing right extends to the underlying sales profit when significant sales activities are undertaken by the agent in the market country, regardless of the legal technicalities.

2.3.2 Preparatory and auxiliary services. Article 5(4) of the UN Model , like the OECD Model, lists a number of activities which are described in the Commentary to be "preparatory or auxiliary" and which do not result in the creation of a PE. The basic idea is that the taxpayer should be able to establish itself in the territory and carry on activities which are not central to the earning of its profits without any taxation in the market country. This is the case even if many or all of the enumerated activities are carried on and even if they are carried on over a long period of time. Concern has been expressed that by manipulating and combining the various functions, taxpayers can establish a substantial presence in the market jurisdiction which contributes to the profitability of the enterprise without the activities resulting in a PE under the existing rules.

2.4 Protecting the Tax Base in the Digital Economy

2.4.1 General. Information and communications technology ("ICT") have significantly changed the ways that companies can do business globally. ICT raises a number of related problems from the point of view of base erosion and profit shifting. First of all, through technological advances, it has become possible to have significant market penetration in a country without creating a taxable presence in the form of a PE. As a result, countries are deprived of revenues from the traditional sale of goods which they would have normally been entitled to tax historically under existing rules regarding taxing jurisdiction. Second, new forms of income have been created in business models using ICT. For example, it is possible to collect data about consumer preferences and other information from the market jurisdiction through the monitoring of digital traffic which can then be sold to third parties to aid them in their marketing strategies. In addition, the ability to deliver goods and services using ICT raises questions concerning the nature of income resulting from the provision of the goods/services. For example, payments might be considered royalties subject to tax on a withholding basis or might be treated as business profits taxable only in the presence of a PE. Finally, the flexibility provided by ICT allows multinational enterprises to centralize their functions in certain jurisdictions, often in tax havens, which then provides a vehicle for base eroding payments for the market jurisdiction. T

expansion of access to digital services and the attendant possibility of the use of ICT to exploit the local market.

2.4.2 Avoiding taxable presence and possible responses. ICT makes it possible to avoid a traditional taxable presence in the jurisdiction. In the simplest case, a distribution model which relied on a local sales office can be replaced by a website selling the product for direct delivery thus eliminating all of the sales income from the domestic tax base. Similarly, a local presence might be maintained but through ICT many of the functions formerly performed by the local presence can be transformed into functions performed offshore.

In these circumstances, it might be possible to reevaluate the traditional presence tests in the light of the technological developments. For example, the types of activities which traditionally have not constituted a PE might perform a different function where the sales into the jurisdiction are done on-

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of activities of taxpayers carrying on business or investing in their jurisdiction. This requires both transparency with respect to the way in which the taxpayer's activities are structured and disclosure of the necessary information. The information involved may be detailed information as to particular transactions, for example, the determination of transfer pricing or more general, higher-level information which allows the tax authorities to view the overall structure of the taxpayer's global business and in particular, the use made of tax haven vehicles as part of a tax avoidance scheme. The OECDE/G-20 Action Plan has several items which are relevant in this connection.

2.5.2. Transfer pricing documentation. Both the OECD Transfer Pricing Guidelines and the UN Practical Manual on Transfer Pricing contain substantial guidance on the structure and application of transfer pricing documentation. Action Plan Item No. 13 mandates that the existing rules on transfer pricing documentation should be re-examined

2.5.3 Country-by-Country ("CbC") reporting

2.5.3.1 General. Currently it is very difficult for developing countries to obtain information about the global activities of MNEs operating in their jurisdiction, where their profits are reported and where and how much tax they pay. This information would allow the developing country tax administrations to assess whether the income reported and the taxes paid in their jurisdiction appeared to be appropriate in the light of the MNE's global activities. It would allow them to identify, for example, where base-eroding payments were ending up or whether the "low risk" return shown by a local distributor was appropriate in light of the residual profit being reported elsewhere. The OECD/G-20 Action Plan in Item 13 proposes a requirement that MNE's provide CbC information in the context of transfer pricing documentation, but it is clear that the importance of CbC reporting goes well beyond transfer pricing issues as it provides insight into the relations between the various parts of the MNE and whether the income and tax allocations in the group broadly seem to make sense. CbC information can be useful as a risk assessment tool to help the tax administration to make decisions as to where it should all

items to be reported will be reduced to revenue, profit before tax, cash taxes and accrued taxes in the

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of a GAAR in some treaties but not others can make the application of other techniques in treaties lacking a GAAR more difficult.

2.5.2.4 Limiting treaty abuse through treaty interpretation. Artificial arrangements which have been structured to attempt to take advantage of treaty benefits can sometimes be dealt with through an appropriate approach to treaty interpretation. Under Article 31 of the Vienna Convention on the Law of Treaties, treaties are to be interpreted in good faith and in the light of the object and purpose of the treaty. Viewed from this perspective, structures without a business purpose or lacking in substance can be ignored in applying the treaty even where the treaty does not have a GAAR. The effectiveness of this approach depends on the general approach of the courts in the relevant country to legislative and treaty inter [illegible]

2.7.1 General. Foreign direct investment in developing countries can be structured as a locally organized subsidiary or as the branch of a foreign corporation. In both cases the shares of the corporation may be held by an off-shore holding company. If the operating assets in the country are

This approach may be difficult to enforce, especially if there is no requirement under local law for the sale of shares to be reported by the domestic corporation. In addition, tax might be collected by a withholding tax obligation on the purchaser to withhold and remit the appropriate amount of tax. Additional administrative issues are involved if the decision is made only to tax the sale of the sales in cases where there is a tax avoidance element.

A related issue is what impact the sale of the shares should have on the tax status of the underlying assets in the domestic corporation. If the sale of the shares is taxable and no adjustment is made in the tax cost of the underlying assets, a second tax would be due on the same economic gain when the assets were sold. Whether or not this pattern of taxation is appropriate will depend on the general structure of corporate-shareholder taxation in the country.

2.7.4 Shares of a foreign corporation. Assuming the decision is made to tax the sale of shares of domestic corporation in certain circumstances, a separate question is how to treat the sale of shares in a foreign corporation which owns the shares of the domestic corporation. There are significant administrative difficulties in implementing a tax on such a transfer as a general matter, both in terms of obtaining the necessary information to assess the tax and implementing effective methods for collection. In any event, it may be desirable to have a provision which taxes such sales where the transaction can be viewed as involving tax avoidance; for example, where the transfer of the shares of the domestic corporation to a foreign corporation is followed by the immediate sale of the foreign shares or in situations where the foreign corporation is merely a shell corporation.

2.7.5 Treaty Aspects. If the decision is made to tax the capital gains on the sale of shares in domestic or foreign corporations, it is important to consider the extent to which that right should be preserved in tax treaties. Many treaties limit the right to tax gains on the sale of shares to shares in companies which have substantial local real estate holdings. The United Nations Model in Article 13.5 provides for source state taxing rights where the percentage ownership of the shares in a domestic corporation exceeds a certain amount regardless of the nature of the underlying assets. In addition, as discussed in Section 2.5, treaty anti-abuse rules may be applicable to protect the source-based taxing claim on the sale of shares of either domestic or foreign corporations.

2.8 Services

2.8.1 General

employee's remuneration is not deductible in computing the profits attributable to the PE or fixed base, and the nonresident employee is not present in the source country for 183 days or more in any 12-month period.

The broad scope of source country taxation of income from employment earned by nonresident employees suggests that opportunities for tax avoidance of source country tax are limited. Where a nonresident employee's remuneration for employment services (performed in the source country) is deductible by the employer in computing income subject to tax by the source country, the nonresident employee is usually subject to tax on that remuneration by the source country. The employee's remuneration will usually be deductible if the employer is a resident or a nonresident carrying on business in the source country through a PE or a fixed base located in the source country. In these circumstances, the employer is usually required to withhold the tax on behalf of the employee from the remuneration.

Nevertheless, a developing country's tax base may be eroded if a nonresident employer avoids having a PE or fixed base in the source country or if a nonresident individual can alter his or her legal status from employment to independent contractor. A nonresident employee of a nonresident employer without a PE or fixed base in the source country is taxable only if the nonresident employee is present in the source country for more than 183 days. If a nonresident is an independent contractor, Article 7 or 14 of the UN Model will limit the source country's right to tax to situations in which the nonresident has a PE or a fixed base in the source country and the income is attributable to the PE or fixed base or the nonresident stays in the source country for 183 days or more in any 12-month period. In contrast, a nonresident employee of a resident employer or a nonresident employer with a PE or fixed base in the source country is taxable on any income from employment exercised in the source country.

2.8.3 Entertainment and Athletic Services

Some entertainers and athletes can make large sums of money in a short period of time. Developing countries that wish to tax income derived by nonresident entertainers and athletes must ensure that the provisions of their domestic law and tax treaties, such as Article 17 of the UN Model, allow them to tax such income irrespective of the legal structure of the arrangements. Article 17 allows the country in which entertainment or sports activities take place to tax the income from those activities. Countries must also have provisions in place to deal with techniques used by nonresident entertainers and athletes to avoid source country

the PE or fixed base. Second, if the services are provided outside the developing country but are deductible in computing the payer's income for purposes of the developing country's tax, the developing country may be unable to tax the income under its domestic law or under the provisions of an applicable tax treaty. If the nonresident service provider has a PE or fixed base in the developing country, the income attributable to the PE or fixed base under the provisions of Article 7 or 14 of the UN Model may include foreign source income if, for example, the remuneration of the employees performing the services is deductible in computing the profits of the PE or fixed base. Nevertheless, unless the domestic law of the developing country includes such foreign source income in the income of a nonresident, the fact that an applicable tax treaty allows the country to tax will be of no effect.

As discussed in section 2. , there are several ways in which taxpayers can structure their affairs to avoid having a PE or fixed base in a country. In some situations nonresident service providers can provide services in a developing country at various locations in the country without any one place being used for more than 6 months. Or a nonresident service provider may attempt to avoid having a PE or fixed base by using the fixed place of business of a

account services provided by related enterprises with respect to the same or connected projects. The same concern applies to construction projects under Article 5(3)(a) of the UN Model. Specific anti-avoidance rules in domestic law or tax treaties might be useful in this regard although the application of such rules requires effective information gathering by the tax administration of the developing country.

A multinational enterprise with a group company carrying on business in a developing country may use another group company resident in a low-tax country to provide various services to the company in the developing country. These services, which often include legal, accounting, management and technical services,[3] may not require employees of the nonresident service provider to be present in the developing country for long periods of time. It is difficult for developing countries to counteract this type of tax planning even with effective anti-avoidance rules in place. Some countries have insisted on a shorter period than 183 days to minimize the limitation on their ability to tax.

2.8.5 Technical Services

Some developing countries have special rules in their domestic law and tax treaties for income from technical services. Under these rules such services are subject to a final gross-based withholding tax at a flat rate and the resident payer for the services is required to withhold from the payments to the nonresident service provider. The types of services to which the rules apply often include managerial, technical and consulting services but these are not defined precisely.

The current UN Model does not contain any specific provisions dealing with income from

technical services. As non tes t 2]TJ 24.002 Tm5y(es1(o)6(m)-1(te)1(dr-is)4(si)2pc/s(ser)-1(v)49(i)-2(c-)5(e

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Tax incentives are widely used by both developing and developed countries to attract foreign investment. Although is seems likely that multinational enterprises use tax incentives to erode the tax base of both developing and developed countries, developing countries may be more susceptible to such base erosion because of a greater need for foreign investment and less capacity for the effective administration of tax incentives.

Tax incentives for foreign investment can be divided into two major 9/r 9/r 9/r 9/270q(pe)4(d ca8s:)Tj

ineffective

the special needs and perspective of developing countries regarding these issues. These involve among others the state of development of the tax system, the administrative resources available to deal with these matters, the nature of the trade and commercial relations with trading partners and regional considerations. Each country must evaluate its own situation to identify its particular issues and determine the most appropriate techniques to insure a sound tax base. The following materials are intended to assist in this task.