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## ARE TAXES CONVERGING?

Review of Eduardo Baistrocchi (ed.), *A Global Analysis of Tax Treaty Disputes* (Cambridge University Press, 2017)

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Gianluca Mazzoni<sup>2</sup>

Eduardo Baistrocchi's outstanding new book on tax treaty disputes is the result of an intense five-year global collaborative project among international tax scholars, practitioners and administrators. The book provides an unprecedented set of information and offers the first global *qualitative* and *quantitative* analysis on one of the most important debates over international tax scholarship across the last decades, that is, whether an international tax regime exists and is binding upon states as a matter of customary international law.

Baistrocchi's book covers over 1,610 leading tax treaty cases and is grounded on both country-by-country and topic-by-topic analyses. In particular, it covers the so-called 'pre-BEPS Reports Era' that took place from 1923 – when four eminent economists reached the compromise underlying the tax treaty network – to October 2015, when the OECD and G20 released the final BEPS package, which, as stated in the official press release by OECD Secretary General Angel Gurría, represents “the most fundamental changes to international tax rules in almost a century.”<sup>3</sup>

Baistrocchi's book allows readers to take an informed decision whether a binding international tax regime exists. It demonstrates an increasing convergence of tax treaties to the OECD model. This finding is consistent with recent research by Elliott Ash and Omri Marian on comparing treaty language using natural language analysis.<sup>4</sup> Ash and Marian found that between 1970 and 2015 the similarity of the text of the over 3,000 tax treaties rose from 60% to 80%, and that this convergence was primarily due to increasing influence of the OECD model treaty.<sup>5</sup>

These conclusions bolster the view that countries are not free to adopt any international tax rules they please, but rather operate within the context of the regime. In this regard, for example, Brazil will likely have to abandon its long tradition of establishing fixed margins for gross profits and markups, with regard to the cost-plus method (CPM) and the resale price (RSP) method, and adopt

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<sup>3</sup> OECD press release, October 5, 2015.

<sup>4</sup> Elliott Ash and Omri Marian, *The Making of International Tax Law: Empirical Evidence from Natural Language Processing*, paper presented at NTA Annual Meeting, Philadelphia, November 9 2017.

<sup>5</sup> The most similar article was article 9 (Associated Enterprise), and indeed that article and the arm's length standard it has embodied since 1935 has the strongest claim to being customary international law, as shown recently by the behavior of the US Treasury in the *Altera* case (in which the government refused to admit that the cost sharing regulations depart from the ALS even though that would have helped its argument).

rules modeled after the OECD guidelines (thus, making use of comparable transactions) in order to be able to join the OECD. Similar changes were made by Mexico and South Korea upon joining the OECD.

Baistrocchi's book also has interesting implications in regard to the ongoing debate on whether the "single tax principle" is part of the international tax regime. Since 1997, the first author has argued that the core of the international tax regime is two norms, which he calls the benefits principle (i.e., active business income should be taxed primarily at source, while passive investment income primarily at residence) and the single tax principle (i.e., income should be taxed once – that is not more and but also not less than once).

This thesis has been quite controversial. While most commentators would agree that the benefits principle has been the core of the international tax regime since 1923, several prominent international tax academics and practitioners in the United States and elsewhere deny the validity of the single tax principle and some doubt its coherence.<sup>6</sup>

In the introduction to the book, Baistrocchi briefly describes a tax treaty dispute that seems inconsistent with the single tax principle. Instead of investing in India directly, foreign direct investors decided to route investments from the Netherlands to India through Mauritius in order to take advantage of the favorable India-Mauritius tax treaty. The use of a 'shell company' incorporated in Mauritius, whose main purpose was investment of funds in India, had two important implications. Firstly, the transfer of shares of an Indian company controlled by a Mauritius-resident company was not subject to capital gains taxation in either country under both the India-Mauritius tax treaty and Mauritius domestic tax law. Secondly, it substantially increased Indian inbound foreign direct investment, which, in the last decade, amounted to \$178 billion. Of this, \$74.56 billion were routed through Mauritius accounting for 42 percent of the total FDI. Indian tax authorities were dissatisfied with this international tax planning strategy also known as 'offshore indirect transfer of shares' and tried to challenge in the *Vodafone* case. Ultimately, in January 2012, the Indian Supreme Court held that in the absence of any look-through provision in s. 9(1)(i) of the Finance Act 2012, the transfer of shares of a foreign target company (CGP Investments (Holdings) Ltd. "CGP", a company resident for tax purposes in the Cayman Islands) by a non-resident (HTI Holdings Limited "HTIHL", a company resident for tax purposes in the British Virgin Islands) to a non-resident (Vodafone International Holdings BV "VIH", a company resident for tax purposes in the Netherlands) would not attract Indian tax even if the object is to acquire

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<sup>6</sup> On this position see, e.g., H. David Rosenbloom, *International Tax Arbitrage and the "International Tax System"*, 53 *Tax L. Rev.* 137 (2000); Michael J. Graetz, *Taxing International Income - Inadequate Principles, Outdated Concepts, and Unsatisfactory Policy*, 54 *Tax Law Review* 261 (2001); Julie Roin, *Taxation Without Coordination* (2002), [http://papers.ssrn.com/paper.taf?abstract\\_id=302141](http://papers.ssrn.com/paper.taf?abstract_id=302141); Mitchell A. Kane, *STRATEGY AND COOPERATION IN NATIONAL RESPONSES TO INTERNATIONAL TAX ARBITRAGE*, 53 *Emory L.J.* 89; Adam H. Rosenzweig, *HARNESSING THE COSTS OF INTERNATIONAL TAX ARBITRAGE*, 26 *Va. Tax Rev.* 555. For the contrary position see, e.g., Reuven S. Avi-Yonah, *Commentary on Rosenbloom*, 53 *Tax L. Rev.* 167 (2000); Yariv Brauner, *An International Tax Regime in Crystallization*, 56 *Tax L. Rev.* 259; Fred B. Brown, *An Equity-Based, Multilateral Approach for Sourcing Income Among Nations*, 11 *Fla. Tax Rev.* 565; Ehab Farah, *Mandatory Arbitration of International Tax Disputes: A Solution in Search of a Problem*, 9 *Fla. Tax Rev.* 703; Victor Thuronyi, *INTERNATIONAL TAX COOPERATION AND A MULTILATERAL TREATY*, 26 *Brooklyn J. Int'l L.* 1641.

Indian assets (acquisition of 67 percent controlling interest in Hutchison Essar Limited “HEL”, a company resident for tax purposes in India).

Thus, under the Indian Supreme Court’s interpretation, the gain from the sale of the shares would not be subject to tax at source or at residence, thus violating the single tax principle. However, the Indian government found this result unacceptable. The Finance Act 2012, through an *ex-post facto* amendment inserted explanation 4 and 5 in s. 9(1)(i). This retrospective amendment asserts India’s source based jurisdiction to charge capital gain tax on indirect transfer of Indian assets including the transaction in the Vodafone case. The legality of this retrospective amendment was subsequently submitted to arbitration by Vodafone under the India-Netherlands Bilateral Investment Treaty, and the final outcome remains in doubt. But it is clear that India views double non taxation as unacceptable in the context of indirect share transfers, and China has taken a similar position.

Despite the existence of many such examples of double non-taxation, it is clear that the tendency in recent years has been for most large countries to support the single tax principle. For example, the 2016 US model tax treaty explicitly endorses the principle. As stated in the official press release, “The 2016 Model ... includes a number of new provisions intended to more effectively implement the Treasury Department’s longstanding policy that tax treaties should eliminate double taxation **without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance**. For example, the 2016 Model does **not reduce withholding taxes on payments of highly mobile income** – income that taxpayers can easily shift around the globe through deductible payments such as royalties and interest – **that are made to related persons that enjoy low or no taxation** with respect to that income under a preferential tax regime.”<sup>7</sup>

Similar positions have been adopted by the EU in the anti-tax avoidance package and by the OECD in the context of BEPS. For example, the new preamble to the OECD model tax treaty states that:

(State A) and (State B)...Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital **without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance...**(emphasis added)<sup>8</sup>

And Secretary General Gurría has stated upon introducing the final BEPS package that:

Base erosion and profit shifting affects all countries, not only economically, but also as a matter of trust. BEPS is depriving countries of precious resources to jump-start growth, tackle the effects of the global economic crisis and create more and better opportunities for all. But beyond this, BEPS has been also eroding the trust of citizens in the fairness of tax systems worldwide. The measures we are presenting today represent the most fundamental changes to international tax rules in almost a century: they will **put an end to double non-taxation**, facilitate a better alignment of taxation with economic activity and value creation, and when fully implemented, these measures will render BEPS-inspired tax planning structures ineffective.<sup>9</sup>

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<sup>7</sup> US Model Income Tax Treaty (Feb. 2016).

<sup>8</sup> OECD Final BEPS Package (October 2015).

<sup>9</sup> OECD press release, October 5, 2015 (emphasis added).

Baistrocchi's book shows how the international tax regime evolved slowly toward coherence from its origins to 2015. The G20/OECD BEPS efforts have now enshrined both principles of the regime in the tax treaty network. In particular, the new multilateral instrument, signed by over 70 jurisdictions, will incorporate the single tax principles into over 1,000 tax treaties. This, as Baistrocchi recognizes, represents a new era in international taxation. But to understand this new era it is essential to appreciate what came before it, and for that Baistrocchi's book will be an indispensable guide.