Submission to IMF consultation on economic "spillovers" in international taxation

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Background
The contents of this submission are based on empirical findings and insights from my PhD research on international tax structures of multinational corporations, in particular structures that involve tax treaty shopping. I therefore focus on the first question of the consultation. My full PhD dissertation is available at http://francisweyzig.com/phd-dissertation. For peer-reviewed articles based on individual chapters, including an empirical analysis of tax treaty shopping, see http://francisweyzig.com/publications.

1. Tax treaties and treaty shopping
Low income countries and lower-middle income countries are usually net importers of FDI. That means they mainly have an interest in facilitating inward FDI, while protecting their domestic tax base and limiting shifts of taxation rights on corporate income from source (FDI host) to residence (FDI home) countries. For capacity-constrained low and lower-middle income countries, withholding taxes on tax-deductible payments may be an important generic defence against profit shifting by multinational corporations. This contrasts with high income and some upper-middle income countries that are large FDI exporters. These countries have a strong interest in facilitating outward FDI as well. They could be more interested to shift taxation rights from source to residence countries or to reduce the overall tax burden of large home-based multinationals. Furthermore, they usually have the administrative capacity to implement more specific measures against profit shifting.

Tax treaty shopping affects low and lower-middle income countries in various ways. On the one hand, treaty shopping may increase the volume of inward FDI, but there is no clear evidence of such an effect. Empirical studies analysing the general effect of tax treaties on FDI produce mixed results. They also have important limitations. For a critical discussion of empirical economic studies on the effect of tax treaties, see paragraph 5.2 in IOB Study 386, a study commissioned by the Dutch Ministry of Foreign Affairs. On the other hand, treaty shopping can reduce tax revenues in the host country, for example by reducing withholding taxes or changing permanent establishment rules. Moreover, a reduction of withholding taxes on interest and royalties can increase opportunities for profit shifting and stimulates debt financing. This further limits the tax base in the host country.

Due to treaty shopping, a host country's tax treaty that is most favourable for foreign investors can effectively become a treaty with the world. This is especially the case for treaties with partner countries that do not levy withholding taxes on certain types of income and allow payments to be passed on via conduit entities. In particular, because internal

barriers within the EU are almost absent, the most investor-friendly treaty of a non-EU host country with an EU country may function as a treaty with the EU as a whole. For low and lower-middle income host countries that want to reduce withholding taxes, for example, it therefore makes sense to do so unilaterally or specify the same maximum rates in all their tax treaties. The latter would require cooperation from treaty partners. Low and lower-middle income countries can also include anti-avoidance clauses in tax treaties to prevent treaty shopping. Such clauses should preferably be standardised, as the most investor-friendly treaty with the weakest anti-avoidance clause can still function as a treaty with the world. Moreover, anti-avoidance clauses may only be effective if partner countries spontaneously exchange relevant information on corporate structures that might be excluded from treaty benefits under such clauses.

While anti-avoidance clauses can provide a useful solution in the short term, they further increase the complexity of the international tax system. This may be especially challenging for capacity-constrained low and lower-middle income countries. Therefore the development of multilateral alternatives to bilateral investment treaties, or other multilateral solutions to reduce mismatches between national tax systems, may be preferable in the medium to long term. To safeguard the interests of low and low-middle income countries, the development of multilateral solutions should involve adequate participation of these countries and the interests of net FDI exporting countries with more negotiating power and administrative capacity shuld not be dominant.