
Table of Contents

Preface

v

Part I

The Effect of Bilateral Tax Treaties on Economic Growth

The Relationship between Double Taxation Treaties and Foreign Direct Investment

*Fabian Barthel, Matthias Busse,
Richard Krever and Eric Neumayer*

1.	Introduction	3
2.	Treaties as motivation for FDI	4
	2.1. The attraction of treaties for host countries	4
	2.2. The attraction of treaties for investors	6
3.	Previous studies	7
4.	The methodology	10
5.	The findings	13
6.	The provisos	14
7.	What explains the findings?	15
8.	Conclusion	17
	Appendix	18

Part II

Treaty Shopping and Avoidance of Abuse

Rethinking Treaty Shopping: Lessons for the European Union

Reuven S. Avi-Yonah and Christiana HJI Panayi

1.	Introduction	21
2.	Treaty shopping and improper use of tax treaties	21
	2.1. Finding the contours of treaty shopping	21
	2.2. Theoretical objections to treaty shopping	25
3.	Responses to treaty shopping: The OECD and the United States	30
	3.1. The OECD approach to treaty shopping	30

Table of Contents

3.2. The US approach to treaty shopping	41
4. Treaty shopping and EU law	44
5. Conclusion	49

Treaty Shopping and Avoidance of Abuse

Niels Bammens and Luc De Broe

1. The relationship between anti-avoidance provisions and foreign direct investment	52
2. Domestic anti-avoidance measures and economic substance	56
3. Limitation-on-benefits clauses in tax treaties	59
4. The beneficial ownership requirement in tax treaties	62
5. Cost-benefit analysis of anti-avoidance measures	71
6. Conclusion	72

Responses to Treaty Shopping: A Comparative Evaluation

David G. Duff

1. Introduction	75
2. Treaty shopping	76
3. Treaty interpretation	79
3.1. Residence	80
3.1.1. Liable to tax by reason of domicile, residence, place of management or any other criterion of a similar nature	81
3.1.2. Place of effective management	84
3.2. Beneficial ownership	86
3.3. Inherent anti-abuse principle	90
4. Anti-avoidance rules	95
4.1. Domestic rules	95
4.2. Treaty rules	99
5. Conclusion	102

The Influence of Public Institutions on the Shadow Economy: An Empirical Investigation for OECD Countries

Friedrich Schneider

1. Introduction	103
2. Some theoretical considerations on the shadow economy	103

2.1.	Defining the shadow economy	103
2.2.	Measuring the shadow economy	106
2.3.	The main causes of the shadow economy	109
2.3.1.	Tax and social security contribution burdens	109
2.3.2.	Intensity of regulations	110
2.3.3.	Public sector services	111
2.3.4.	Other public institutions	112
2.3.5.	Summary of the main causes of the shadow economy	113
3.	Estimation and calculation of the size of the shadow economies in OECD countries	114
3.1.	Econometric estimation	114
3.2.	Size and development of the shadow economy in 21 OECD countries	117
4.	Summary and policy conclusion	120
4.1.	Policy measures	120
4.2.	Conclusions	121
5.	Appendix: The MIMIC estimation procedure, its advantages and disadvantages	122
5.1.	MIMIC model	122
5.2.	Application of the MIMIC procedure	124
5.3.	Advantages and disadvantages of the MIMIC estimates of the shadow economy	125
5.3.1.	Advantages	125
5.3.2.	Disadvantages	126

**The 2003 Revisions to the Commentary to the OECD Model
on Tax Treaties and GAARs: A Mistaken Starting Point**

Juan José Zornoza Pérez and Andrés Báez

1.	Introduction: scope and structure of the article	129
2.	The factual approach to GAARs: A technical mistake and a misleading starting point	132
2.1.	The factual approach is ambiguous	132
2.2.	The factual approach is a goal-oriented reasoning	133
2.3.	Factual approach and widening of the concept of sham: A risk in certain jurisdictions	135
3.	Legal approach to GAARs: The need to add nuances	138
3.1.	Nature and limits of interpretation	139
3.2.	Combating intended avoidance: The case of attribution	143
3.3.	Real avoidance cases	150

Table of Contents

4.	The guiding principle: A critical analysis of its components according to legal theory and European Community Law	153
4.1.	Main purpose of the transaction	153
4.2.	Tax treatment contrary to the object and purpose of the relevant provisions of the treaty	155

Part III

International Allocation of Cross Border Business Profits: Arm's Length Principle

Tax Competition and International Tax Agreements: Lessons from Economic Theory

Wolfgang Eggert, Jun-ichi Itaya and Hannes Winner

1.	Introduction	161
2.	Corporate tax burden in the European Union	162
3.	Mechanisms in tax competition	167
3.1.	A non-cooperative game	167
3.2.	Pareto-efficient taxation and a participation constraint	170
3.3.	Dilemmas	172
4.	Corporate tax harmonization in the European Union	173
5.	Explaining co-operation in tax policy	176
5.1.	Repeated play	176
5.2.	Renegotiation	178
6.	Conclusions	180

Supplementing Consolidation and Apportionment with Anti-Abuse Provisions

Marcel Gérard and Edoardo Traversa

1.	Introduction	183
2.	The economic argument	184
2.1.	Separate Accounting	185
2.2.	Consolidation and Formulary Apportionment in the three countries	187
2.3.	Consolidation and Formulary Apportionment and the Enhanced Cooperation Agreement	188
2.4.	Consolidation and Formulary Apportionment, Enhanced Cooperation and supplementary measures	189

2.5.	Tentative conclusion	190
3.	Legal analysis of the proposed reform	190
3.1.	Territoriality	192
3.2.	Anti-abuse measures in the relations between countries with Consolidation and Formulary Apportionment	194
3.3.	The relations between Consolidated and Formulary Apportionment countries and (non-EU) third countries	195
3.3.1.	Denying exemption of foreign income from low-tax jurisdictions/switch from exemption to credit	195
3.3.2.	CFC legislation and anti-abuse measures aimed at disregarding capital outflows to third countries	197
3.4.	The relations between C&FA countries and other EU Member States	202
4.	Conclusion	205
	Appendix	205

Part IV

Source versus Residence

The Potential of Multilateral Tax Treaties

Kim Brooks

1.	The rich literature supporting multilateralism	211
2.	Possible approaches to improving tax coordination: The road to multilateralism	213
3.	The advantages of multilateral tax treaties	218
3.1.	Advantages in facilitating trade	220
3.2.	Advantages in preventing or reducing evasion and avoidance	221
3.3.	Administrative advantages	223
3.4.	Potential for preventing tax competition	225
3.5.	Potential disadvantages	226
4.	Potential of the CARICOM multilateral double taxation agreement	227
4.1.	Brief review of the history and design of the CARICOM treaty	229
4.2.	Advantages in facilitating trade	232
4.3.	Advantages in preventing or reducing evasion and avoidance	232

Table of Contents

4.4.	Administrative advantages	234
4.5.	Potential for preventing tax competition	235
5.	The importance of some form of multilateralism	236

Legal and Economic Principles Support an Origin and Import Neutrality-Based over a Residence and Export Neutrality-Based Tax Treaty Policy

Eric C.C.M. Kemmeren

1.	Introduction	237
2.	Rationale tax treaties	239
3.	Legal principles for allocation of tax jurisdiction in tax treaties	244
3.1.	General	245
3.2.	Economic relationship with a state	246
3.3.	Sufficient economic relationship	248
3.3.1.	Qualitative principles	253
3.3.1.1.	Nationality or citizenship	254
3.3.1.2.	Incorporation or real seat	256
3.3.1.3.	Domicile or residence	258
3.3.1.4.	Source	261
3.3.1.5.	Origin	264
3.3.1.5.1.	Income and capital gains tax	264
3.3.1.5.2.	Net wealth tax: Economic location	276
3.3.1.6.	Functionality	277
3.3.2.	Quantitative principles	280
3.3.2.1.	Universality principle	280
3.3.2.2.	Territoriality principle	282
3.4.	Interim conclusions	287
4.	Economic principles for allocation of tax jurisdiction in tax treaties	288
4.1.	General	289
4.2.	Capital and labour export neutrality versus capital and labour import neutrality	291
4.3.	Neutrality and direct investments	294
4.4.	Neutrality and portfolio investments	299
4.5.	Neutrality and operational leases	303
4.6.	Neutrality and labour	304
4.7.	Interim conclusions	305
5.	Summary and conclusions	309

Part V
Credit versus Exemption

**Credit versus Exemption under Domestic
Tax Law and Treaties**

Guglielmo Maisto

1.	Defining credit and exemption methods	319
	1.1. Classification of credit systems	320
	1.2. Classification of exemption countries	322
2.	International tax policy aspects of credit and exemption	323
	2.1. Credit and exemption in the light of the different approaches to neutrality of tax systems	323
	2.2. Credit and exemption in recent studies and legislative proposals worldwide	326
3.	Constitutional aspects of credit and exemption	329
	3.1. Constitutional principles that may be significant with regard to credit and exemption	330
	3.2. Whether constitutional principles require a state to give relief from international double taxation and/or imply a preference for credit or for exemption	331
4.	History of tax treaties with regard to credit and exemption	333
5.	Further studies carried out at the OECD level with regard to credit and exemption	340
6.	The OECD Model Convention and its Commentaries	341
	6.1. The OECD Model Convention	341
	6.2. The OECD Commentaries on the Model Convention: When it is appropriate to limit the scope of the exemption?	343
	6.3. The OECD Commentaries on the Model Convention: When it is appropriate to limit the scope of the credit?	345
	6.4. Conclusion	346
7.	Credit and exemption in tax treaty negotiation	348
	7.1. The tax treaty policy of credit or exemption countries in terms of relief method	348
	7.2. Do countries deviate from their tax treaty policy in terms of relief method when negotiating with a country that has an opposite treaty policy?	351
	7.2.1. Countries that have a credit treaty policy: Empirical evidence	352
	7.2.2. Countries that have an exemption treaty policy: Empirical evidence	353

Table of Contents

7.3.	Recent economic studies with regard to countries' behaviour in tax treaty negotiation	355
8.	Credit and exemption and the principle of <i>non-aggravation</i> by tax treaties	357
9.	WTO aspects of credit and exemption	359

Rethinking Foreign Tax Creditability

Daniel Shaviro

1.	Introduction	363
2.	The case against allowing foreign tax credits	365
2.1.	Global welfare, unilateral national welfare, and cooperative national welfare	365
2.2.	Evaluating the foreign tax credit from a unilateral national welfare perspective	368
3.	Why is the desirability of offering foreign tax credits so widely accepted?	371
3.1.	Aversion to "Double Taxation"	372
3.2.	Foreign tax credits as a tool for advancing worldwide efficiency	376
4.	Conclusion	379

Elimination of Double Taxation and Tax Deferral: The Example of the Merger Directive

*Domingo J. Jiménez-Valladolid de L'Hotellerie-Fallois
and Félix Alberto Vega Borrego*

1.	Introduction	381
2.	Tax consequences of the contribution of a foreign permanent establishment under the OECD Model Convention	382
3.	Tax consequences of the contribution of a foreign permanent establishment under the Merger Directive	386
3.1.	Overview of the tax regime envisaged in the Merger Directive in respect of the contribution of a foreign permanent establishment	386
3.2.	Application of the exemption method	389
3.3.	Application of the credit method	391
3.3.1.	The scope of the derogation provided by Art. 10(2) of the Merger Directive	391

3.3.2.	Is the ordinary tax credit permissible under Art. 10(2) of the Merger Directive?	394
3.3.3.	The calculation of the notional tax credit	395
4.	The taxation of the contribution of a foreign permanent establishment under Spanish law	398
4.1.	The taxation of the contribution of a foreign permanent establishment in Spanish domestic law when the special tax regime implementing the Merger Directive is not applicable	398
4.2.	The taxation of the contribution of a foreign permanent establishment in Spanish domestic law when the special tax regime implementing the Merger Directive is applicable	402
5.	Concluding remarks	408

Part VI

Tax Treaties and Developing Countries

Tax Treaties with Developing Countries: A Plea for New Allocation Rules and a Combined Legal and Economic Approach

Pasquale Pistone

1.	Starting point and subject	413
2.	Economic theories and the legal dimension: the need for a combined approach	416
3.	Looking backwards: a few selected remarks on tax jurisdiction from past to present	420
4.	Rethinking the allocation of taxing powers in tax treaties with developing countries	424
4.1.	Why still conclude a tax treaty?	428
4.2.	For a new balance in the allocation of taxing powers	429
4.3.	Some ideas for shifting to exclusive allocation of taxing powers in tax treaties according to the category of income	431
5.	Conclusions	437

Tax Treaties and Developing Countries

Victor Thuronyi

1.	Developing a treaty strategy	441
2.	Unilateral measures	445
3.	A “light” treaty	450
4.	Conclusion	455

Part VII

**Tax Treaty Application: Cross Border Administrative Issues
(Including Exchange of Information, Collection of Taxes,
Dispute Settlement, Legal Certainty in
Tax Treaty Application)**

**Arbitration of Unresolved Issues in Mutual Agreement Cases:
The New Para. 5, Art. 25 of the OECD Model Convention,
a Multi-Tiered Dispute Resolution Clause**

Carlo Garbarino and Marina Lombardo

1.	Introductory remarks on the arbitration method in international tax matters	459
2.	The evolution of international tax arbitration	462
3.	The procedure of the tax arbitration of Art. 25(5) of the OECD Model Convention	467
4.	The effectiveness of the tax treaty arbitration of Art. 25(5) of the OECD Model Convention	474

**Identifying the New International Standard
for Effective Information Exchange**

Michael J. McIntyre

1.	Introduction	481
2.	The emerging standard of <i>effective</i> information exchange	484
3.	The OECD and its lapse of leadership on effective information exchange	493
4.	A proposed Model TIEA	500
5.	Concluding comments	504
	Appendix – A Model Effective Tax Information Exchange Agreement	505

Tax Treaty Application – Cross-Border Administrative Issues

D.P. Sengupta

1.	Introduction	517
	1.1. Exchange of information	517
	1.2. Need for information	517
	1.3. Difficulty in collecting taxes	518
	1.4. Mutual agreement procedure	518
	1.5. Dispute resolution	518
	1.6. Conclusion	519
2.	Exchange of information	519
	2.1. Need for information	519
	2.2. Difficulty in obtaining information	521
	2.3. Inherent weaknesses in Exchange of Information (EOI) article	523
	2.4. Domestic law of India	524
	2.5. EOI with Mauritius	526
	2.6. EOI with Singapore	529
	2.7. EOI with United Arab Emirates (UAE)	530
	2.8. EOI with Switzerland	532
	2.9. EOI with the United Kingdom (UK)	533
	2.10. EOI with the United States	534
	2.11. Spontaneous and automatic information	536
3.	Assistance in collection	537
4.	Mutual agreement procedure (MAP)	539
5.	Dispute resolution	541
	5.1. Authority for Advance Ruling (AAR)	541
	5.2. Dispute Resolution Panel (DRP)	544
6.	Conclusion	546

Tax Treaty Application: Cross-Border Administrative Issues (Including Exchange of Information, Collection of Taxes, Dispute Settlement and Legal Certainty in Tax Treaty Application)

*Martin Wenz, Alexander Linn, Bernhard Brielmaier
and Matthias Langer*

1.	Introduction	547
2.	Recent developments in international tax cooperation	551
	2.1. Unilateral international tax cooperation	551
	2.2. Mutual Legal Assistance Treaties	551

Table of Contents

2.3.	Tax Information Exchange Agreements	552
2.4.	Double Taxation Conventions	553
2.5.	Multilateral and supranational arrangements	555
2.6.	Other methods of international tax cooperation	556
3.	Bilateral agreements: Liechtenstein	557
3.1.	Mutual legal assistance treaty	557
3.2.	Tax information exchange agreements	559
3.3.	Double taxation conventions	561
4.	Multilateral agreements: Liechtenstein	562
4.1.	Schengen-Dublin Agreement	562
4.2.	EU Anti-Fraud Agreement	563
4.3.	EU Savings Agreement	564
5.	Effects of tax cooperation agreements	565
5.1.	Legal certainty	565
5.2.	Source versus residence	566
5.3.	Level playing field of tax competition	568
5.3.1.	Economic models of tax non-compliance	569
5.3.2.	Economic models of tax competition	570
5.3.3.	Economic effects of TIEAs and DTCs	572
6.	Discussion and developments	575
7.	Conclusion	577

Part VIII

International Tax Neutrality and Non-discrimination

On the Relationship between International Tax Neutrality and Non-Discrimination Clauses under Tax Treaties for Source-Based Taxes

Catherine Brown and Jack Mintz

1.	Introduction	581
2.	The existing system and neutrality	584
2.1.	Tax neutrality	591
3.	Non-discrimination and the OECD Model Treaty	593
3.1.	Non-discrimination and the taxation of resident, national or foreign-owned enterprises (investments)	595
3.2.	Non-discrimination and the taxation of Permanent Establishments (PEs)	596
3.3.	Non-discrimination and the taxation of non-residents (including foreign-owned enterprises)	598

4.	Is there a relationship between non-discrimination in the OECD treaty and international tax neutrality?	599
	4.1. What should the non-discrimination article include?	600
5.	Conclusions	605

International Tax Neutrality and Non-Discrimination: Plea for a More Explicit Dialogue between the State and the Market

Cees Peters

1.	Introduction	607
2.	The intermediary state	607
2.	Inter-nations equity	609
3.	International tax neutrality	611
	3.1. The rationale for international tax neutrality	611
	3.2. The relationship between (international) tax neutrality, efficiency and equity	614
	3.2.1. Introduction	614
	3.2.2. Metaphorical explanation	614
	3.2.3. Illustration by means of the discussion concerning the concept of inter-nations neutrality	617
	3.2.4. Implicit value judgements about the international political economy and the concept of international tax neutrality	620
	3.2.5. Conclusion about international tax neutrality	622
4.	The link between different concepts of international tax neutrality and inter-nations equity	624
5.	Conclusion	627

International Tax Neutrality and Non-Discrimination – A Legal Perspective

Alexander Rust

1.	Introduction	629
2.	Scope	629
3.	Consequences of a violation of the non-discrimination provisions and mode of operation	630
4.	Relationship between the distributive norms and the non-discrimination provision	632
5.	The non-discrimination provisions in detail	634
	5.1. Art. 24(1): Nationality non-discrimination provision	634

Table of Contents

5.2. Art. 24(2): Stateless persons	637
5.3. Art. 24(3): Permanent establishment	638
5.4. Art. 24(4): Deductibility	640
5.5. Art. 24(5): Ownership	641
6. Permissible distinctions	644
7. Purpose of the non-discrimination article	646
8. Necessary changes	647
Contributors	651