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The Implications of the Use of DTCs as Compared with TIEAs

Many different mechanisms serve as instruments for the exchange of tax information. Some are purely a matter of domestic law, while others are bilateral in nature and yet others are multilateral. In general, multilateral arrangements are employed among countries with integrated economies or countries which have similar economies and are at similar stages of development.

Bilateral exchange of information provisions are most commonly set out in double taxation conventions. Such agreements typically provide for reciprocal economic benefits, the limitation of double taxation and the partitioning of taxing rights and enforcement cooperation. In understanding the role of such DTCs it is important to bear in mind that the taxation regimes of countries are typically biased so as to enhance the international competitiveness of the country creating the relevant taxation system, and that tax information may be required to give effect to such biases. DTCs may be seen as offsetting, over-riding or modifying some of those biases in order to promote international commerce between the signatories.

Currently there are approximately 2,500 tax treaties in existence, linking more than 170 countries.[120] Based on the information in the 2006 Assessment and information from other publicly available sources, it would appear that something approximating one-third of the 2500 treaties are among OECD member countries and that almost two-thirds of these 2500 treaties have at least one of the 30 OECD countries as a counterparty. The OECD countries may therefore be seen as being at the core of the tax treaty network.

Treaty-related linkages create a myriad economic benefits which only countries which are party to this treaty network are able to enjoy and which those closest to the economic centre of the network have the greatest opportunity to benefit from.[121] By way of example, double taxation conventions, as the name implies, generally limit the economic inefficiency created by double taxation, for example by providing for lower withholding tax rates. Countries which are parties to the treaty network may enjoy such benefits, with the result that countries outside the network are left at an economic disadvantage.

Consider the following hypothetical and simplified example in which there is an investor who is considering an investment in one of two countries. One country is a participant in a treaty network in that it has a DTC with the investor's home country, whereas the other country has no such treaty. The investor's home country taxes worldwide income at a rate of 25 per cent and neither exempts taxed foreign income nor gives credit for foreign taxes paid. Each of the two countries in which the investor is considering investing applies a withholding tax on relevant income of 25 per cent which is applied in the absence of any treaty-based derogation from this rate. One of the provi-

sions of the relevant DTC between the investor's home country and one of the countries in which an investment is being considered is that withholding tax rates on income are reduced to 5 per cent. Apart from tax considerations, the countries offer the investor the same opportunities.

If the investor invests in the country that is part of the treaty network, his after-tax return on investment will be greater than if he invested in the country excluded from the treaty network. This arises by virtue of the fact that the investor would pay 25 per cent tax in his country of residence plus 5 per cent withholding tax if investing in the country within the treaty network, but 25 per cent plus an additional 25 per cent if he was investing in the country outside the treaty network. Whether intended or not, the logically foreseeable end result of exclusion from treaty networks is that in such circumstances private sector entities, who could provide much-needed development capital, may 'vote with their feet' by placing their investments in jurisdictions which offer the greater treaty advantage and after-tax return, a form of tax competition not covered in the Harmful Tax Competition Initiative.

Tax information exchange agreements have existed in something like their current form since the League of Nations developed exchange of information models in the period 1921–45. However, the League of Nations document was not used historically as a stand-alone instrument, as generally countries only agreed to negotiate the exchange of tax information under conditions which were mutually beneficial and typically within the context of a conventional taxation treaty such as a modern DTC. The modern form of TIEA and its role in the hierarchy of tax-related international agreements arguably emerged in the 1980s. Richard Gordon, then a senior advisor to the US Internal Revenue Service, originally proposed two alternatives to conventional tax treaties which could be used in the context of countries which the US regarded as 'tax havens', which in that context included both OECD and non-OECD countries. One of these alternatives was a bilateral tax information exchange agreement combined with specific economic inducements, and the other was a modified form of tax treaty designed to limit certain economic distortions which might occur in relation to the application of conventional DTCs between countries with high rates of direct tax and those with low rates of direct tax, as well as to prevent certain other perceived misuses. In the end, the USA chose the TIEA plus inducements option (the inducements taking the form of the Caribbean Basin Initiative benefits plus the avoidance of the 'big stick').[122] The OECD's Harmful Tax Competition Initiative in its initial form may be seen as the offspring (whether legitimate or not) of this 1980s US approach, modified by the removal of the benefits set out in the Caribbean Basin Initiative. The 'big stick', however, was retained. As noted by Langer:

> This is yet another example of a Caribbean jurisdiction getting only the worst half of a tax treaty. It must give information, but it gets nothing in return.[123]

Forty-six TIEAs are identified in the 2006 Assessment, almost two-thirds of which have the USA as one of the parties.[124] Most of the small number of TIEAs to which the USA

is not a party exist in parallel with a conventional tax treaty which provides mutual economic benefits. Most of the US TIEAs were negotiated in the context of the Caribbean Basin Initiative. As noted by the ITIO:

> It is to be presumed that absent such benefits [Caribbean Basin Initiative], and in particular in situations in which there are significant tax rate differentials, few countries have found TIEAs attractive as they do not provide the types of reciprocal economic benefits found within comprehensive taxation agreements.[125]

Arguably, in the promotion of a polarised DTC or TIEA approach, there is a danger for small and developing countries of the emergence of a 'two-tiered system' which would allow the 'first class' rich countries, as well as countries with greater geopolitical influence or scarce resources, such as oil, to share in the benefits of the treaty network, while smaller countries and naturally resource-poor countries are excluded. This could potentially exacerbate development problems for small and developing countries which are restricted to the stand-alone TIEAs and are prevented from participating in the benefits of the treaty network. From a global perspective, any approach which relegates these small and developing countries to the status of a 'second class' country would arguably violate any principle of 'fairness'. As noted by Ms Latu, the former Attorney General of Samoa:

> Small and developing countries are frequently excluded from or not given the opportunity to participate in such treaty networks because they do not have the economic influence of larger nations – specifically in such areas as trade and export of commodities or resources. … [T]his becomes a 'vicious circle' in which the economic influence of small and developing countries is held back by being excluded from treaty networks.[126]

The exclusion of smaller countries with minimal geopolitical influence from the treaty network and their relegation to TIEA class is undoubtedly a possible means of competition available to larger countries, which can unfairly bias the economic effects of selected mechanisms for the exchange of information. Essentially, it can be argued that, from a regulatory competition perspective, by excluding small and developing countries from the treaty networks the larger more geopolitically powerful states may have wittingly or unwittingly exercised 'the competitive adjustment of rules, processes or enforcement regimes in order to achieve an advantage.'[127] Unless this situation is corrected, the rich will get richer and the poor will continue to be disadvantaged.