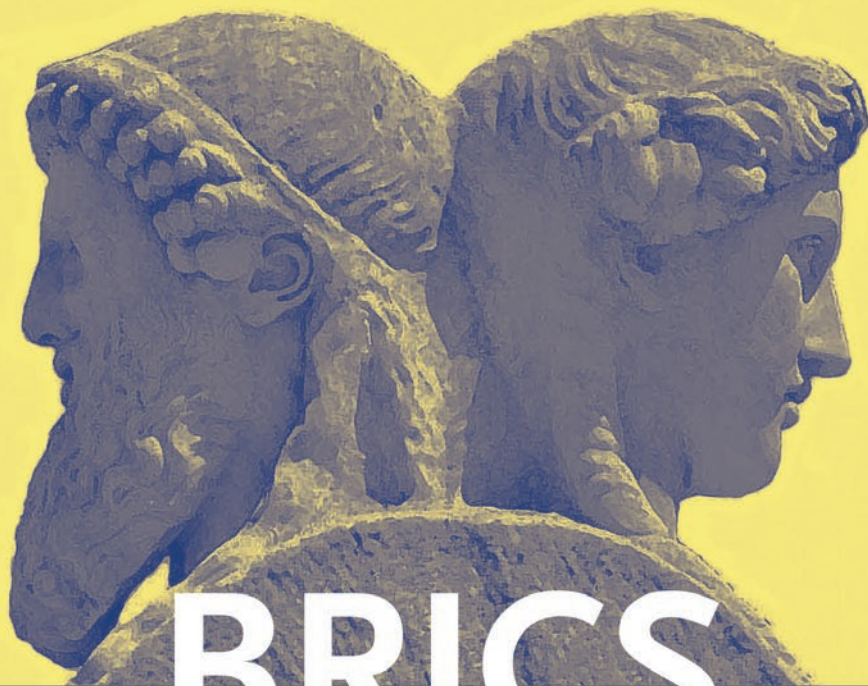


Editors Yariv Brauner / Pasquale Pistone



BRICS

AND THE EMERGENCE
OF INTERNATIONAL
TAX COORDINATION

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BRICS and the Emergence of International Tax Coordination

Why this book?

The BRICS have been all the rage from the beginning of the millennium. This book focuses on the shift of power in the global economy from the traditionally dominant nations that comprise the OECD, or, even more narrowly, the G7, to emerging economies, perhaps led by the BRICS. The remodelling of the power structure shaping the global economy and global economic governance more generally is possibly being paralleled by a corresponding reformatting of international taxation. The dominance of the richest countries in the world over the international tax regime that had evolved over the second part of the 20th century is being defied as the 21st century progresses. Emerging economies, within and outside the OECD, assert their newly found power to acquire voice and influence on the international tax agenda.

This book is the first to map and analyse the effect of these power shifts on the evolution of the international tax regime in general and on tax treaties that follow the OECD Model in particular. This effect is examined from a wide variety of perspectives and views, considering its substantive tax technical, institutional and political aspects. A leading group of experts contributed to form this new discourse that focuses on, yet is not limited to, the BRICS. They take an independent, scholarly and realistic approach to the various options available to the BRICS and other emerging economies in their quest for a voice in the governance of the international tax regime. The potential for cooperation among the BRICS and similar nations is at the core of the discourse. It is explored in depth on its own and as a primary influence on the emergence of international tax cooperation more generally.

Title:	BRICS and the Emergence of International Tax Coordination
Editor(s):	Yariv Brauner, Pasquale Pistone
Date of publication:	February 2015
ISBN:	978-90-8722-304-5
Type of publication:	Print book
Number of pages:	544
Terms:	Shipping fees apply. Shipping information is available on our website
Price:	EUR 110 / USD 140 (VAT excl.)

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Introduction

Pasquale Pistone and Yariv Brauner

1.1. Purpose and scope

The BRICS countries (Brazil, Russia, India, China and South Africa) have been all the rage from the beginning of the Millennium. The catchy term¹ and the impressive economic performance elevating them to the status of emerging economies, have fed much hope, as well as anxiety, among government officials, businesses, scholars and others engaged in the international economic affairs discourse.²

This book, however, is not strictly just about the BRICS; it is rather concerned with the shift of power in the global economy from the traditionally dominant countries that comprise the OECD, or, even more narrowly, the G7,³ to emerging economies, perhaps led by the BRICS. The remodelling of the power structure shaping the global economy and global economic governance more generally is possibly being paralleled by a corresponding reformatting of international taxation. The dominance of the richest countries in the world over the international tax regime that had evolved over the second part of the 20th century⁴ is being defied as the 21st century progresses. Emerging economies – most vocally, China and India – are

1. Originally coined by Jim O’Neill of Goldman Sachs, in *Building Better Global Economic BRICs*, Global Economics Paper 66 (2001), available at <http://www.goldmansachs.com/our-thinking/archive/archive-pdfs/build-better-brics.pdf>. South Africa was not originally grouped together with what were then called the BRIC countries.

2. However, by looking at the features and content of their international taxation and – more specifically – tax treaties, one might wonder whether in fact they share anything more than an acronym.

3. Comprised of Canada, France, Germany, Italy, Japan, the United Kingdom and the United States. The European Union is also represented at the forum. Russia joined the group to form the so-called G8, and even presided over it (see <http://en.g8russia.ru>), yet was ousted in 2014 due to the crisis in Ukraine. See http://www.g8.utoronto.ca/summit/2014brussels/ukraine_140425.html. For more on the G8, see <http://www.g8.utoronto.ca> (a University of Toronto website tracking the organization).

4. E.g. R.S. Avi-Yonah, *Commentary (Response to article by H. David Rosenbloom)*, 53 Tax L. Rev. (1999), at 167, 169 (explaining that the regime is constructed around the network of bilateral tax treaties, essentially all of which are modelled on the OECD Convention). See also R.S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 Tex. L. Rev. (1996), at 1301.

challenging this dominance, effectively asserting some of their newly found power in various forums.⁵ Even within the OECD, most of the new members (and some less recent additions) share more tax policy challenges with emerging economies than with their richest co-members at the OECD.⁶ This book seeks to map and analyse the effect of these power shifts on the evolution of the international tax regime in general, and on tax treaties that follow the OECD Model in particular. It does so through the primary prism of the BRICS countries and their international tax policies, as they represent, or are viewed as representing, the most imminent challenge to, or, to some, the most anticipated promise for the current regime.

This book further explores the various options available to the BRICS and other emerging economies in their quest for a voice in the governance of the international tax regime. The potential for cooperation among the BRICS has been at the core of the lively discourse that their emergence has ignited. Yet, the grouping of the BRICS countries together is not obvious and may even be considered arbitrary, as their economies are not necessarily complementary; their policies and politics diverge significantly; and their particular interests often conflict. Nonetheless, they share size and political importance; a grievance about the present and past dominance of the Western powers over the international agenda; and some important policy interests. These led to their current status as an emerging bargaining group that is feeling its way toward a modus operandi within the key existing international organizations. As such, they operate loosely with slow progress on the institutional side, without a central forum or a dispute resolution element.⁷

The BRICS may continue to operate “inside the system” as a loosely coordinated bargaining group. As such, they may focus on their mutual interests, on particular interests of the individual BRICS countries or even on the more general interests of the “developing world”. This is a realistic outcome due to the significant imbalances among the BRICS themselves (China’s sheer size and potential, for example).

5. E.g. the leadership of an ex-Indian official of the new Global Forum on Transparency and Exchange of Information for Tax Purposes (*see* <http://www.oecd.org/tax/transparency>) and China’s involvement in the development of the UN’s *Practical Manual on Transfer Pricing for Developing Countries* (UN, Dept. of Econ. & Soc. Affairs, *United Nations Practical Manual on Transfer Pricing for Developing Countries* (2013)).

6. E.g. the resistance of these countries to adopting the new article 7 of the OECD Model (2010), which is also rejected by the United Nations, as well as other developing countries.

7. E.g. U. Ghori, *The BRICS+: Fault Lines and Opportunities*, in *The Rise of the BRICS in the Global Political Economy: Changing Paradigms?* (V.I. Lo & M. Hiscock eds., Edward Elgar Publishing 2014), at 191-218.

They may also lose importance and disappear, as such, if, for example, some or all of the BRICS countries choose to join the current regime rather than challenge it, or if, alternatively, the international tax regime is reshaped to incorporate the interests of the BRICS countries.

Finally, further institutionalization and closer cooperation between the BRICS may occur – one that would serve to counterbalance current power centres. Even then, this could take two different paths, emphasizing either conflict or reconciliation with the existing order.

Each of these possible outcomes has different and material implications for a wide array of arrangements. Nonetheless, there are sound arguments in support of separately assessing the future of the international tax regime in light of the above-mentioned developments. First, tax policy has its own idiosyncrasies and therefore has often been discussed separately from other international economic policy areas. Second, international tax institutions have evolved separately from other international institutions. Third, it is possible that progress will be achieved in some policy areas (including tax) and not in others. Finally, a topical analysis such as this is, in any event, a necessary first step in a more general analysis of the processes being discussed. This book does not aspire to draw conclusions beyond the scope of international tax policy, yet, naturally, parts of the analysis may contribute to a discussion of the broader implications of the ascent of the BRICS countries.

1.2. The BRICS

The economies of the BRICS vary significantly. Focusing on the larger BRICS countries, they have already elevated themselves to the ranks of the 10 largest economies in the world and are expected, as a group, to overtake the G8 in terms of the size of their economies, perhaps sometime during the second quarter of the century.⁸ At present, they account for about one fourth of the world's GNP, even though their population is approximately 40% of the world's total. China is the dominant world manufacturer and a strong service provider. It is already the world's second largest economy and promises soon to surpass that of the United States. As such, it shadows the

8. Researchers disagree about exactly when this is likely to happen and for which BRICS countries. E.g. R. Foroohar, *BRICS Overtake G7 by 2027*, Newsweek (20 Mar. 2009); J. O'Neill & A. Stupnytska (Goldman Sachs), *Global Economics Paper No. 192: The Long-Term Outlook for the BRICs and N-11 Post Crisis* (4 Dec. 2009) (revising a prior prediction of 2050 to 2032).

rest of the BRICS. India has a stronger position in the service supply category. Russia is a world-class raw materials supplier, as is Brazil, although Brazil is also a significant provider of manufactured goods and services. South Africa's is a much smaller economy and, as explained below, serves as a strategic (African) partner rather than an equal economic power partner in the group.

Research, led by multiple reports prepared by the firm Goldman Sachs, has tracked the progress and development of the BRICS over the last decade or so,⁹ yet there are speculations that the BRICS countries have been meeting and reaching agreements since before their identification as a group by Goldman Sachs. Nonetheless, there is no official evidence supporting these speculations. Formally, there are a few limited agreements among the BRICS countries. They are, however, all members of the G20 Forum,¹⁰ which has grown in importance during the last few years, reflecting also on the power of the BRICS. Perhaps most importantly, the G20 has effectively led the base erosion and profit shifting (BEPS) initiative which is being managed by the OECD and which purports to reshape the international tax regime in the next years.¹¹

The rise of the BRICS has sent people in search of the next trend. Countries such as Indonesia, Mexico, Nigeria, Korea (Rep.) and Turkey have been mentioned as potential rivals or partners of the BRICS countries in terms of growth, yet some already belong to the OECD and others have not yet been active in the global discourse on tax policy to the extent that the BRICS countries have been. This book illuminates the unique positions of some of these countries in the evolution of the international tax regime as secondary players, perhaps, to the BRICS countries.

1.3. Organization and cooperation

A key question – perhaps the key question of the book – is whether the BRICS countries are likely to organize themselves as a bloc, and attempt to influence the evolution of the international tax regime. Will they focus on their economic rivalries or on their complementary properties? Their recent political alliance-in-the-making, coupled with a few economic moves, do

9. Available at <http://www.goldmansachs.com/our-thinking>.

10. See <https://www.g20.org>.

11. For the OECD website for the BEPS initiative, see <http://www.oecd.org/tax/beps.htm>.

not necessarily signal that the answer will be in the affirmative. The fifth BRICS summit was hosted by South Africa in 2013. It focused on the relationship between the BRICS and African countries, yet little pragmatic agenda-setting took place.

This book exposes the many differences among the BRICS, in economic and tax policies and interests. It further emphasizes the idiosyncrasies of some of the BRICS countries, particularly China, the economy of which overshadows the rest of the group, and which may view itself as sufficiently powerful to act on its own. The book also highlights the similarities and shared interests that could lead to some level of cooperation or policy coordination. If that happens, it would likely be highly impactful and contribute to the progress towards serious international tax coordination, which would be a desirable development in the authors' opinion.

1.4. The book

To accomplish its goal, this book sets the stage for the in-depth analysis in Part I, in which, first, Tsilly Dagan underpins the theoretical framework for the discussion of the choice between cooperation and competition that is at the heart of the book. Dagan uses a classical law and economics approach, supported by game theory analysis, to conclude that effective competition is superior to cooperation in the context of the international tax regime. She therefore advocates focussing on how to improve – rather than curtail – tax competition among countries. While not ignoring the faults of the current regime, her noteworthy chapter also generally counters the conclusions of the BEPS initiative that a shift to cooperation is required for the survival of the international tax regime. In this framework, one may consider that coordination among the BRICS could play an important role in determining the actual content and shape of the future international tax regime, shifting the balance away from the G7 core countries.

Somewhat in response to the arguments raised by Tsilly Dagan, Reuven Avi-Yonah considers the supranational perspective of the current international tax regime. He writes consistent with his longstanding position (corresponding to the present authors' own positions) about the existence and merits of the international tax regime and its consistent policy trend towards convergence and increased cooperation, in a chapter that calls for an even more inclusive approach, especially where the BRICS countries are concerned. His chapter demonstrates the strengths of the regime, while noting areas of fragility and suggestions for reform inspired by tax policy positions

often taken by the BRICS countries. The creation of supranational tax law is perhaps the biggest current challenge of international taxation. The current work carried out in the framework of BEPS proves that this is no longer an unrealistic scenario, to the extent that sufficiently strong political support backs up such development.

The pluralistic approach of this book is reflected in this part, which presents very different perspectives on what constitutes desirable tax policy and the directions in which the international tax regime should develop.

The core of the policy and technical tensions among the BRICS countries is explored in Part II, which builds on the theoretical staging, first, with a focused analysis of each of the BRICS countries, drawn along the lines of a uniform questionnaire, and the evolution of their international tax policies, and, second, supporting this analysis with perspectives from a few additional selected jurisdictions to emphasize the book's point that the shift of power in the international tax regime cannot be viewed as exclusively related to the BRICS countries as such, but should be understood from a wider perspective.

First, Luís Eduardo Schoueri presents the case of Brazil in chapter 4 as a perfect example of the dismay of some developing countries with the norms of the current international tax regime that are viewed as conflicting with their – and in this case, with Brazil's – national interests and deeply rooted traditions (such as the heavy reliance on source taxation). Although he does not make firm predictions as to the possible resolution of these conflicts, Schoueri concludes with advice regarding the steps that should be taken where reconciliation is to be sought. Yet the present authors find that the Brazilian vision of international taxation also contains some notable elements – such as tax sparing clauses in tax treaties – for building up the milestones of an international tax justice that respects the right of source countries to remain the masters of their international tax policy decisions. An endorsement of such rules by the BRICS as a bloc could generate a significant impact on the current dynamics of international taxation in the direction of strengthening international tax justice. Other Brazilian rules – such as those on predetermined margins in the field of transfer pricing – could be of interest for the BRICS and, even more, for those developing countries that consider sustainability of tax administration as more important than a sophisticated international tax system requiring technical knowledge for which they have little capacity at present.

Next, Danil Vinnitskiy presents a Russian perspective, very different from Brazil's, in chapter 5. He discusses the development of the Russian tax treaty project that differs from global (OECD) norms more in its implementation than its content. This framework raises very compelling issues from the perspective of legal interpretation of tax treaties and the impact of the OECD Model Convention (OECD Model) on treaties that are patterned along its clauses. This is even more significant if one considers the influence that the OECD Model otherwise has on treaties involving at least one non-OECD state, showing that the BRICS can, in fact, have an influence in international taxation even when they formally accept the wording of clauses that are of common usage. The key role of domestic law in Russia and the reluctance to submit to the power of international organizations – perhaps even in a BRICS format – shape much of Russia's tax treaty policy and may affect its role in future developments. The present authors' own view is that the current international political scenario will increase the interest of Russia to seek synergic strategies with the BRICS, while slowing down the process of its incorporation in the OECD and altering its position and the overall equilibrium within the G20. The implications of this phenomenon for international taxation could soon increase Russia's attention to what it shares with the other BRICS.

D.P. Sengupta presents the case of India in chapter 6. India is apparently the most active among the BRICS in challenging the prevailing international tax norms. Although different reasons may justify this, the present authors feel that the interpretation and application of tax treaties has been the object of attention in India for a longer period of time, considering their impact on Indian trade and the economy. The Indian challenges to international taxation are now conspicuous, due to the active participation of India in various forums, including a leadership role in the UN and the Global Forum, and, most importantly as a not-so-silent observer at the OECD. Additionally, in recent years India's courts have heard a multitude of court cases concerning international tax issues that made the conflicts between India and the OECD norms more visible than in other countries. Sengupta describes these cases, explaining also their domestic effects, including significant uncertainty for taxpayers – domestic and foreign alike. Against this background, he acknowledges the difficulties of international tax coordination, yet expresses cautious optimism about the possibilities for its enhancement. The dynamics of interpretation in Indian international tax law are not always easy to gather from the outside, in particular as to the frequent major differences between administrative and judicial interpretation, or the technical arguments used to justify a defence of the national interest with

limited attention on the international repercussions, (such as with regard to the boundaries of the concept of permanent establishment and of services under Indian tax treaties).

Tianlong Hu and Na Li present the case of China in chapter 7. China is the largest and, clearly, most powerful BRICS country. It also is distinctly focused on its competitive position in the global market. From a tax treaty perspective, this can be seen in the differences that can be generally noted across Chinese treaties with OECD countries, on the one hand, and the least developed countries, on the other. As such, it is questionable whether China will contribute to a collaborative international effort, especially with some of its fiercest competitors. Hu and Li discuss the difficulties of such cooperation among the BRICS countries, while at the same time emphasizing some of the commonalities among them and suggesting grounds for initiating collaboration that could possibly help developing countries in general. An additional peculiarity of the Chinese tax system concerns the scarcity of judicial interpretation, which is generally replaced by administrative rulings by tax authorities. This structural feature has a strong impact on the consistency of international taxation with the planned policy objectives. However, it does not contribute to make legal interpretation of Chinese rules intelligible to other BRICS countries that may wish to share policy objectives with China in a context where judicial interpretation is a more common feature. Furthermore, one might wonder whether it secures an effective protection of the rule of law.

Lastly, Johann Hattingh presents the case of South Africa in chapter 8. As the latest addition to the BRICS – and a primarily politically motivated addition, at that, South Africa on one hand shares some of the interests of the other BRICS countries, while on the other has operated under policies that were very much in sync with global OECD norms. Hattingh sensibly assesses the differences among the BRICS countries and is not particularly optimistic about the likelihood of their forming a cohesive power centre, yet he acknowledges their potential importance in the development of the international tax regime. Eventually, the present authors think that South Africa can play a key role in establishing a dialogue of the BRICS with the OECD and the least developed countries, namely by being familiar with all the respective types of tax issues that arise in such different contexts.

The second prong of Part II includes a parallel analysis of non-BRICS countries with a stake in the process described and perhaps some common features with the BRICS countries. First, in chapter 9, Billur Yalti presents the case of Turkey, an OECD member that is also primarily a “source” country,

and which is struggling to form policies that conform to the existing rules established by the developed countries while at the same time guarding its economic interests. Moreover, Turkey is often counted together with other large, promising economies in groups that often accompany the BRICS in relevant debates.¹² Yalti highlights the complexity of Turkey's situation and illuminates several possible paths for charting a clear way forward. Besides a very advanced legal culture in tax matters – fairly reflected in the chapter by Yalti, but often unperceived at the international level for reasons that are mostly linked to the language, the potential of Turkish international taxation to become proactive in sharing common ground with the BRICS is perhaps hampered by the fact that not all judicial decisions are made public. In the present authors' opinion, this matter can also potentially harm the rule of law and the effective protection of taxpayer rights.

Belema Obuoforibo presents the case of the largest African economy, Nigeria, in chapter 10. Nigeria is another large economy that is often mentioned as part of the next wave of economies that promises to emerge. It has also recently surpassed South Africa as the largest economy on the continent. Yet, unlike Turkey, it is not a member of the OECD and faces a long route to development. The chapter emphasizes the challenges faced by a country that relies heavily on natural resources extraction. It also exposes the struggle of Nigeria to make sense of its tax treaty negotiations in light of the meagre achievements of such negotiations in the past. It demonstrates not only the similarity of interests between the so-called BRICS & Co., including Nigeria, but also the possibility that the rise to power of the BRICS would empower other countries, such as Nigeria, to make more gains in negotiating its tax treaties.

Finally, in chapter 11, Thomas Dubut presents the perspective of the least developed countries that may, on the one hand, benefit from any achievements of the BRICS countries, or may be left further behind as the BRICS join developed economies, leaving them with no strong potential allies. Dubut demonstrates these circumstances using the narrative of the coordination of tax policy and enforcement among the Partner States of the East African Community (Burundi, Kenya, Rwanda, Uganda, Tanzania and Uganda), which have – to date – failed to develop their own independent tax policies.

12. Most notably, it is one of the MINT countries (Mexico, Indonesia, Nigeria and Turkey).

Part III builds on the country analyses to examine the institutional aspects of the BRICS revolution. The present authors found it particularly crucial to focus attention on the impact of such developments on the relations with the UN. The main reason for this is that the past few decades witnessed a dramatic increase of the influence of the OECD Model, while the UN Model suffers marginalization. Qualitative¹³ and quantitative¹⁴ legal studies on tax treaties prove that several UN Model clauses are still particularly significant. The present authors have the impression that a closer coordination among the BRICS can revitalize the attempt to shift the balance of taxing powers, including the allocation thereof in tax treaties, in a direction that more closely reflects the standards of international tax justice in relations with developing countries. This process can find an additional, essential support in the proactive attitude that some countries, such as the Netherlands,¹⁵ have recently begun to adopt in the renegotiation of their treaties with developing countries.

Jeffrey Owens, who was one of the leading architects of the current international tax regime in his capacity as the head of the OECD's Committee on Fiscal Affairs, sets the stage for the impact analysis in chapter 12 by providing an overall, political economy perspective of the challenges posed to the international tax regime by the BRICS countries. He lays down the framework for discussion of the tensions that these challenges create, as well as the opportunities they present for the evolution of the regime.

In chapter 13, Richard Vann discusses the impact of recent developments on tax treaties through the prism of its central source versus residence dichotomy. He demonstrates the contribution of the BRICS countries to the discourse about the proper balance between source and residence taxation, and analyses the impact of this discourse on Australian international tax policy and on the contemporary BEPS initiative led by the OECD that promises to shape the future international tax regime.

Alfredo Garcia Prats, in chapter 14, discusses the impact of the BRICS on the tax work done within the UN, and the support by the UN for the rise of the BRICS in this area. He enthusiastically supports the BRICS' taking a

13. *The Impact of The Impact of the UN and OECD Model Conventions on bilateral tax treaties* (M. Lang et al. eds., Cambridge University Press 2012).

14. J.J.P. de Goede & W.F.G. Wijnen, *The UN Model in Practice 1997-2013*, 68 Bull. Int'l Taxn. 3 (2014), at 118.

15. Netherlands – Policy Document on tax treaty policy published – details (17 Feb. 2011), News IBFD.

leadership role in the reshaping of the international tax regime and in taking tax coordination outside the OECD, perhaps to the G20 group that includes the BRICS countries.

Jan de Goede, in chapter 15, focuses on the technical tax work on the UN Model, seen from the perspective of the activity in which he has been personally involved in his IBFD capacity. He explains the central role of the BRICS in the process of developing the significant positions taken by the UN in its Model Convention (the UN Model). He further discusses the use by the BRICS countries of the platform provided by the tax work at the UN to establish and voice their tax policy-related positions.

Kim Brooks reviews the tax policy decisions taken in recent times by the BRICS countries. In chapter 16 she demonstrates that they generally have highly sophisticated tax systems which reflect the complex amalgam of their interests and needs. Her in-depth analysis of the policy trends among the BRICS countries reveals their progress and responsiveness to the changes they experience, their opportunities for cooperation and competition, and their place in other international tax policy trends, all as they find their new voice at the decision-making table. Brooks further asserts that their tax systems are also generally in transition. She concludes that with some coordination, there is an opportunity for BRICS countries to lead a rich discussion and to help shape, and set, the international tax policy agenda for the future.

The most salient impact of the BRICS countries may be on the institutionalization of the international tax regime. Diane Ring explores this impact in chapter 17. She exposes the complexity of the organization of the BRICS, and, at the same time, the opportunity that they have to impact the shape of the emerging international tax regime in whatever format they ultimately take as a group or otherwise.

In Part IV, which consists of chapter 18, the book concludes with a summation of what has been learned from this study and responses to the research questions posed above.

Notes

A series of 23 horizontal dotted lines for writing notes.

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