Should the Netherlands sign tax treaties with developing countries?

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June 2013

Colophon

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17 June 2013

This report was first published on 11 June and amended on 17 June 2013 with a clarification of an analysis of anti-abuse provisions in treaties and in domestic laws in chapter 4.6. Special thanks are due to Sol Picciotto for assistance on this point.

Author: Katrin McGauran
Cover Layout: Frans Schupp
Cover photo: iStockphoto
ISBN: 978-94-6207-026-4

This publication is made possible with financial assistance from The Dutch Ministry of Foreign Affairs. The content of this publication is the sole responsibility of SOMO and can in no way be taken to reflect the views of The Dutch Ministry of Foreign Affairs.

Acknowledgements: The author would like to thank Roos van Os, Rodrigo Fernandez and Mark van Dorp for their input and comments to this report. The impact assessment was developed by SOMO's economic justice team, in particular Rodrigo Fernandez. Mark van Dorp and Indra Römgens' input was also central. Thanks are also due to Filip Lazarevski and Frederike Rijkse for their research support.

An earlier version of this paper was kindly reviewed by Martin Hearson (Action Aid at the time), Mirco Goudriaan (Ministry of Foreign Affairs), Bart Kosters (IBFD), Geerten Michielse (IMF), Irma Mosquera (The Hague University), Nicky Pouw (University of Amsterdam), Albert Hollander & Koos de Bruijn (TJN Netherlands at the time), Bosire Nyamori (Africa Bureau of Tax Policy and Law), and Francis Weyzig (Radboud University). Their invaluable comments have greatly improved the report. Any interpretations, factual errors or omissions are, of course, that of the author.

Special thanks are due to the Tax Justice Network Africa (Kenya), the Centre for Budget and Governance Accountability (India) and Latindadd (Peru). Discussions with Alvin Mosioma, Johannes Chiminya, Sarah Muyonga, Pooja Rangaprasad and Esteban Serrani have been central to the conclusions of this report.

Published by
SOMO
Stichting Onderzoek Multinationale Ondernemingen
Centre for Research on Multinational Corporations

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Acronyms

APA	Advance pricing agreement
ATR	Advance tax ruling
BEPS	Base erosion and profit shifting
BIT	Bilateral Investment Treaty
CBS	*Centraal Bureau voor de Statistiek* (Central Statistics Bureau of the Netherlands)
CBCR	Country-by-country reporting
CIT	Corporate income tax
CSO	Civil Society Organisation
DNB	*De Nederlandsche Bank* (Dutch Central Bank)
DRM	Domestic Resource Mobilisation
DTA	Double Taxation Agreement, used in academic literature as acronym for tax treaties
EU	European Union
FDI	Foreign direct investment
IMF	International Monetary Fund
LDC	Least developed country
LOB	Limitation on benefits
MNC	Multinational Corporation
NGO	Non-governmental organisation
OECD	Organisation for Economic Co-operation and Development
PCD	Policy coherence for development
SFI	Special Financial Institution
TIEA	Tax Information Exchange Agreement
TJN	Tax Justice Network
WHT	Withholding tax

1. Introduction

"Developing countries that have very few or no treaties may in fact be doing the right thing." [1]

"How much longer can we truly accept that tax treaties allocate taxing powers mainly on the pattern developed by an organization that reflects the policy goals of developed countries only?" [2]

As the above quotes indicate, there is growing concern about the negative impact taxation treaties can have on the domestic revenue mobilisation of developing countries. Double taxation treaties, which developed with the increase of international investment flows to avoid double taxation of the same income, allocate taxing rights between signatory states on income from cross-border investments. They used to be necessary to avoid double taxation as states had no national measures to exclude certain income from double taxation and can have benefits such as improved compatibility between tax rules of signatory states, assistance in tax compliance, certainty for investors and better inter-state cooperation in tax enforcement.

However, because tax treaties reduce withholding taxes levied in a source country of passive income, MNCs use these reduced tax rates in countries of operation to shift profits out of operating subsidiaries into tax havens. This is especially the case in developing countries, where tax enforcement and administration are often weak. They also often have unfavourable treaty terms in the form of zero or low withholding tax rates and no anti-abuse provisions. The Netherlands, which has a very large bilateral treaty network, is used by international business as a tax avoidance conduit jurisdiction, whereby money flows from source countries to the Netherlands and out again to tax havens. The scale of this practice is indicated by the fact that the country topped the world ranking by the International Monetary Fund (IMF) for global foreign direct investments in 2009. The total stock of incoming direct investment was as much as 3,000 billion dollars, while the stock of outgoing direct investment amounted to 3,700 billion dollars in 2009, the equivalent of 377% and 465% of the Gross National Product, respectively.[3] The Netherlands continues to top global FDI stock tables.

The over 90 tax treaties, together with the country's large bilateral investment treaty (BIT) network (58 of the 93 DTA treaty partners also have a BIT with the Netherlands) are central to the attractive Dutch fiscal climate. Not only do Multinational Corporations (MNCs) have a large coverage of countries, Dutch treaties are particularly favourable to investors because many of them reduce withholding taxes (WHT) at source on outgoing interest, dividends, royalties and capital gains to zero, or stipulate very low WHT rates. An understanding of double taxation treaties and the principles of international profit allocation is therefore crucial when debating the Dutch tax treaty network in the context of international economic justice. As recent media reports highlighting corporate tax evasion have shown, there is an urgent need to review Dutch fiscal policy with view to poverty alleviation in developing countries, but also with view to the current austerity measures and new poverty levels hitting developed economies.

Although double taxation treaties or agreements (DTAs) are important instruments in the international tax avoidance industry, they are rarely scrutinised by national parliaments or civil society regarding their impact on development. This changed in the Netherlands in 2009, when a parliamentary motion was accepted, instructing the Dutch government to assess the negative impact of the Dutch fiscal

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1 Thuronyi, Victor (2010) Tax Treaties and developing countries, in Lang et al. Tax Treaties: Building Bridges between Law and Economics, IBFD, Amsterdam, p 455.

2 Pistone, Pasquale (2010) Tax Treaties with developing countries: a plea for new allocation rules and a combined legal and economic approach, in Lang et al. Tax Treaties: Building Bridges between Law and Economics, IBFD, Amsterdam, p 429.

3 'Dismantle Dutch fiscal shelters', SOMO news, 22.8.2011, http://somo.nl/news-en/dismantle-dutch-fiscal-shelters.

regime. The parliamentary debate on tax and development has been lively since, helped by the analyses and advocacy efforts of the Dutch Tax Justice Network.

This report aims to provide information for relevant stakeholders (parliamentarians, policy-makers, journalists and civil society organisations) on the impact of DTAs in developing countries. An impact analysis is particularly important in the context of the new 2011 Dutch fiscal treaty strategy, which announced the government's plan to extend its tax treaty network to more developing countries. The report also identifies areas for further research to develop alternatives to the current regime of international taxation, which is in large part based on taxation treaties. The urgent need for a fundamental change in the current system is particularly highlighted by the fact that developing countries are experiencing massive annual revenue losses in the midst of a financial crisis and related austerity measures that are hitting the poor the hardest.

This research is based on a literature study and data analysis on DTAs, amongst others, on their impact on levels of foreign direct investment (FDI) and on developing country revenues. Treaty shopping and anti-abuse provisions are also discussed. The Dutch treaty network is analysed with regard to asymmetric[4] and symmetric[5] treaties. It is assumed here that low- to upper-middle income countries have an asymmetrical relationship with the Netherlands as regard foreign investment flows, meaning that the flows are predominantly originating from the Netherlands. No bilateral data analyses, however, have been made beyond a comparison of domestic and treaty WHT rates and the revenue losses incurred as a result.

Published case studies show how specific companies enjoy treaty benefits in the form of lower WHT rates, reducing taxation at source in the process. The revenue losses suffered by Dutch treaty partners are calculated on the basis of Dutch FDI stock positions abroad, capital income reported in the Netherlands, differences in domestic and treaty tax rates and, where available, the attribution of investments to Dutch mailbox companies (see Annex 2).

This report is structured as follows:

Chapter 2 provides background to the Dutch political context in which DTAs are currently debated. Despite a plethora of case studies and media reports clearly indicating that the Netherlands is an important conduit country in international tax avoidance, the government continues to defend its tax regime. Mongolia, however, has recently cancelled its DTA with the Netherlands for revenue loss reasons and the Dutch government has announced an impact assessment of some of its DTAs. It appears to be seen whether these developments will bring about a change in the Dutch treaty policy towards developing countries.

Chapter 3 describes some of the principles of international taxation and tax treaties. The function of treaties is outlined as are the basic components of the UN and OECD Model Conventions (also referred to as Treaties in this paper). Tax treaties, it is argued, are no longer necessary to avoid double taxation, but fulfil other important functions that could be achieved by alternative agreements that do not reduce domestic policy space to increase tax rates.

In Chapter 4 a number of theoretical points are made that argue treaties are not necessarily good for capital-importing countries. The argument that tax treaties are necessary to attract FDI has no empirical basis, as a literature review finds. The dilemmas developing countries face are outlined and the problem of treaty shopping and the difficulties in fighting it are described.

4 Meaning treaties signed between a capital-importing (developing) and a capital-exporting (developed) state.
5 Meaning treaties signed between two capital-exporting (developed) states.

Chapter 5 presents a DTA impact assessment on the basis of FDI data showing that treaty partners lose out on tax revenue as a result of lower interest and dividend WHT rates in treaties. Case studies and FDI data further show the Netherlands is used for treaty shopping and related tax avoidance. Whilst the presented data cannot provide a comprehensive picture of tax-related FDI diversion through the Netherlands, they indicate there is a structural problem of treaty shopping, with Dutch FDI stock abroad being largely attributable to mailbox companies. The calculations also show that companies benefit from lower withholding tax rates in developing countries, reducing source countries' tax revenues.

The paper ends with conclusions and a set of recommendations in Chapter 6. The Dutch regime could be reformed to stop treaty shopping by implementing a number of anti-abuse measures recommended by the European Commission. What is needed, however, is political will.

1.1. Methodology

One of the main arguments put forward by commentators in favour of DTAs is their claimed stimulation of FDI and assumed resulting economic development. This paper therefore includes an assessment of this claim in form of a literature review assessing the correlation between the existence of DTAs and FDI. Relevant academic literature was consulted for the review and the seminal texts and findings are presented. These include theoretical discussions on the positive and negative impact of DTAs, recent literature on treaty shopping as well as a number of econometric studies on the relation between DTAs and FDI (chapter 4).

SOMO calculated revenue losses incurring as a result of signing a treaty with the Netherlands, applying a number of assumptions and using FDI stock positions, capital income data, and withholding rate comparisons. SOMO has developed a methodology for calculating revenue losses in signatory states resulting from differences in Dutch DTA and domestic withholding tax rates on two forms of passive income, namely, interest and dividends. The methodology, assumptions and limitations, data used and relevant calculations are described in Annex 2 to this report.

Finally, the revenue loss calculations are illustrated with a number of published company case studies in which the Netherlands is one of the jurisdictions used for corporate tax avoidance, using Dutch treaties to reduce withholding tax rates on passive income. Except two extractive industry cases, which only draw conclusions from the companies' corporate structures[6] rather than providing an in-depth analysis of company accounts or local tax codes, all cases are previously published by NGOs.

An earlier version of this paper was reviewed by a number of external experts. Their comments were included in the rewriting of this report where possible.

6 Namely, lending money through to an operating subsidiary which is borrowed from a tax haven subsidiary, thereby reducing withholding taxes on interest.

2. Reform of Dutch tax treaty policy?

2.1. Introduction

This chapter briefly sketches the political context in which DTAs are currently debated in the Netherlands, such as the Dutch tax treaty policy note of 2011 and the DTA impact assessment announced by the government for some treaties, and highlights the recent cancellation of the Dutch DTA by Mongolia. This context is, of course, important when discussing DTA impact assessments and policy coherence for development and is therefore provided before a discussion on the function and content of DTAs in the following chapter.

Fiscal policy and its link to development are firmly on the international agenda, and also on the Dutch political agenda. Until recently, however, the government's interpretation of policy coherence with regard to tax has predominantly focused on capacity building, such as technical support for developing country tax administrations. This changed in 2009, when a parliamentary motion[7] was accepted calling on the government to assess the impact of the Dutch tax regime on potential tax avoidance in developing countries. This was followed by a series of questions and debates[8] on the negative impact of Dutch DTAs on developing countries in the context of the government's new *Memorandum on Dutch Tax Treaty Policy 2011*, published in late 2010.[9] The Memorandum announced the extension of the Dutch treaty network to developing countries as a form of development aid, and is based on the assumption that tax as well as investment treaties are beneficial to these countries because they provide legal security for investors. This, in turn, will attract FDI which automatically leads to development, so the argument goes.

The new strategy also provides an analytical framework for negotiations with developing countries; in practice this means although the government follows the OECD Model Convention as its starting point, it is "is willing to accept parts of the UN Model Convention" in negotiations on specific Articles that are known to be problematic from a development country perspective because they can be used for tax base erosion.[10] However, it will only accept the UN Model "provided that the interests of Dutch taxpayers are not disproportionately harmed"[11]. Although a parliamentary motion for more room for developing countries to negotiate higher withholding tax (WHT) was accepted in June 2011, the treaty strategy generally views withholding taxes as a barrier to investment, a position it plans to communicate to partners in its treaty negotiations. It is, however, known and even pointed out by the OECD itself that a lack of or very low WHT rates on passive income lead to profit shifting by business, which in turn reduces the taxable base in countries of operation. A more detailed analysis of the Memorandum is given in chapter 5.

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7 Motie Vendrik, http://www.rijksbegroting.nl/algemeen/gerefereerd/1/3/6/kst136276.html

8 Report of parliamentary debate, 8 June 2011, https://zoek.officielebekendmakingen.nl/behandelddossier/25087/h-tk-20102011-98-43?resultIndex=9&sorttype=1&sortorder=4

9 Notitie Fiscaal Verdragsbeleid 2011, http://www.rijksoverheid.nl/bestanden/documenten-en-publicaties/kamerstukken/2011/02/11/notitie-fiscaal-verdragsbeleid-2011/aanbiedingsbrief-notitie-fiscaal-verdragsbeleid.pdf, section 1.2.7.

10 Such as definition of Permanent Establishment or (higher) withholding tax rates on passive income and service fees, see Notitie Fiscaal Verdragsbeleid 2011, sections 2.6.2 and II.3. It also announces to extend its information exchange to include spontaneous and automatic procedures, see 2.16.1.

11 Notitie Fiscaal Verdragsbeleid 2011, section II.2.

2.2. Mongolia cancels tax treaty with the Netherlands

The generally accepted view that 'DTAs are good for you' received a major blow in late 2012, when Mongolia cancelled its DTAs with the Netherlands, Luxemburg, Kuwait and the United Arab Emirates because, according to the Mongolian Ministry of Finance, these jurisdictions are primarily used for tax avoidance by large extractive industry companies. The mining sector, which extracts, amongst others, coal, copper and gold, makes up more than 80 per cent of Mongolia's exports and accounts for 30% of GDP and 32% of government revenue. The main investors are Multinational Corporations (MNCs) with ultimate owners from Canada, China, and Russia, but they use holdings companies in favourable tax jurisdictions to reduce their tax bill in Mongolia. The Mongolian Ministry of Finance calculated that as a result of the above-named four treaties the mining project Oyu Tolgoi alone enjoyed unintended tax savings of 45 million euro. The project is a joint venture between the Mongolian government, which owns 34% and Turquoise Hill of Canada, which owns the remaining 66%. Turquoise Hill Resources is majority owned by Rio Tinto. The tax advantages for the investors lie in lower WHT rates on dividends, interest, royalties and reimbursement for technical services laid down in those treaties when compared to existing domestic rates.[12]

The news of the treaty cancellation was all the more surprising because it was the IMF that had advised Mongolia to renegotiate these treaties, although not to cancel them. In 2010 the IMF published a report advising the Mongolian government to assess its treaty policy. In 2012 another IMF report provided a detailed analysis of the country's treaties and advice on which elements to renegotiate. The IMF critique of the Dutch DTA with Mongolia is described in more detail in chapter 5.

Mongolia is not the only developing country currently rethinking its treaty strategy: Argentina has opened a new perspective for the analysis and debate of alternatives to DTAs. The decision made by the government to review the existing agreements with the creation of the "Double Taxation Evaluation and Review Commission" led to the termination of the country's DTAs with Austria, Chile, Spain and Switzerland in early 2013.[13]

These developments, and this report, show that the assumption that DTAs are good for development is not based on empirical research. Indeed, this assumption is increasingly being challenged because DTAs are shown to play a negative role in eroding countries' tax bases.[14] Despite a vibrant and critical parliamentary debate over the past years and increasing indications that Dutch treaties are harming poor countries, the government still firmly holds on to the claim that its tax regime is not proven to harm developing countries and fulfils all the norms of the international tax system. It remains to be seen whether the criteria for the announced impact assessment of some Dutch tax treaties will be comprehensive enough to provide a realistic picture of revenue losses suffered by signatory states as a result of having a treaty with the Netherlands.

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12 'Mongolia Mining and Tax Guide 2012/2013', Ernst & Young, 2012, http://www.ey.com/Publication/vwLUAssets/Mongolia_Mining_and_Tax_Guide_-_2012_2013/$FILE/Mongolia%20Mining%20and%20Tax%20Guide%20-%202012_2013.pdf

13 'Double Taxation Agreements in Latin America. Analysis of the links among Taxes, Trade and Responsible Finance', Executive Summary, Latindadd, April 2013 (publication forthcoming).

14 See, for instance, the OECD's Base Erosion and Profit Shifting project, http://www.oecd.org/tax/beps.htm and the IMF's analysis of Mongolian tax treaties: 'Mongolia: Technical Assistance Report - Safeguarding Domestic Revenue – A Mongolian DTA Model', November 2012, IMF Country Report No. 12/306, http://www.imf.org/external/pubs/ft/scr/2012/cr12306.pdf.

2.3. Impact assessment and transparency

During a debate of the Finance Committee of the Dutch House of Representatives with State Secretary for Finance, Frans Weekers, in June 2011, two important parliamentary motions that would have led to evidence-based policies and more policy coherence with regard to development were not successful. This concerned a motion that called for an impact assessment of a Dutch tax treaty on a developing country *before* negotiations started, and a motion calling for the Dutch government to start implementing country-by-country reporting (CBCR). CBCR would greatly increase financial transparency and give insight into the extent of corporate tax planning by foreign businesses in the Netherlands.[15] The refusal of the Dutch government to create more transparency in the financial reporting of companies incorporated in its jurisdiction - often with the argument that it would disturb the level playing field of international business if such rules are not implemented internationally - is duplicitous. The government itself uses the lack of reliable data as an argument to undermine civil society research that finds developing countries to lose out on tax avoidance:

"Civil society organisations cite differing amounts of revenue developing countries are said to lose as a result of tax avoidance and evasion. [...] Figures were often based on extrapolation of assumptions rather than on reliable data. A fundamental problem is the lack of data. Moreover, if data were available and if it could be analysed, this would probably only at the aggregate level. A breakdown per (developing) country would unfortunately be much more difficult".[16]

Civil society organisations generally recognise that there is an insufficient evidence base for precise calculations, yet extrapolations from case studies and, as this report shows, from bilateral investment data, go a long way in providing evidence on the fiscal impact of treaties. The Latin American civil society network Latindadd has recently published a DTA impact assessment on Argentina, Colombia, Ecuador, Nicaragua, Uruguay and Venezuela. The research analyses the impact of DTAs on the governments' financing systems and the tax structures in Latin America and intends to "open the dialogue to establish more progressive and fairer tax systems in the region."[17]

Because government impact assessments are lacking, civil society organisations have started conducting impact assessments and analyses themselves. Yet the Dutch government has, of course, more resources and technical knowledge at its disposal to carry out an assessment of not only treaties but its fiscal system as a whole. The demand for such an assessment therefore remains a relevant recommendation by civil society organisations in North and South.

This demand was at least partially met in late 2012, when the Minister for Foreign Trade and Development Cooperation, Lilianne Ploumen, announced that her ministry would, together with the Dutch Ministry of Finance, conduct an impact assessment with regard to tax treaties and their policy coherence for development.[18] In May 2013, the minister informed the parliament that the two ministries were currently looking at Dutch tax treaties with Ghana and Zambia (results expected in

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[15] For an overview of the debate and the motions see Fair Politics (30.6.2011) *Verschillende moties aangenomen fiscaal verdragsbeleid: Kamer wil meer transparantie,* http://www.fairpolitics.nl/nederland/cases/fair_taxes/2011_06_30_verschillende_moties_aangenomen_belastingbeleid

[16] Finance Secretary Weekers Nr. 31, Brief van de Staatssecretaris van Financien aan de Voorzitter van de Tweede Kamer der Staten-Generaal, Den Haag, 14.3. 2012 (Dossier 25087), https://zoek.officielebekendmakingen.nl/dossier/33400-IX/kst-25087-31.html

[17] Double Taxation Agreements in Latin America. Analysis of the links among Taxes, Trade and Responsible Finance', Executive Summary, Latindadd, April 2013 (publication forthcoming).

[18] Ploumen gaat ontwikkelingslanden helpen bij belasting innen, 17.2.2012, http://www.rijksoverheid.nl/nieuws/2012/12/17/ploumen-gaat-ontwikkelingslanden-helpen-bij-belasting-innen.html

June 2013) and considering an independent impact assessment.[19] It is as yet unclear what the Terms of Reference of the current assessment are.

This SOMO research complements the announced impact assessment and hopes to contribute to a comprehensive research agenda that takes into account all relevant factors and possible negative effects of Dutch treaties. The outcomes should inform the negotiations of the Dutch government not only with regard to Least Developed Countries (LDCs), but all non-OECD countries.

[19] 'Ploumen maakt vooral veel beloftes tijdens tweede deel van het Algemeen Overleg', Lennaert Rooijakkers, 24.5.2013, http://www.viceversaonline.nl/2013/05/ploumen-maakt-vooral-veel-beloftes-tijdens-tweede-deel-van-het-algemeen-overleg

3. What are tax treaties and what do they do?

3.1. Introduction

This chapter looks in more detail at the origin and function of DTAs and the underlying assumptions of the current international tax system with regard to international investment.

The increase of global investment flows and economic liberalisation, together with international competition between states to attract foreign direct investment (FDI) has led to enormous policy challenges with regard to international taxation. The development of Multinational Corporations (MNCs) with a global corporate structure and legal entities active in numerous jurisdictions has put states before the question of how to allocate income (profit and losses) made by the group to the different jurisdictions it is active in. International income allocation refers to the apportionment of this global income to states where a corporate group is active.

The challenges states face, however, are not only related to the allocation of income in the face of diverging national rules and definitions. The differences between national tax laws have led to loopholes that companies can exploit in order to avoid or evade tax on their global income. This, in the context of international competition for FDI, has led to total decline in corporate income tax rates and trade tariffs, and in global revenue.[20] The decline has a disproportionally negative impact in resource-rich developing economies, as corporate taxes form a large part of their total tax revenues.

Because globally organised businesses started trading between subsidiaries belonging to the same group, they are able to manipulate prices and thereby shift profits, leading either to double non-taxation or a shift of the taxable income from high- to low-tax jurisdictions. As a harmonised tax system or information exchange between national jurisdictions was (and to certain extent still is) lacking, corporations could avoid, evade or reduce tax in jurisdictions where profit was generated. Of course, they could also be subjected to double taxation, which the OECD defines as “the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter for identical periods”.[21]

During the early 20th century, states that were home to MNCs (in tax terms, residence countries or capital-exporting nations) were therefore forced to adapt their tax systems to capture international payments and investment flows to host states (or source countries). They did this by starting to negotiate tax treaties, of which there are now more than 3.000 worldwide.

3.2. The function of tax treaties (DTAs)

Broadly speaking, double taxation treaties, referred to as agreements in academic literature (DTAs) have the following purposes:

1. To allocate taxing rights between signatory states,
2. To define who is entitled to enjoy treaty benefits (by defining a resident for treaty purposes),
3. To avoid double taxation by agreeing on exemption, credit or tax sparing methods and defining tax-relevant principles for both jurisdictions,

[20] In emerging and developing economies, statutory corporate tax rates (simple averages across countries) have declined since the mid-1990s from about 31% to 26%. See Ali Abbas & Klemm (2012), p. 7.

[21] OECD (1977)

4. To allow for exchange of information and administrative cooperation (enforcing tax compliance),
5. Increasingly they contain anti-treaty shopping provisions.

By signing double taxation treaties, states therefore invariably give up some taxing rights, the extent of which is subject to lengthy and complex treaty negotiations with another state with which mutual investment takes place. Assuming an equal level of investment between states, the trade-off between taxing rights might be more or less equal (with both countries retaining taxing rights on passive income earned by its residents abroad). The taxes lost are assumed to be offset by the reduction in administrative burdens on investment as well as tax compliance costs, leading to less costs and a potential increase in investment and therefore revenue for both states. Whilst this could indeed be the case with symmetrical treaties, i.e. treaties between two capital-exporting states, it argued here that it is not the case when treaties are signed between a state that primarily exports capital and a state that primarily imports capital, i.e. a developing and a developed country (see chapter 4).

Taxation treaties regulate which types of income the source state is entitled to tax and when residence states are obliged to grant tax relief to avoid double taxation. One country's tax gain is therefore another country's tax loss, referred to by Avi-Yonah as the "zero sum game" of international taxation.[22] As the case study of the Netherlands in this report shows, however, this balance is often not met because international tax law and practices such as treaty shopping allow for international tax avoidance by profit shifting.

For certain items of income the right for the source state to tax the gross amount of the payments made (e.g. dividends, interest and royalties) is limited, whilst the state of residence is given the right to tax this income. Double taxation treaties therefore redistribute the right to tax from one state to another by generally limiting the tax rate a host country can impose on (typically passive) income.[23] Residence and source taxation are therefore important principles in international taxation.[24]

Tax treaties have many more functions than avoiding double taxation on the same income. Indeed, there is today a consensus that unilateral measures introduced by most countries since the advent of the treaty network are largely sufficient to avoid double taxation of the same income. Acknowledging this, the OECD dropped the reference to "Double Taxation" in the title of its Model Convention in 1992, replacing it with "Tax Convention".

The benefits of tax treaties today are generally said to be:

- **improved compatibility between tax rules of signatory states** (by addressing specific conflicts between national rules and developing common definitions),
- **assistance in tax compliance** (e.g. by reducing administrative burdens and trading off difficult-to-tax income with easy-to-collect income with the signatory state),
- **certainty for investors** (by clarifying tax rules and help investors measure their tax liability) and
- **improved inter-state cooperation in tax enforcement** (e.g. through mutual assistance, and information exchange).

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22 Avi-Yonah (1996:1303)

23 See Dagan (2000:982)

24 For a discussion see 'Source and Residence Taxation, Tax Justice Network, September 2005, http://www.taxjustice.net/cms/upload/pdf/Sourceresidence.pdf

3.3. OECD and UN Model Conventions

Bilateral treaties are based on the OECD Model Convention, which was developed in the 1960s and regularly revised.[25] The OECD Model and commentaries are not binding but the wording of most existing treaties is based on the OECD Model. Their interpretation by courts in cases of disputes, for instance, takes place with help of the OECD commentaries.[26] The UN Model Convention, which gives more taxing rights to source countries, is also widely used among developing countries in their negotiation and the Netherlands says it is open to base its negotiations with developing countries on the UN Model Convention (see chapter 5.2).

The OECD and UN Model Conventions are in large part identical in wording and since the 2011 revision of the UN Model Convention, also in structure. They lay down the principles that

a) the country of residence eliminates double taxation by giving a credit or exemption, and

b) the source country accepts a restriction in its right to tax at source. Whilst the OECD Model suggests lower tax rates for passive income where jurisdiction is retained, the UN Model leaves it up to negotiating partners which rate to apply.

Broadly speaking, the model treaties stipulate that the business profit of a company can only be taxed by the source state when it can be attributed to a 'permanent establishment' in that country, whilst the right to tax return on investment (passive income) is given to the country of residence of the owner or investor, or split between source and resident country, depending on negotiations. Again, the UN Model differs from the OECD Model in this regard, by giving source states more taxing rates than the OECD Model. Furthermore, both model treaties propose global profit allocation by the method of assigning taxing rights to different jurisdictions on the basis of types of income, to be calculated on the basis of transfer pricing mechanisms. Here also, the UN Model more explicitly refers to alternative methods, such as formulary apportionment.

More than the sum of its parts: transfer pricing vs. formulary apportionment

Global profits are currently allocated on the basis of the arm's-length principle articulated in Article 9 of the OECD Model Convention. The OECD's transfer-pricing guidelines set out five major transfer-pricing methods, based on the separate entity approach, which does not treat MNCs as a single entity and assumes its subsidiaries trade according to market prices. The arm's-length method reflects an era "when companies delivered tangible goods, provided services in person, and conducted business through simple corporate structures". Today, however, companies "deliver goods and services electronically, conduct cross-border operations via an intangible economic presence, and operate through complex, often hybrid corporate structures. The arm's-length method ignores those realities and requires that multinational enterprises have a permanent establishment to be subject to tax in a country. It requires them to calculate their profits as if their integrated operations were separate and distinct from each other and to price every internal transfer of goods and services under the fiction that those transfers occurred with unrelated parties at market prices."[27]

In its recent report 'Addressing Base Erosion and Profit Shifting' (BEPS),[28] the OECD acknowledged that the current system of treating global corporations as separate entities rather than one group is flawed. Solutions to BEPS will ultimately require alternative methods of allocating taxable profits across borders. Pressure by civil society and tax specialists has increased and concrete proposals have been put forward to allocate international income on a formulary basis.[29]

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25 The OECD Model was revised in 1977 (OECD Model Double Taxation Convention on Income and Capital and commentaries) and in regular intervals since. The Model and commentaries were further revised in 1992, and updates have since been regularly made (1994, 1995, 1997, 2000, 2003, 2005, 2008 and 2010).

26 See Goldberg (1983: 851ff), Picciotto (1992:1-63), Baker (2001), Uckmar (2006:150-152) or Lang (2010) for a comprehensive outline of the history and development of the OECD and UN Model Treaties.

27 Weiner (2009:1)

28 OECD (2013)

29 Li (2002:825)

The following section outlines relevant provisions in Model treaties that deal with the above treaty effects in more detail, whilst highlighting issues relevant to developing countries, such as the erosion of the domestic tax base or loss of policy space. These are issues that developing but also developed countries interested in protecting public good *vis a vis* private business interests should be aware of in their treaty negotiations.

3.3.1. (1) Allocating taxing rights

Arguably the most important aspect of tax treaties is the allocation of taxing rights on different types of income. Generally speaking, the source state may only tax (active) income from the business if it is attributable to a fixed place of business, i.e. a 'permanent establishment' (often abbreviated PE). The definition of a PE is therefore crucial in determining whether a capital-importing state may tax business profits. The UN Model definition of a PE allows for more taxing rights for source states. In the OECD Model, the qualification threshold for a permanent establishment is set high because the Model represents developed countries' interests in reducing source-based taxation of capital-exporting enterprises.

Income from movable property such as dividends, interest and royalties are primarily taxed in the residence state, but the source state may impose a reduced tax, depending on negotiations. As the resident state is given most taxing rights, it is also obliged to avoid double taxation of its residents by exemption, credit or tax sparing method (see below). As outlined in Annex 1, the definition and classification of types of income covered by the treaty is also crucial to the allocation of taxing rights of developing countries.

→ Reducing source-based taxation on passive income

Provisions in DTAs that shift taxing right on passive income from source to resident countries are at the heart of tax treaties. They are the reason why developing countries lose out when signing tax treaties with developed countries, because of the asymmetry between capital-importing and capital-exporting economies regarding passive income. There is no reciprocity or rather balancing out of revenue gains and losses, because capital-importing states will not benefit from increased revenue from tax on earnings from 'their' capital investments in the DTA partner state, because they simply do not exist. Different models permit or deny taxing rights on specific forms of passive income. The OECD model permits limited source taxation on dividends and interest but not on royalties. The UN Model accepts a limitation of source taxation on passive income but does not set percentage limits (the percentage to be established through bilateral negotiations), and allows for limited source taxation on royalties.

3.3.2. (2) Applicability: defining who can(not) enjoy treaty benefits

Treaties only grant treaty benefits to residents of both contracting states, who must be "liable to tax [in any of the states] by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature". Given the widely-used practice by non-contracting states' businesses of using conduit structures to benefit from treaties, the definition of a resident corporation is central to tax treaties. Yet both Models Conventions fail to include a test to qualify a corporation (or other legal entity) to treaty benefits,[30] making this an ineffective anti-abuse instrument. Another attempt to fight treaty abuse is by only granting treaty benefits (reduced withholding tax rates) to the "beneficial owner" of the income covered by the treaty. The concept of ''beneficial ownership'' is a

[30] For example, "any reference to the residence of the controlling shareholder or shareholders or any requirement that the corporation must itself carry on business in whole or in part in the country of residence or that the corporation must not be merely an investment holding company not carrying on business at all." (Ward, 2008:4)

specific anti-avoidance concept to prevent treaty shopping through conduit entities. Chapter 4 and Annex 1 outline possible anti-abuse and anti-shopping measures discussed by the OECD and UN Models.

3.3.3. (3) Eliminating Double Taxation vs. granting tax concessions

As mentioned above, tax treaties lay down that residence countries are obliged to avoid double taxation of their residents by granting them an exemption or a foreign tax credit (or a combination thereof) on their global income. With regard to developing countries, the choice of tax credit or exemption is a contentious negotiation point if the developing country grants tax incentives to foreign investors. This is because the exemption method has no effect on tax concessions provided to investors in source countries, whilst the credit method effectively remunerates the residence state, rather than investor, when concessions are given: the exemption method gives the source country the exclusive right to tax, so that tax concessions lead to a lower tax rate for the investor. The credit method entails the resident remaining liable in the country of residence on his or her global income. Any lowering of tax rates in the source state is calculated against the resident state's tax rate, leading to one tax rate for the investor. It also leads to a revenue shift from source to residence country, as the investor effectively pays any tax concession received in the source country to the residence country.

→ Tax Sparing and developing countries

In order for tax incentive measures not to be cancelled out by the domestic tax policies of the other signatory state, developing countries can negotiate "tax-sparing" credits in bilateral treaties. Tax sparing entails capital-exporting country granting a credit not only for the tax paid but for the tax spared (annulled or reduced) in source countries with the aim of providing incentives for investments. Tax sparing credit is therefore an extension of the regular tax credit. This report argues that tax factors are not necessarily decisive in investment decisions and that fiscal incentives are not an appropriate policy tool to stimulate sustainable economic development.

Given the high potential for abuse of the tax sparing provision by investors and the effective double non-taxation (and general revenue loss) resulting from tax sparing, also the OECD is very critical of the inclusion of such provisions in treaties. The OECD does not explicitly advise its members against entering tax sparing provisions, but lists criteria and possible anti-abuse measures.[31]

Developing countries that find themselves with limited policy space and in a 'prisoner's dilemma' with regard to FDI, might therefore want to examine policy alternatives to tax sparing in bilateral treaties. If tax incentives exist, however, it goes without saying that tax sparing or exemption should exist in the investor's resident state.

3.3.4. (4) Exchange of information and administrative cooperation: enforcing compliance

Provisions on administrative cooperation and exchange of information between tax authorities are also seen as important elements of tax treaties. From a domestic revenue perspective, and therefore of central importance to developing countries and poverty alleviation, effective exchange of information between tax authorities is one of the most important aspect of international taxation. Having financial information on economic activities of individuals and corporations abroad is necessary to enforce residence-based taxation on a country's own residents, which is why tax treaties have historically

[31] It should also be mentioned that even if no tax sparing clause is signed, "tax holidays usually benefit taxpayers even without tax sparing" due to the "availability of deferral and averaging (cross-crediting between high and low tax jurisdictions)" (Avi-Yonah, 2007:12).

been central to tax cooperation between capital-exporting states.[32] Developing countries, however, often have less administrative capacity and different needs than developed countries. Their specific situations require specific forms of administrative cooperation and arguably a different international profit allocation system altogether.[33]

3.3.5. (5) Anti-treaty shopping provisions

Finally, tax treaties are increasingly used by states in the fight against international tax evasion and avoidance by attempting to curve double non-taxation (even though ironically, they also allow for double non-taxation by treaty shopping to occur in the first place). Even though tax evasion and avoidance were already identified in the 1920s as a fundamental and emerging problem, most tax treaties do not contain specific provisions dealing directly with treaty shopping.[34] Despite early attempts by the OECD to develop anti-shopping measures, discussed especially in a report by the Committee on Fiscal Affairs from 1987,[35] both the OECD and UN Models fail to include specific anti-abuse articles in the actual model treaty text (although they discuss treaty abuse at length in their commentaries. States which do have such provisions in their treaties can find it difficult to apply them in practice, as accurate application depends on the availability of information or assistance from the treaty partner state, to verify the beneficial ownership of the recipient entity.

3.4. Conclusion

This chapter discussed the function and content of tax treaties and what they mean for capital exporting and capital importing states. The history and principles of residence vs. source taxation of passive income were briefly outlined and the differences in the OECD and UN Model Conventions and provision contained therein explained. Whilst this chapter provided an outline of the substantive provision in treaties and the *intended* effects thereof, the next chapter criticises the underlying political-economic assumptions that the treaty system is based on and argues that tax treaties (can) have *actual* revenue eroding impacts on developing countries, including those based on the UN Model Convention, given it also follows residence-based taxation of passive income.

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[32] In fact, the U.S. refused to sign a DTT with Israel for almost 20 years because of the latter's refusal to cooperate in information exchange (Avi-Yonah 2007).

[33] See chapter 3.3. A comprehensive discussion of formulary apportionment is provided by Li (2002). Christian Aid provides a good analysis and overview of state of affairs regarding financial transparency of MNCs, international tax avoidance and developing countries in 'Shifting Sands: Tax, Transparency and Multinational Companies', November 2010, http://www.christianaid.org.uk/images/accounting-for-change-shifting-sands.pdf

[34] Dunbar (2010:447)

[35] Entitled "Double Taxation Conventions and the Use of Conduit Companies" (OECD, 1987); see Ward (2008).

4. Are treaties necessary - and are they bad for developing countries?

4.1. Introduction

This chapter provides an overview of problematic elements of DTAs from a Southern perspective. Next to outlining the substantive aspects of treaties, which shift taxing rights on passive income from source to residence countries and are therefore disadvantageous for capital importing *vis a vis* capital-exporting states, this chapter looks in more detail at the underlying assumptions and arguments made in favour of DTAs.

A combination of factors contributes to the fact that signing DTAs is not beneficial to most developing countries. These include:

- Substantive and procedural provisions contained in model tax treaties (such as low withholding tax rates on passive income), which lead to tax losses.
- High administrative burden (and related costs) tax treaties imposed on negotiating states.
- Given the low administrative capacity in developing countries, active income is more difficult to tax than passive income (withholding at source), so that relinquishing the rights to tax passive income is not compensated.
- Lack of technical expertise and/or bargaining power in treaty negotiations.
- Tax avoidance techniques (treaty shopping) by MNCs using lower withholding tax rates means that corporations can easily reduce their tax bill in source countries.
- Other factors, such as weak tax administration or lack of administrative (judicial) capacity in general result in developing countries often not reaping the potential benefits of tax treaties, such as administrative cooperation and information exchange.

All these and other factors mean DTAs lead to revenue losses for developing countries.

Next to these structural barriers that developing countries face, there are a number of assumptions which are used by policy makers and OECD countries, including the Netherlands, to explain their drive to sign DTAs and to extend their treaty network. These assumptions are subject to debate and contested in existing literature on taxation treaties and their debatable positive impact.

4.2. Asymmetrical interests - exporting or importing capital?

As outlined above, DTAs are based on a zero-sum assumption in international taxation, whereby an equal level of investment between two states takes place. States both receive investments from the signatory state and themselves have resident investors who invest into signatory states. Income from these investments is received and paid out and subject to a DTA, which lays down which signatory (host or resident) state has the right to particular types of income (dividends, royalties, interest and capital gains). The allocation of taxing rights assumes that investment goes both ways and that both parties to the treaty therefore gain. In cases of unequal investment flows, capital-importing states sign away taxing rights without enjoying the trade-off in the form of low source taxation for their own investors, because they simply do not exist to the extent as is the case for OECD states.[36]

[36] Dagan (2000:989-995). See also 'Source and Residence Taxation, Tax Justice Network, September 2005, http://www.taxjustice.net/cms/upload/pdf/Sourceresidence.pdf

Hence, "developing countries soon realized that the tax treaties implemented between developed countries are inherently biased against them and were reluctant to sign them".[37] This asymmetry appears an obvious fault in the current system in international taxation and can only be explained by the history of the treaty system and the development of a highly competitive global economic system.

Whilst developing countries attempted to advance alternative models, the OECD successfully lobbied for its model, representing capital-exporting countries' interests. Due to the perceived need for FDI by means of investor treaty protection as well as the need for a global comparative standard, the OECD model prevailed, also in the conclusion of the by now large asymmetric treaty network (i.e. double taxation treaties concluded between capital-importing and capital-exporting states). In 2008, 73 per cent of the United Kingdom's tax treaty network and 53 per cent of the United States' tax treaty network were asymmetric.[38] In early 2013, if including upper-middle income countries, almost 66% of the Dutch treaty network (excluding EU Member States) was asymmetric (36% if only counting low- and lower-middle income economies).

4.3. Are treaties necessary to avoid double taxation?

The classic argument for double taxation treaties is that they are necessary to avoid double taxation. This has, however, long been disputed in the relevant literature on international taxation, as double taxation is by now largely prevented by unilateral measures, and taxation treaties merely fine-tune domestic legislation.[39] Although exceptions might still exist and some states might still want to agree on double taxation avoidance mechanisms in a bilateral treaty rather than introducing domestic laws, these individual cases do not justify the existence of a DTA network comprising more than 3000 treaties. This was also recognised by the OECD itself in 1992 when it dropped the reference to "Double Taxation" in the title, replacing it with "Tax Convention". Yet, "[a]uthors and courts have been slow to recognize that the principal purpose of tax treaties has changed. Many still refer to tax treaties as "DTCs" […]".[40] The Netherlands, for example, has a Unilateral Decree on Avoidance of Double Taxation, which will ensure that after the cancellation of the Dutch Mongolian DTA takes effect in 2014, income from Mongolia will not be subject to double taxation. Since the 1977 OECD Model Convention, the primary purpose of relieving double taxation in respect of foreign source income has therefore become obsolete, so that the most important effect of treaties is arguably the shift of taxing rights from source to residents' states.[41]

4.4. Are treaties necessary to enforce tax compliance?

Whilst the exchange of information between tax authorities with the aim of facilitating tax collection has always been a standard feature of tax treaties, until 2002, the OECD Model "was silent on the question of mutual assistance in the collection of taxes."[42] In 2003, a new Article on assistance in the collection of taxes was added to the OECD Model Tax Convention. For a long time treaties were necessary for capital-exporting states to gain information about their residents' tax liability abroad in order to tax their global income. However, information exchange has since been subject to more international agreements, namely Tax Information Exchange Agreements (TIEAs). Since an

[37] Dagan (2000:991). See also Picciotto (1992: 55-8), Goldberg (1983) and Rosenbloom & Langbein (1981).
[38] Baistrocchi (2008:353)
[39] Tax treaty provisions are commonly used, for example, to clarify definitions such as the source of income for purposes of credit or exemption relief.
[40] Ward (2008:3, fn. 4)
[41] See Jones (1999), Dagan (2000), Easson (2000), Avi-Yonah (2007), Ward (2008), Thuronyi (2010), amogst others.
[42] Uckmar (2007:178)

amendment of the 1988 OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters, non-OECD member states can also become party to the Convention.[43]

The argument that tax treaties are necessary for the purpose of administrative cooperation and information exchange is therefore no longer convincing. Civil society organisations point out that existing information exchange instruments such as TIEAs and the Mutual Assistance Convention contain loopholes that raise the question whether it is worth for developing countries to sign on to them.[44] Nevertheless, if developing countries seeking to obtain more information on their investors abroad, they do represent alternatives to DTAs which do not involve giving up taxing rights.

From a developing country perspective, it should also be noted that the inclusion of information exchange agreements does not ensure detection of evasion and avoidance. On-request information exchange (the most common form) typically fails to detect tax avoidance and evasion because strong indications need to exist to be able request information from another tax authority. Lack of transparency and the complex nature of international tax planning, however, mean that an initial suspicion is hard to prove. Administrative capacity to deal with large amounts of data is another barrier to detecting evasion and avoidance, not only in developing countries. Civil society has therefore long campaigned for states to sign multilateral and automatic (rather than voluntary and on request) information exchange instruments, parallel to abandoning the transfer pricing system[45] for other methods that better reflect a globally integrated economic reality, such as formulary apportionment. It is beyond the scope of this report to discuss the workability or desirability of such a system. Calls for alternatives to transfer pricing are, however, increasingly being debated by the media and UN and OECD fora, even if resistance to such a fundamental change of the current system of international taxation remains.

4.5. Are treaties necessary to attract foreign direct investment?

Taxation treaties, it is argued, are necessary to avoid double taxation and to attract much needed foreign direct investment (FDI) into developing countries. The tax losses produced by DTAs, it is also argued, can be compensated because treaties significantly increase the total amount of FDI. The causal relationship between taxation treaties and FDI, however, is inconsistent, so that the reasoning that treaties are necessary to secure inward investments is incorrect. The Dutch government, whilst critical of the evidence base for arguments that tax treaties are being used for international tax avoidance purposes, continues to claim that treaties are beneficial for developing countries. Indeed, since 2011, the Dutch government equates 'Dutch' investment with development aid,[46] and the

[43] The G20 summit in Cannes (3-4 November 2011) called on states to sign the OECD/Council of Europe Mutual Assistance Convention. Political will to sign the Convention was long lacking, yet with the extension to non-OECD/CoE members, it is gaining more signatories. The Convention incorporates internationally agreed standards for exchange of tax information, tools for cross-border tax cooperation, multilateral simultaneous tax examinations, service of documents, and cross-border assistance in tax collection. In 2007, in order to assist in the implementation of mutual tax assistance, the OECD Committee on Fiscal Affairs developed a Manual on the Implementation of both Article 27 of the OECD Model and the OECD/Council of Europe Convention, providing technical advice to tax officials.

[44] See Meinzer (2010) for a detailed discussion on existing information exchange policy instruments and the Tax Justice Network website 'On Exchange of Information for Tax Purposes', for an overview and more background literature, http://www.taxjustice.net/cms/front_content.php?idcat=140

[45] See Tax Justice Network, http://www.taxjustice.net/cms/front_content.php?idcat=139,

[46] For more background information, see http://www.rijksoverheid.nl/nieuws/2011/09/20/aan-de-slag-met-het-nieuwe-ontwikkelingsbeleid.html, http://www.rijksoverheid.nl/onderwerpen/ontwikkelingssamenwerking/aanpak-ontwikkelingssamenwerking and 'Van hulp naar investeren. Een overzicht van instrumenten voor een beter ondernemingsklimaat en internationaal ondernemen in ontwikkelingslanden', http://www.rijksoverheid.nl/onderwerpen/ontwikkelingssamenwerking/documenten-en-publicaties/brochures/2012/01/03/van-hulp-naar-investeren.html. The new policy focuses on less countries and specific sectors of interest for Dutch business. A recent critique of the new development policy agenda is published by the Dutch NGO alliance FGG here: http://bothends.nl/nl/Publicaties/document/100/FGG-Ploumen,-stop-kaalslag-OS-en-waarborg-sociale-winst

extension of the DTA network to developing countries is explicitly framed as an investment promotion and therefore development instrument:

"Developing countries are also increasingly important for investments by Dutch companies as production locations and/or markets. The revised Dutch policy on development cooperation, which is increasingly based on knowledge transfer and business investment in partner countries, will further increase the interest in investing in developing countries. Tax treaties, together with investment protection agreements, provide the legal security which entrepreneurs and citizens seek when they consider investing in developing countries."[47]

The assumptions underlying this development framework are twofold, namely, it is assumed that:

- the existence of a bilateral tax treaty network leads to foreign investments, and that
- foreign investment leads to economic development.

It is beyond the realm of this report to provide an in-depth discussion on the claim that investment equals economic development. It should be noted, however, that although the relationship between FDI and development is often portrayed to be self-evident in debates among policy-makers, this robust and positive relation between FDI and economic development is not mirrored in academic literature. A literature review conducted by SOMO in 2008 shows an inconclusive and complex relationship between FDI and development.[48]

An argument in favour of FDI-led development is the existence of spillovers, whereby domestic companies benefit from the information and knowledge about technology, marketing and management techniques that MNCs bring into the country. FDI is also said to contribute to economic growth if it contributes positively to government revenues. Spillover effects, however, are limited in some sectors *"because these TNCs are 'footloose', and therefore have little incentive to invest in training and education of their workers (in the garment sector, for example), or operate in an 'enclave' setting characterised by limited linkage with the local economy, demonstrated by large numbers of foreign employees and heavy reliance on imports for machinery and intermediate products (in the mining sector, for example)."*[49]

Furthermore, the question whether FDI contributes economic development and government revenues is dependent on:

- (1) the amount of capital that leaves the country in the form of profit repatriation, royalties and interest payments on intra-company loans,
- (2) the balance between FDI imports (such as machinery and intermediate products) and FDI exports, and
- (3) the balance between tax payments made by MNCs and the subsidies provided by the government to attract them, as well as the extent of transfer mispricing – the manipulation of prices of intermediate goods that are traded within the corporate group to avoid taxation.[50]

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[47] *"Ontwikkelingslanden zijn bovendien steeds belangrijker voor investeringen door Nederlandse bedrijven als productielocatie en/of afzetmarkt. Het bijgestelde Nederlandse beleid op het gebied van ontwikkelingssamenwerking waarin in toenemende mate wordt vertrouwd op kennisoverdracht en investeringen door het bedrijfsleven in de partnerlanden, zal de belangstelling voor investeringen in ontwikkelingslanden verder versterken. Belastingverdragen bieden samen met investeringsbeschermingsovereenkomsten de rechtszekerheid die ondernemers en burgers zoeken wanneer zij investeringen in ontwikkelingslanden overwegen"*., Notitie Fiscaal Verdragsbeleid 2011, http://www.rijksoverheid.nl/bestanden/documenten-en-publicaties/kamerstukken/2011/02/11/notitie-fiscaal-verdragsbeleid-2011/aanbiedingsbrief-notitie-fiscaal-verdragsbeleid.pdf

[48] SOMO (2008) See also Lipsey & Sjöholm (2004), Moran et al (2005),Lall (2000) and Rodrik & Subramanian (2008) for a variety of academic contributions debating the relation between FDI and development.

[49] SOMO (2008), p4.

[50] Ibid.

If, for instance, investment takes place in Argentina, whilst the profits made in Argentina as a result of this investment are at the same time reduced by profit shifting using tax treaties, the corporate income tax (CIT) paid by companies in Argentina remains low or zero. This investment therefore does not contribute to government revenue in Argentina in the form of CIT. As this report and recent media reports highlight, it is precisely this form of capital flight through tax avoidance that takes place, amongst others, with the help of tax treaties. FDI can thus not be equated with development.

The same uncertainties exist in the case of the first assumption of the relationship between DTAs and FDI. The overall determinants of FDI are found in a broad array of variables, which include historical links between states, political contexts and other macro-economic external factors (other than the existence of treaties). The results of studies on the statistical relation of DTAs and FDI are mixed.[51] In this body of literature, scholars have used different types of data, covering different countries and periods. One study using US inbound and outbound FDI data finds that in some periods, the relation is positive, in others, it is negative: whilst between 1966 and 1982 a positive correlation between DTAs and FDI was found, the sample from 1983-1992 showed a negative relation.[52] In another study it is argued that renegotiated tax treaties do not promote FDI.[53] One study analysed the effect of DTAs and Bilateral Investment Treaty (BIT) on the FDI flows from developed economies into transition economies using data from 1990 to 2001.[54] This study did find a positive effect in the FDI promotion of BITs but failed to find the similar effect of DTAs. A study from 2010 covering a data set of 105 host countries did find a significant FDI promoting effect of both DTAs and BITs.[55] One often-cited study also used US data and found a positive relationship, but only in middle-income countries. FDI promotion of DTAs was found to be absent in the data group of developing countries.[56] A recently publicised case of Dutch investment in Angola has confirmed this picture: A staggering 45% of FDI in Angola is invested via the Netherlands, whilst no treaty between the two countries exists.[57]

It is of course also the case that even if a positive correlation between DTAs and FDI is found to exist in specific instances, this does not necessarily imply, firstly, that this increased FDI compensates for the costs of DTAs, and, secondly, that a causal relationship between the two. Regarding the first point, it has been pointed out that *"whether the demonstrated benefits of signing up to DTAs in the form of increased FDI are higher than the substantial costs developing countries incur negotiating, signing and concluding DTA's together with loss in tax revenues is impossible to tell."*[58]

Regarding the second point, if a positive relation is found to exist, both could be the outcome of other external factors. Most research does not take into account other causal factors, given they are impossible to calculate statistically. For instance, the Netherlands (an indeed most countries) sign treaties when there is an indication of growing investment between two countries, as is the case with the Netherlands and Ethiopia, which negotiated a treaty in 2012. If in a number of years an economic study finds that investment increased as of 2012, when both countries finalised treaty negotiations, this could be an investment trend that was already well under way, and therefore caused by other external factors.

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51 Barthel, Busse, & Neumayer (2010); Blonigen & Davies (2004). Coupé, Orlova & Skiba (2008); Davies (2003); Neumayer (2007).
52 Blonigen & Davies (2003).
53 Davies (2003)
54 Coupe et al. (2008)
55 Barthel, Busse, & Neumayer (2010)
56 Neumayer (2007)
57 Financieel Dagblad, 3.6.2013, 'Ontbreken verdragen Angola geen probleem'
58 Neumayer (2007)

Two conclusions can be drawn from the existing studies:

- Firstly, there is no evidence base for the claim that tax losses and others costs related to signing DTAs are offset by an increase in FDI produced by tax treaties, because econometric studies have not found a conclusive (i.e. consistent) statistical relation between the two.
- Secondly, FDI flows cannot be reduced to single causal relations, but are typically embedded in a range of macroeconomic, sectoral, institutional and geo-political issues. The assumption that FDI is increased because of the existence of a DTA reduces investment decisions by corporations to a single cause, whilst in reality they depend on specific corporate, sector and temporal variations. Indeed, a recent study on the location decisions of investors showed that infrastructure, political stability, labour productivity, low corruption, minerals for extractives companies and other economic fundamentals were more important to an investment decision than the tax regime.[59]

The complex relationship between tax, FDI and development means that rather than generally assuming DTAs are good for investment or development, the benefits of DTAs would have to be assessed *before* entering DTAs. This assessment would have be comprehensive and include bilateral investment data analyses by signatory states, taking into account specific economic relations and sectors, the potential effect of DTAs on investment levels and government revenues, or the link between FDI and development, amongst others. It should also be taken into account that administrative cooperation, information exchange and income and tax definitions could also be agreed upon in other bilateral or multilateral treaties as well as in unilateral measures.

4.6. Treaty shopping

Tax treaties allow for global profit shifting and tax avoidance through treaty shopping. Treaty shopping occurs when a resident of a third country takes advantage of a treaty between states, typically by setting up a conduit company or other legal entity in a state which has a suitable treaty, solely for the purpose of enjoying the benefit of the treaty.[60] Typically the beneficial owner of the conduit entity is not resident in the country where the entity is created, and the conduit entity has minimal presence or economic activity in the country in which it is resident; the channelled income benefits from the treaty provision granting low or zero withholding taxes in the treaty-partner country which is the source of the income, and is subject to minimal (or no) tax in the conduit country.[61]

Treaty shopping erodes source countries' tax bases and is therefore particularly damaging for poor developing economies, although in absolute terms, developed economies lose out most from treaty shopping, because they experience much higher levels of in- and outward investment. OECD states therefore have a long history in trying to avoid treaty shopping by different avoidance measures, either domestic legislation, in treaties or as a result of court judgments. Such measures include applying an economic substance over legal form principle to disqualify the conduit entity from being treated as a resident, domestic general anti-avoidance rules (GAARs), or through more technical and specific concepts included in treaties, such as the beneficial ownership concept and limitation on benefits

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[59] Bhinda & Martin (2009), cited in Christian Aid (November 2010).

[60] The OECD commentaries define a conduit as "using artificial legal constructions to benefit both from the tax advantages available under domestic laws and the tax relief provided for in double taxation conventions. This would be the case, for example, if a person (whether or not a resident of a Contracting State), acts through a legal entity created in a State essentially to obtain treaty benefits that would not be available directly. Another case would be an individual who has in a Contracting State both his permanent home and all his economic interests, including a substantial shareholding in a company of that State, and who, essentially in order to sell the shares and escape taxation in that State on the capital gains from the alienation (by virtue of paragraph [6] of Article 13), transfers his permanent home to the other Contracting State, where such gains are subject to little or no tax."

[61] Krishna (2009:540)

provisions.[62] The term 'limitation on benefits' (LOB) refers to provisions included in double taxation treaties that specifically limit the applicability of the treaty. LOB provisions are typically negotiated by more powerful, capital-exporting states, in particular the US.[63]

4.6.1. Anti-abuse provisions in tax treaties

Although more states have started including anti-abuse provisions in their negotiations, the failure of such provisions to curtail tax avoidance or evasion from taking place, and the failure of tax administrations to combat conduit structures, points to a more fundamental change needing to be made if treaty shopping and tax avoidance using the Netherlands as a conduit country are to be curtailed. Advertisements by Dutch tax advisors, for instance, emphasise the ease with which companies can use the Netherlands for tax avoidance purposes. They also illustrate the fact that current provisions are ineffective and promote tax avoidance and evasion. The law firm Loyens & Loeff,[64] which provides "top-level legal and tax advice for international businesses, financial institutions and government bodies", explains in a Memorandum from 2008, entitled *The Netherlands: Sound and Proven Gateway to the world. Advantages for non-residents of using a Dutch Intermediate Holding/Finance Company*, how reducing tax bills in source countries remains the main attraction of the Dutch tax treaty network for foreign investors:

"Simply put, one may create within a limited period of time and without too much difficulty a Dutch limited liability company […]. In doing so the investor may achieve a tax neutral position or, against the background of the vast tax treaty network of the Netherlands, improve his worldwide tax position ***as compared to the situation in which he would be holding those investments directly*** [emphases added]*. This probably explains why many others have already found and followed this route."*

The reference to direct investments here assumes that routing investments through the Netherlands constitutes indirect investment. If taxation at source is thereby reduced with the help of treaties, as the article suggests, this amounts to treaty shopping. Treaty shopping thus leads to a "tax neutral position", which is another term for tax avoidance

Next to anti-abuse provisions in treaties, the OECD is recommending governments refuse tax deductions that will be untaxed in another jurisdiction (the US already practices this). The Netherlands, for example, currently allows companies to deduct its payments to tax havens, which is one major tax avoidance route by intra-group loans and interest rates, or royalty payments, for example.[65]

The European Commission, in its recent Action Plan proposal to fight harmful tax regimes[66], proposes for Member States to include a General Anti-Abuse Rule (GAAR) in their national legislation and anti-abuse rules in tax treaties, as well as general measures to fight specific tax planning routes that lead to double non-taxation. Specifically, Member States are urged[67]:

- *"to introduce a subject-to-tax requirement both in their unilateral double tax relief rules and in their bilateral tax treaties, whereby income is only to be allocated to a certain State when this*

[62] Krishna (2009:541). See Ward (2008) for an outline of possible anti-avoidance rules and a discussion on their effectiveness.

[63] The United States limits the applicability of a double taxation treaty by excluding legal entities from being defined as a resident for the purpose of the treaty if they are not subject to residence-based taxation in the other contracting state (Streng, 1991; Wacker, 1993). In 2004, the U.S. included a 'substantial presence' test to avoid treaty abuse in a Protocol to the Netherlands –U.S. treaty. Domestic law also lays down that royalty payments made by a "conduit" should be treated as U.S.-source income and subject to a 30-percent withholding tax (Rubinger, 2007:44, fn 47).

[64] Loyens & Loeff (2008:1)

[65] Financial Times (14.1.2013) 'Unsafe Offshore'.

[66] The set of proposals followed a related Commission Communication from 27.6.2012 (COM(2012) 351 final) and are p ublished at http://ec.europa.eu/taxation_customs/taxation/tax_fraud_evasion/index_en.htm

[67] Loyens & Loeff (6.12.2012) 'European Commission publishes Action Plan to strengthen the fight against tax fraud and tax evasion', http://www.loyensloeff.com/nl-NL/News/Publications/Flashes/Pages/TaxFlash6december2012.aspx

income is actually taxed there. The other State would thus retain the right to tax in situations where there would otherwise be double non taxation."

- to incorporate a GAAR in their national legislation, which should be defined as follows: *"An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their economic substance.*

The recommendation contains an explanatory section on how this provision is to be applied and interpreted. The Commission further proposes to review the anti-abuse provisions in the EU Interest and Royalty Directive, the EU Merger Directive and the EU Parent-Subsidiary Directive to bring them into line with the GAAR.

The Netherlands, as the following chapter shows, could end its conduit role by introducing these recent far-reaching Commission proposals. Next to anti-abuse provisions in tax treaties, a GAAR would be a welcome complementary anti-abuse measure to capture avoidance taking place outside of treaties, such as transfer mispricing with the use of royalties, as recent media reports about tax planning techniques of Apple, Google and Starbucks have highlighted.

The United States has included anti-abuse provisions (limitation on benefits clauses) to prevent tax avoidance practices of US corporations by way of treaty shopping through the Netherlands from as early as 1984 onwards.[68] Although anti-abuse provisions should be a standard feature of tax treaties, especially in treaties with tax conduit countries such as the Netherlands, more research is necessary to assess their effect. International tax literature suggests that "it remains unclear that the limitation-on-benefits provisions really achieve this purpose."[69]

US limitation on benefits provision[70]

The United States, which curbs treaty shopping through the Netherlands since the 1980s,[71] limits the applicability of a double taxation treaty by restricting the definition of a resident with the aim to effect taxation of the resident in either contracting state. In other words, the US tries to only reduce taxation at the source if the other contracting state actually levies the corresponding tax instead. For example, if a resident (including a corporation) in a country that does not have a treaty with the United States sets up a conduit base in a country whose residents enjoy limited withholding tax rates under a treaty with the US, they only qualify as resident for treaty purposes if that country does not eliminate or significantly reduce taxation on that income through domestic law (for example, with a participation exemption rule, which the Netherlands grants).[72] Domestic US legislation also contains anti-abuse provisions. Under Code Sec. 861(a)(4), for example, royalty payments made by a "conduit" should be treated as US source income and subject to a 30-percent withholding tax.[73]

68 Avi-Yonah (2007: 8-9). The U.S. limitation-of-benefits articles "are often much more complicated than the model version because other countries want to create loopholes to allow for treaty-shopping". In the 1980s, US companies had established subsidiaries in the Netherlands Antilles, a Caribbean tax haven that used to belong to the Netherlands, where they could benefit from a zero per cent withholding tax (WHT) on interest on the basis of the US-Netherlands tax treaty. In 1984, the United States terminated the extension of the DTA to the Netherlands Antilles and enacted a portfolio interest exemption and introduced a limitation of benefits, which has been a central part of US-Netherlands tax treaties since.

69 Avi-Yonah (2007:10)

70 Avi-Yonah (2007: 8-9)

71 And more recently in 2004, the U.S. included a 'substantial presence' test to avoid treaty abuse in a Protocol to the Netherlands-U.S. treaty.

72 Streng (1991), Wacker (1993)

73 Rubinger (2007:44, fn. 47)

The prisoner's dilemma: Courts condoning treaty shopping
In India, the Supreme Court has ruled in favour of tax payers engaging in tax avoidance through treaty shopping in the belief that non-taxation is a necessary evil when faced with the need for foreign direct investment. This was explicitly stated by judges in the case of *Union of India v Azadi Bachao Andolan*.[74] In this case, decided by the Supreme of Court of India on 7 October 2003, foreign investors had used a conduit company based in Mauritius to channel investment from OECD countries to India to avoid capital gains tax in either country, leading to double non-taxation. This is possible, for example, if investment from the Netherlands into India is channelled through a Mauritian conduit. The alienation of shares of companies based in India controlled from a conduit company based in Mauritius would not be subject to capital gains either in India or in Mauritius under the India-Mauritius tax treaty, and the dividends from and capital gains on the shares would not be taxed by the Netherlands because of its participation exemption law either.

The main issue before the Indian Supreme Court was whether this scheme was valid under the India-Mauritius tax treaty, considering that the only justification for channelling the investment in that way was tax avoidance. The Supreme Court decided in favour of the taxpayer, arguing that:

"Developing countries need foreign investments, and the treaty shopping opportunities can be an additional factor to attract them. […]' The developing countries allow treaty shopping to encourage capital and technology inflows, which developed countries are keen to provide to them. The loss of revenue could be insignificant compared to the other non-tax benefits to their economy."

This case shows that developing countries are under high pressure and face high competition in attracting FDI. They are therefore in a "prisoner's dilemma" when it comes to protecting their tax base, and therefore "sign treaties that hurt them" or rule in favour of investors who engage in treaty shopping.

4.7. Conclusion: why do poor countries sign DTAs?

Treaties, as a rule, imply that signatory states give up policy space. As the experience from bilateral investment relations shows, giving up domestic policy space by signing treaties has become a serious barrier to states' ability to raise revenues, illustrated by the rise in investor-state disputes under Dutch bilateral investment agreements.[75] The same can be said about double taxation treaties. States make concessions to achieve investment benefits and cooperation in their international tax matters. But the question a state has to consider when entering treaty negotiations is at what cost treaties come and whether they really do have a positive impact with regard to foreign investments.

Given the disadvantages the current tax treaty network has for developing countries, the question arises why developing countries sign tax treaties, and in particular OECD model-based tax treaties. Only a political-economy perspective can explain why poor countries sign "treaties that hurt them",[76] which has been widely discussed in investment literature in relation to bilateral investment treaties.

Firstly, after the UN Model Convention failed to become a global standard, developing countries were faced with existing internationally accepted tax treaty standards reflecting OECD country interests. It has been argued that the OECD tax treaty network provides a number of advantages for members (including non-OECD members) of that network.[77] This could be the minimisation of communication[78] and enforcement costs[79] or reputation advantages (such as a credible commitment to predictability

[74] The details of this case, including the example of the investments being routed through a Dutch conduit, are reproduced from Baistrocchi (2008:361).
[75] SOMO (2012)
[76] Guzman (1998)
[77] All examples below are reproduced from Baistrocchi (2008:380-384).
[78] Tax treaties are based on the same model and are written in the same language (i.e. English) is instrumental in minimising the communication cost of the tax treaty network.
[79] The OECD treaty network provides developing countries' domestic courts with the option of minimising its enforcement cost

and legal stability) over competitors for FDI who are not members of the tax treaty network. Whilst non-OECD countries should aim to negotiate stronger source country rights in DTA, in practice, their negotiating powers are weak, so that they are not only unable to secure concessions. They also have no official role in shaping the OECD Model treaty.[80] Poor countries may also lack expertise not only in high-level negotiation practices, but also the technical aspects of the international tax system.

Secondly, whilst being in a weaker bargaining position than OECD states, poor countries are dependent on capital import. In particular since the abolition of protectionist economic measures since the 1980s onwards under WTO free trade rules, this has compelled developing countries to enter into fierce competition with each other with investment-friendly policies. They follow the OECD model "for fear of driving FDI away to competing jurisdictions".[81] Indeed, tax competition between developing countries is why the so-called asymmetric treaty network has grown substantially since the 1980s. Whilst the US, for example, had very few tax treaties with developing countries until the 1990s, this has recently changed[82] because tax treaties are seen to attract US investors by providing certainty regarding the tax law of the other country.[83] Not only have governments signed on to treaties that hurt them, but developing countries' domestic courts have also been found to rule in favour of treaty shopping. Some court decisions have explicitly states that even if a DTA erodes the domestic tax base, it attracts necessary foreign direct investment and is therefore necessary (such as in the case of the India-Mauritius treaty mentioned above, which is widely used by companies and wealthy individuals to escape capital gains tax by setting up a conduit in Mauritius).[84]

Although the current DTA regime is a global standard, recent developments at the G20 and OECD level indicate that change is taking place. The UN Tax Committee has hosted a number of debates on the fairness of the international tax system and Model treaties. The rise of the BRICS has also contributed greatly to opening up the discussion on developing country interests in the international tax system. And the recent cancellation of DTAs by Argentina and Mongolia are a first in international tax practice. In May 2013, the UN launched its revised 'Practical Manual on Transfer Pricing' to help tax officials in developing countries pinpoint the prices of goods and services traded by multinationals. South-South exchange is also high on the agenda in international tax matters; chapter 10 of the UN Manual outlines the transfer-pricing experiences of Brazil, China, India and South Africa. It remains to be seen what the result of these increasing debates and cancellations of DTAs will be. They have already brought the differing interests of capital-importing and exporting countries back on the political agenda and highlighted the problems the current system poses in many countries. Calls for a simplification of the international tax system, including transfer pricing, in the form of formulary apportionment or unitary taxation are also subject to increasing research[85] and, it appears, gaining more political will.[86]

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by referring to legal sources which are unavailable to countries outside of the tax treaty network (case law produced by foreign domestic courts interpreting OECD-based tax treaties, for example). Members also have access to procedures for solving transfer-pricing disputes such as the multilateral advance pricing agreement (APA) regulated by Article 25 (3) of the OECD model.

80 Pistone (2010:414)

81 Baistrocchi (2008:355)

82 As mentioned above, in 2008, 53 per cent of the United States' tax treaty network were asymmetric (Baistrocchi, 2008:353).

83 Avi-Yonah (2007:4)

84 *Union of India v Azadi Bachao Andolan*, see Baistrocchi (2008) for a detailed discussion of the case.

85 For instance, the global policy research network *International Centre for Tax and Development*, based at the University of Sussex, has recently started a research project into 'Unitary Taxation of Transnational Corporations', http://ictd.ac/en/knowledge/unitarytax.

86 See, amogst others, the OECD's Base Erosion and Profit Shifting project, http://www.oecd.org/tax/beps.htm.

5. The Dutch treaty network and treaty shopping

5.1. Introduction

The Netherlands currently has 93 bilateral tax treaties (for an overview of the Dutch DTA and Bilateral Investment Treaty network, see Annex 3).[87] As chapter 5.3 below shows, the Dutch DTA network enables firms with affiliates in countries that have a treaty with the Netherlands to move passive income payments from a subsidiary in one country to a parent company in another country through a holding domicile led in the Netherlands. The Dutch treaty network thereby facilitates the inflow of capital to a Dutch subsidiary by reducing or eliminating withholding tax on dividend, royalty and interest payments as well as capital gains tax.

The Netherlands has DTAs with many European Union countries. These treaties are not included in the overview below, because the EU has abolished WHT on passive income within the EU under a number of Directives in recent years. Dutch DTAs therefore no longer provide special advantages in the form of WHT rates for investors. Other tax advantages such as the participation exemption and other domestic tax legislation providing tax benefits do, however, still apply.

The composition of non-EU Dutch treaty partners is currently as follows: six are low income countries[88], 18 are lower-middle-income countries,[89] 20 are upper-middle-income countries[90] and 23 are high income countries. Given that upper-middle-income countries include poor countries that can be assumed to have a weak bargaining position, are net capital receivers and are subject to high competition for investment, it is assumed that these countries are likely to lose out from treaty shopping through Dutch DTAs. It is also assumed that high-income countries are equal treaty partners that are able to mitigate potentially negative effects of bilateral tax treaties on revenues with compliance and administration as well as equal bargaining powers, or gain from treaties through reciprocal FDI flows. If these assumptions are found to be valid, then almost 66% of the Dutch DTA network is potentially damaging the domestic revenues of treaty partners as a result of reduced withholding tax rates.

As chapter 5.4 shows, of the 36 countries for which Dutch FDI stock data was available, 28 experience revenue losses as a result of lower withholding tax rates in Dutch treaties, amounting to an annual revenue loss of 771 million euro on dividend and interest income alone. Especially Venezuela, Brazil and Kazakhstan lose out in absolute terms, but many more countries are affected. Asian countries such as Indonesia, the Philippines and Malaysia are also shown to suffer unnecessary revenue losses. Eastern Europe also has very disadvantageous treaty provisions, leading to high

[87] Treaty overview as of 1 January 2013. All countries that have a DTA with the Netherlands are included. The selection is not based on the substantive content of the DTAs. The overview includes Kyrgyzstan and Turkmenistan, agreements with which still fall under the conditions old Soviet treaties. They are also included on the list of treaties provided by the Ministry of Finance. For a full list, see http://www.rijksoverheid.nl/onderwerpen/belastingen-internationaal/documenten-en-publicaties/circulaires/2013/01/01/verdragenoverzicht-op-het-gebied-van-directe-belastingen.html

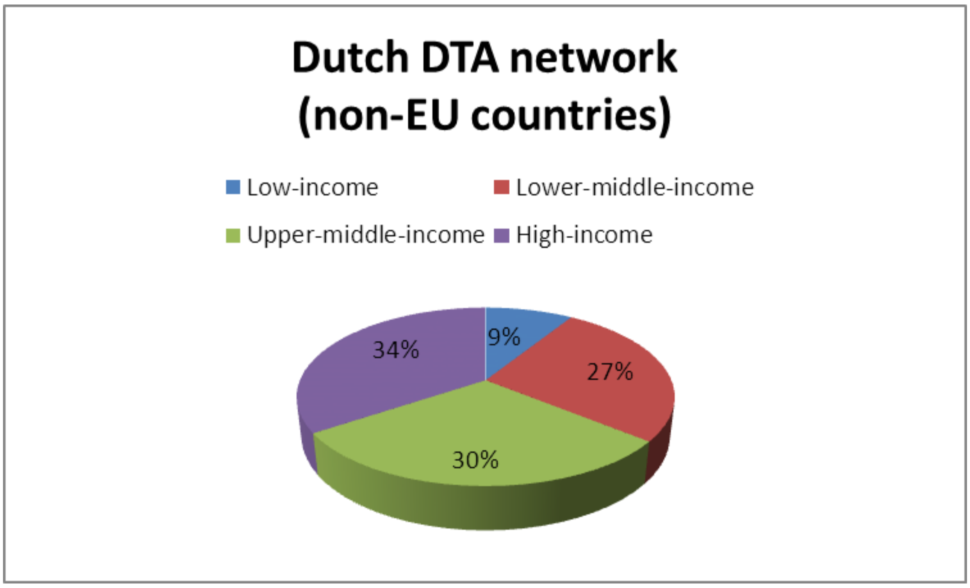
[88] Low-income countries: Bangladesh, Ethiopia, Kyrgyzstan, Malawi, Uganda, Zimbabwe (7).

[89] Lower-middle-income countries: Armenia, Egypt, Georgia, Ghana, India, Indonesia, Moldova, Mongolia, Morocco, Nigeria, Pakistan, Philippines, Sri Lanka, Turkmenistan, Ukraine, Uzbekistan, Vietnam, Zambia (17).

[90] Upper-middle-income countries: Albania, Argentina, Azerbaijan, Belarus, Bosnia and Herzegovina, Brazil, China, Jordan, Kazakhstan, Malaysia, Mexico, Panama, Russian Federation, Serbia, South Africa, Suriname, Thailand, Tunisia, Turkey, Venezuela (20).

revenue losses in Serbia and Croatia, for instance, especially when compared to these countries' gross domestic products.

Graph 1: Dutch DTA Network (non-EU countries)



Until 1997, the Dutch position in treaty negotiations with developing countries largely followed the UN Model with regard to Article 5 (permanent establishment) and Article 7(3) (allowable deductions for business profits),[91] but not the 'limited force of attraction' rule contained in the UN Model (Article 7(1)), which grants source taxation on some types of business profits that are not necessarily attributable to a permanent establishment.[92] The Dutch acceptance of shared taxation rights on royalty rights has also been limited, as has its willingness to grant increased source taxation rights on capital gains by the alienation of shares (because of its domestic participation exemption law) or other income.[93]

Chapter 2 already contextualised the recent parliamentary debates on the potentially negative effect of Dutch DTAs on developing countries. In 2011, the Netherlands announced its intent to expand its tax treaty network to more developing countries. The following low- and lower-middle-income countries have been approached for negotiation: Algeria, Angola, Colombia, and Chile. Negotiations have started with Costa Rica, Kenya (almost finalised) and Peru.[94] The paragraphs below outline the current Dutch tax treaty policy approach in more detail, highlighting a number of issues that remain problematic from a developing country perspective. The problem of treaty shopping is discussed, with a brief explanation of Dutch holding structures and their role in tax avoidance. The chapter then provides a calculation of lost revenue for Dutch treaty partners as a result of low or no WHT on interest and dividends. This estimation is complemented with a number of published company case studies, illustrating the large-scale and widespread nature of the problem.

[91] See Kosters (2004), who was a tax treaty negotiator for the Netherlands, for details.

[92] The rule allows source taxation of certain profits (not attributable to the PE) that relate to sales of similar goods or merchandise in the source country, as well as other business activities of the same or similar kind carried on by the enterprise in the source country. For example, when the head office provides goods or services directly to the customers in the source country and the PE in the source country is also involved in the same line of activity, the profits earned by the head office directly shall be taxed as a profits attributable to the PE. The rule is limited to business profits (not applicable to passive income); it also excludes sales through independent commission agents nor purchase activities (Lennard, 2009:7)

[93] Kosters (2004).

[94] Notifications of negotiations on Ministry of Finance website.

5.2. 2011 Memorandum (policy note) on Dutch Tax Treaty Policy

In February 2011, following policy developments in the international tax arena towards increased transparency and the fight against tax evasion and avoidance, the Dutch government issued a new policy note on tax treaties.[95] Whilst addressing some specific legal issues,[96] the *Memorandum on Dutch Tax Treaty Policy 2011*[97] proposes no significant changes to the previous treaty regime.

The Memorandum pledges to continue the long-standing Dutch policy of offering an attractive fiscal climate for international businesses and following OECD Model Tax Convention in its negotiations (whilst certain provisions of the UN Model may be followed in negotiations with developing countries). Problematic from a developing country perspective is the explicit goal of consistently seeking to agree on exclusive resident state taxation for passive income, whilst at the same time actively pursuing an expansion of the Dutch treaty network to (more) developing countries.

Withholding tax policy principles for future Dutch tax treaty negotiations (2011)[98]

Dividends

The Memorandum indicates that the Netherlands will seek to include a 0% dividend withholding tax rate in the source country for participation dividends (with the beneficial owner (company) holding a minimum percentage (10%-25%) of the share capital or voting power). To curb treaty shopping specific anti-abuse rules may be included in tax treaties.

Interest and royalties

Consistent with current policy, the Netherlands will seek to include a 0% withholding rate for the source country for cross border interest and royalties payments (the Netherlands itself also does not levy withholding tax on royalties and ordinary interest). The Memorandum states that at the request of a tax treaty partner, the Netherlands is willing to consider, within reasonable limits, a specific anti-abuse rule.

Capital gains

Capital gains realised in connection with the sale of shares will only be taxable in the country of residence of the seller, irrespective of the nature of the underlying assets. The Memorandum states that if the tax treaty partner, in accordance with the OECD model treaty, requests exclusive source country taxation for capital gains on shares in real estate companies, the Dutch government may concede to this, but its policy would then be to limit the scope of this provision as much as possible.

The Memorandum points out that almost all countries that have not as yet signed a tax treaty with the Netherlands are non-OECD countries and announces preliminary talks for negotiations for several capital-importing countries such as Angola, Costa Rica and Ethiopia. A treaty with Ethiopia was concluded in 2012, with bad treaty terms from a development coherence perspective (see chapter 5.4.1).

The Memorandum points out the importance of anti-abuse provisions,[99] but the wording of the policy note is weak, as it stipulates that the Netherlands "can propose to include an anti-abuse provision in

[95] Earlier policy notes on the Dutch position taken in the (re)negotiation of tax treaties were published in 1987, 1996 and 1998.

[96] Such as the interaction between EU law and tax treaty policy or clarifying the applicability of the treaty. See van den Berg & Vrolijk (2011:727) for the main issues dealt with in the Memorandum, such as clearer rules for residency of exempt entities and hybrid entities, 0 per cent withholding rates for participating dividends, interest, and royalties; the use of recent OECD commentary, inclusion of an arbitration clause, and explicit language curbing treaty abuse. The Memorandum also announces that the Netherlands officially abandons the use of a standard Dutch model tax treaty in favour of the OECD Model Convention guidelines, whilst striving to take account of specific characteristics of potential tax treaty partners with "tailor-made solutions".

[97] Notitie Fiscaal Verdragsbeleid 2011 (11.2.2011)

[98] See van den Berg & Vrolijk (2011:729).

[99] The Memorandum distinguishes between two categories of anti-abuse provisions. Either based on the nature or the activities of the person entitled to the element of income (a person or entity-based approach, such as "limitation on benefits"

the treaty" and "is willing to consider reasonable anti-abuse provisions" on request of the treaty partner (rather than 'will'). This is especially problematic when considering the fact that even if anti-abuse rules are included, they are typically not sufficient to curb treaty shopping. Not only should anti-abuse provisions therefore be a standard feature of tax treaties and sufficiently defined, but they should also be complemented by (Dutch) domestic tax measures. Because the erosion of the tax base "can only be prevented by limiting possibilities for deductible items (e.g. thin capitalisation rules[100]) or through the imposition of withholding tax on specific types of capital flows (e.g. royalties, technical service fees and insurance premiums)".[101]

It should also be mentioned that the Memorandum announces that the Netherlands will no longer agree on including tax-sparing credits in tax treaties, and will continue to seek to end tax-credit provisions in its existing treaties. This has important implications for developing countries that use fiscal incentives. If no tax sparing or exemption arrangement exists, fiscal incentives will benefit the resident state rather than MNCs. Incentives would be offset against the credit system of the resident state, as any lowering of tax rates in the source state is calculated against the resident state's tax rate, leading to one tax rate for the investor. It also leads to a revenue shift from source to residence country, as the investor effectively pays any tax concession received in the source country to the residence country.[102] Fiscal incentives (tax exemptions) should therefore be abolished when entering in a tax treaty with the Netherlands, or if fiscal incentives for businesses are retained, no Dutch treaty should be concluded.

5.3. Treaty shopping through Dutch conduit structures

As outlined above, the Netherlands has long been recognised by investors and tax and investment advisory companies as a legitimate home for treaty shopping, and the country has faced criticism by the OECD[103], the European Union[104] and the United States[105] for a fiscal climate that allows for an erosion of other countries' tax bases through harmful tax competition and conduit structures. In 2006, SOMO published a detailed report on the different tax advantages multinational corporations can

provisions), or applicable to types of transactions (the nature of the intent).

[100] Author's note: this strategy is used to lower the taxable base of a subsidiary by letting it pay a high (tax-deductible) interest on loans from another group company. To fight this form of tax avoidance, revenue authorities will often limit the amount that a company can claim as a tax deduction on interest, particularly when it receives loans at non-commercial rates (e.g. from connected parties). However, some countries simply disallow interest deductions above a certain level from all sources when the company is considered to be too highly geared under applicable tax regulations. Another solution is used by Hong Kong, which protects tax revenue by prohibiting companies from claiming tax deductions for interest paid to foreign entities, thus eliminating the possibility of using thin capitalisation to shift income to a lower-tax jurisdiction.

[101] Michielse (2011:4).

[102] The UN Commentaries on Article 23 (United Nations, 2001) reflect developing countries' rejection of the foreign tax credit method because special tax concessions granted by them "may in large part be to the benefit of the treasury of the capital-exporting country rather than to the foreign investor for whom the benefits were designed. Thus, revenue is shifted from the developing country to the capital-exporting country".

[103] The OECD ranked the Netherlands as one of the top five industrialised countries that supported harmful tax competition. It identified 9 potentially harmful tax practices in Dutch law, excluding holding company regimes and similar provisions: because of the "complexities raised by such regimes, including their possible interaction with tax treaties", the Forum decided further research was needed to assess the effect of holding company structures (OECD 2000).

[104] The EU Code of Conduct Group on Business Taxation (Primarolo Group) was designed to detect measures constituting harmful tax competition, i.e. measures which "unduly affect the location of business activity in the Community by being targeted merely at non-residents and by providing them with a more favourable tax treatment than that which is generally available in the Member State". In a 1999 report the Group identified 66 tax measures with harmful features, of which 40 in EU Member States, 15 in Dutch Law and 7 in the Netherlands Antilles.

[105] US Commerce data show that US businesses kept $118bn of income in Dutch holding companies between 2006 and 2009 ('Tax wars: the accidental billion-dollar break', Financial Times, 27.9.2011, http://www.ft.com/cms/s/0/69703dfe-e82e-11e0-9fc7-00144feab49a.html#axzz1fTOPnukW) and U.S. President Barack Obama famously named the Netherlands a tax haven in May 2009 ('Netherlands surprised at Obama tax haven slur', NRC.nl, 5.5.2009, http://vorige.nrc.nl/international/article2232958.ece)

enjoy. These benefits result from payments being routed through the Netherlands, by using royalty conduit companies, interest conduit and group financing companies or a combination of holding, financing, and licensing activities. Double taxation treaties are a central part of this conduit regime.

Statistical proof that the Netherlands is used for treaty shopping
A recent statistical analysis[106] of micro data from Dutch Special Financial Institutions has confirmed that the Netherlands serves as a conduit for treaty shopping. Weyzig concludes that

"Many multinationals divert Foreign Direct Investment (FDI) through conduit countries that have a favorable tax treaty network, to avoid host country withholding taxes. This is referred to as tax treaty shopping. The Netherlands is the world's largest conduit country; in 2009, multinationals held approximately €1,600 billion of FDI via the Netherlands".

The research uses micro data from 'Dutch Special Purpose Entities' to analyse geographical patterns and structural determinants of FDI diversion. Tax treaties are a key determinant of FDI routed through the Netherlands, the research finds. Furthermore, it is found that lower WHT rates on dividends contributes to treaty shopping:

"The effect of tax treaties on FDI diversion partly arises from the reduction of dividend withholding tax rates, which provides strong evidence for tax treaty shopping."

Dutch holding companies are also found to be used for intra-group financing activities, which provides tax benefits to the group as a whole:

"Anonymised micro data show that in 2007, Dutch SPEs had onlent more than €450 billion to foreign affiliates. The sources of these funds were roughly €250 billion of debt securities issued by the SPEs, €150 billion of intra-group loans, and €50 billion of third party loans. The onlending activities account for more than 25% of Dutch SPEs' combined balance sheets and are often combined with holding activities."

Tax avoidance, rather than being solely the responsibility of companies, is facilitated by states that have harmful tax regimes in place. This was recognised by the OECD in 1998 with its report on harmful tax competition[107] and the EU's Code of Conduct Group on business taxation (Primarolo Group) in its 1999 report.[108] In the drive to compete for FDI, some jurisdictions have specialised in offering certain services used by MNCs for international tax avoidance.[109] Rather than solely aiming to attract FDI (involving material economic activity) into their countries, economies such as the Netherlands have developed niche markets as tax havens or 'conduit' havens. Conduit countries offer the following tax avoidance possibilities:

For a reduction on royalty rates or intra-firm lending (which can amount to 'thin capitalisation'[110]) the Netherlands offers many advantages, whilst companies might choose Luxemburg, Ireland or Cyprus for channelling insurance or pension premiums due to favourable domestic laws in those countries. Conduit countries and traditional offshore centres therefore complement each other. Combined, they permit firms to move profits and payments from foreign subsidiaries to a foreign parent company or branch office through the Netherlands to low-tax jurisdictions.

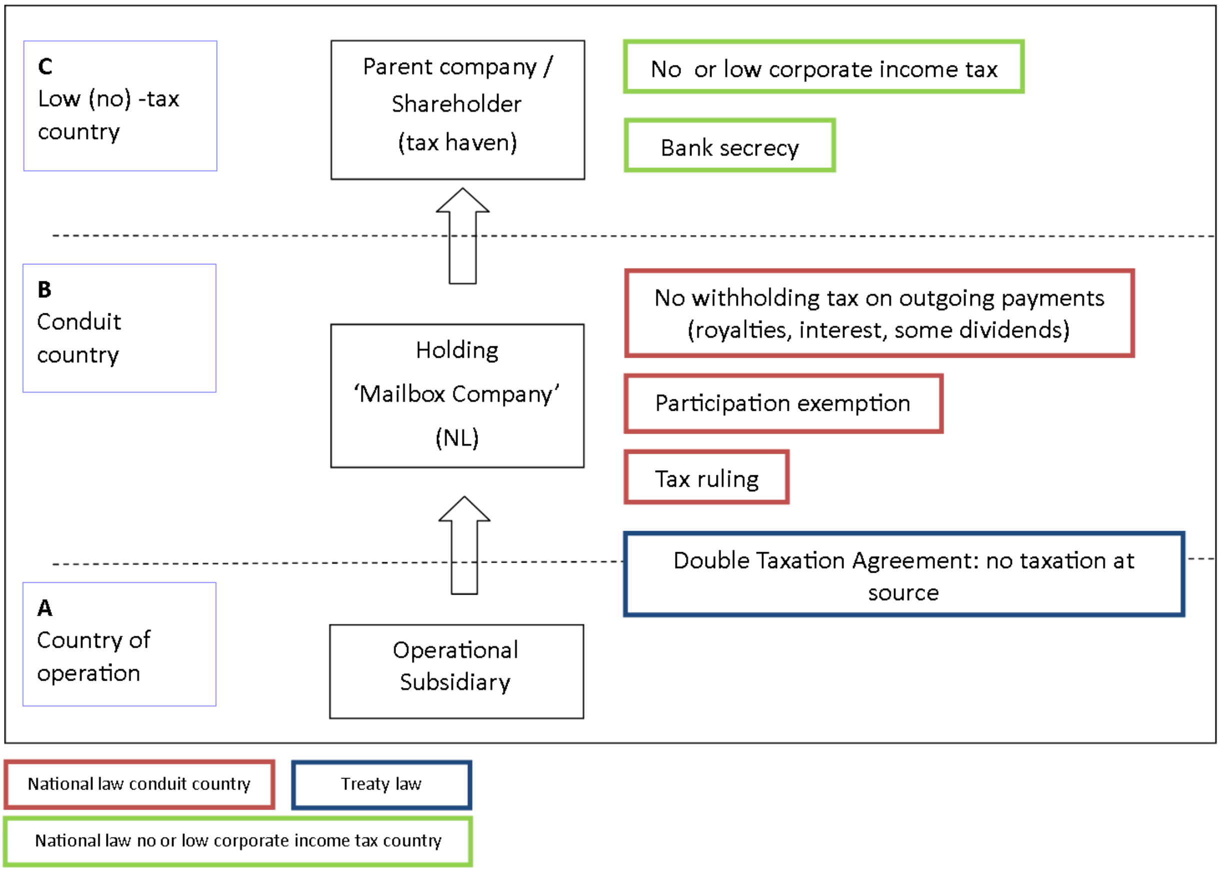
[106] Weyzig (2012)
[107] OECD "Harmful Tax Competition: An Emerging Global Issue'. This and other reports are published on the OECD's website: http://www.oecd.org/ctp/harmfultaxpractices/
[108] The Code of Conduct group identified a series of harmful measures of Members States in its 1999 report, published at http://ec.europa.eu/taxation_customs/resources/documents/primarolo_en.pdf. The EU's work on harmful tax practices is outlined in more detailed here: http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/
[109] For a historical overview of how tax havens and harmful tax regimes developed see N. Shaxson, 'Treasure Islands: Tax Havens and the Men who Stole the World (London, 2011).
[110] See footnote 100.

The Dutch conduit therefore works by

1. facilitating capital inflow through the large network of tax treaties (from A to B in the graph below),
2. reducing tax rates on capital in the Netherlands (B in the graph below) and
3. facilitating capital outflow without or low taxation on that capital (B and C below).

The type of holding structure outlined below is described as a tax avoidance vehicle in more detail in the recent OECD report on Base Erosion & Profit Shifting (BEPS).[111] The report explains principles of international taxation and the opportunities the current system holds for profit shifting by companies. It also exemplifies these with corporate structures used for BEPS. Company structures used for intra-group financing, which typically involves a Dutch holding structure, are also included in the report.

Graph 2: Simplified example of a holding structure



5.3.1. Facilitating inflow

Dutch double taxation treaties facilitate capital inflow by allowing for payments on interest, royalties and dividends to be moved from a subsidiary in one country (A) to a parent company in another country (C) through a holding domicile led in the Netherlands (B). The negative impact on source countries consists of reducing withholding tax rates on these types of passive income, thereby reducing revenue in treaty partner countries.

5.3.2. Reducing tax rates in the Netherlands

Once the payment has arrived in the Netherlands, there are various methods to reduce effective tax rates on that income. Some common methods are:

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[111] OECD, 'Addressing Base Erosion & Profit Shifting', 2013, http://www.oecd.org/tax/beps.htm.

a) applying for an advanced tax ruling (ATR) or pricing agreement (APA) on the costs (typical for financial holdings),[112]
b) using the participation exemption,[113]
c) reducing the effective tax rate in the Netherlands by using a third low-tax country (e.g. a branch in Switzerland, Luxemburg or Netherlands Antilles) and apply an advanced ruling to allocate the majority of profit to that branch. The overall effective tax rate is reduced because of lower rates in these countries.[114] A research report by the Swiss NGO Berne Declaration has recently shown the route to be used by most Swiss commodity trading companies, such as Trafigura.[115]

5.3.3. Facilitating outflow

In principle, protection under a DTA is not needed for the outflow from the Dutch intermediate company as the Netherlands does not levy withholding taxes (WHT) on interest and royalties, and important tax exemptions apply to most dividends. Next to treaty WHT rates, under the Dutch participation exemption, the dividend and capital gains income received by the holding company from subsidiaries is exempt from corporate income tax in the Netherlands (under certain conditions). Furthermore, capital outflow to tax havens is facilitated by the fact that the Netherlands also allows for certain payments to tax havens to be tax-deductible in the Netherlands, reducing the Dutch tax base.

5.3.4. IMF analysis of the Mongolian DTA

To illustrate how specific bilateral treaties are problematic from a revenue raising and developing country perspective, it is useful to look more closely at a recent IMF analysis of the Mongolian DTA network. This treaty analysis[116], including the Dutch-Mongolian DTA, highlighted a number of concrete provisions in DTAs that are detrimental to developing countries for a number of reasons. A zero WHT rate on dividend payments in the Dutch-Mongolian DTA, for instance is used for profit-shifting by international extractive companies, the IMF finds. The Dutch State Secretary of Finance argued in his response to parliamentary questions[117] that the zero WHT on dividends was the main problem with the treaty, which the Dutch government was also willing to renegotiate. The IMF analysis of the Dutch treaty, however, highlights numerous problem areas:

- The Dutch DTA lays down a maximum of 5% WHT on technical service fees, which is low considering they are used for profit shifting by MNCs. The IMF therefore advises 20%.
- The zero WHT rate on bank loans is viewed as problematic by the IMF: *"Interest payments on bank (or third party) loans should not be exempt. The capacity of the Mongolian tax administration to identify back-to-back loans and guarantee situations is currently low."*

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[112] The Netherlands has a practice of advance tax ruling that provides companies with clarity on the way in which specific corporate structures and transactions will be taxed in the future (e.g. agreement with the authorities about tax deductible items, such as interest payments or loans). This allows firms to devise complex price transfer transactions and corporate structures in a risk free environment. The advance tax ruling system in effect aids firms to plan their corporate structure and transactions in order to minimise taxation.

[113] Under certain conditions, the dividend and capital gains income received by the holding company from subsidiaries is exempt from corporate income tax in the Netherlands. The regulation has been effective since 1893.

[114] If a subsidiary of a Dutch parent is located in a foreign country, the Netherlands has taxing rights and could theoretically tax 100% of the capital flow from the Dutch holding/parent to the foreign branch office. Dutch law, however, allows for advance tax agreements on splitting profits between subsidiaries (to facilitate the capital flowing out). A popular way of reducing the effective tax rate at the intermediary level in the Netherlands is by use of a Swiss branch.

[115] Erklärung von Bern (2011)

[116] 'Mongolia: Technical Assistance Report - Safeguarding Domestic Revenue – A Mongolian DTA Model', November 2012, IMF Country Report No. 12/306, http://www.imf.org/external/pubs/ft/scr/2012/cr12306.pdf.

[117] Ministry of Finance, 'Opzegging belastingverdrag door Mongolië', 20.3.2013, IFZ/2013/136, http://www.rijksoverheid.nl/bestanden/documenten-en-publicaties/kamerstukken/2013/03/20/brief-over-opzegging-belastingverdrag-mongolie/brief-over-opzegging-belastingverdrag-mongolie.pdf

- Then there is the definition of royalties: the Dutch DTA excludes many payments from the definition of royalties. However, because DTAs limit source state taxing rights to business income of a permanent establishment (PE), defining payments as “business profits” rather than royalties is often not advantageous for source states. The definition of a PE is therefore central to a DTA: whilst it gives the source state the right to tax the active income of a subsidiary of a foreign-owned business, conversely, a weak definition can lead to a big loss in tax revenue for source states.[118] (see also Annex 1). With regard to the Dutch-Mongolian DTA, the IMF observes: *“The withholding tax cannot be levied if the definition of “royalty” does not cover the use or right to use industrial, commercial, or scientific equipment (i.e. lease payments). [In the Dutch DTA] also payments for the use, or right to use films or tapes for radio or television broadcasting are considered business profits. In such situations the tax can only be levied if the non-resident maintains a permanent establishment in Mongolia, which will usually not be the case.”* The report does not explain why non-residents in Mongolia usually do not maintain a PE; this might be related to the non-applicability of the PE definition to extractive industry operations.
- Another substantive provision which until recent domestic law changes was used for profit shifting out of Mongolia is capital gains from sales of licences: Under the Dutch treaty, Mongolia cannot tax indirect transfers of mining licenses, whilst domestic law does not allow the direct sale of licences: *“Mongolia is only able to safeguard its taxing rights on an indirect sale of exploration and mining licenses in a limited number of DTAs. An indirect sale through the sale of shares in the company owning such licenses is the only method available to investors to transfer the ownership, as the mining law does not allow a direct sale of such licenses. […] If DTAs do not include a special rule for the indirect sale of immovable property through a sale of shares, Mongolia will not be able to execute its domestic taxing right.”* Mongolia is currently changing its Mining Law to introduce taxation on indirect transfers of licenses, which required a renegotiation of the Dutch treaty.
- Finally, the Dutch DTA has no anti-abuse provision. An anti-abuse clause is central to avoiding profit-shifting because it restricts wide use of the treaty by MNCs or individuals who the treaty benefits are not intended for. As this chapter and chapter 4.6 show, the definitions of resident or beneficial owner are not sufficient enough to stop treaty abuse from taking place.

5.4. Impact assessment: tax revenue losses incurred by Dutch DTAs

The Netherlands is widely used for treaty shopping by foreign corporations by setting up (financial) holding companies (Special Financial Institutions, SFIs) in the Netherlands. This report shows that lower withholding tax rates in treaties lead to a direct and unnecessary revenue loss for treaty partners. SOMO has calculated a part of this loss on the basis of FDI stock data provided by the Dutch Central Statistics Bureau (CBS), the International Monetary Fund (IMF) and the OECD. The Dutch Central Bank separates investment attributable to these SFIs, also making it possible to calculate lost tax revenue income attributable to SFIs and therefore treaty shopping. The findings are presented here, followed by some company case studies. The methodology used to calculate these losses, including assumptions applied and data used, is explained in more detail in Annex 2, using the example of Argentina. The Annex provides a table with step-by-step calculations for each treaty partner. Revenue losses calculated relate to the year 2011 only.

Given the focus on developing countries, only low-income, lower-middle and upper-middle income treaty partners were included in the calculations.[119] This type of impact assessment is, however, also

[118] For a detailed description of Articles 5 and 7 OECD Convention, see Uckmar (2006:166-168). As outlined in Annex 1, tax treaties lay down the method of attributing profits to the PE as transfer pricing.
[119] Economies are divided according to 2010 GNI per capita, calculated using the World Bank Atlas method. The groups are:

interesting for high-income countries, because the Netherlands is a known conduit country for tax evasion used by businesses located in OECD countries (the United States, for instance).

It should be pointed out that these calculations are partial and conservative: neither transfer mispricing nor profit shifting using a reduced royalties or capital gains WHT rate in Dutch treaties are included here. The calculations also do not take into account double-conduit constructions, whereby, for instance, Ireland and Luxemburg are used as additional conduits on the same investment between the Netherlands and source countries. Finally, the lost revenues are of course only attributable to the Dutch treaty network; lost revenues from other treaties are not included. The results presented here are thus partial and conservative; lost tax revenue as a result of the Dutch treaty network and other forms of tax avoidance can be expected to be much higher.

Rather than representing absolute figures, the findings therefore give an indication of the scale of the problem per treaty partner country and provide arguments for the renegotiation or even cancellation of some of these treaties. Of course, a more comprehensive analysis of bilateral treaties and their effect would be needed to make sound policy decisions on tax treaties.

5.4.1. Findings

A review of existing domestic vs. treaty tax rates shows that a number of DTAs have the same or higher treaty rates when compared to domestic WHT rates on outgoing dividends and interest. These countries are: India, Morocco, Nigeria, Russian Federation, South Africa and Turkey. When treaty rates are equal to domestic rates, they do not lose out on lower rates, but they also cannot increase their domestic WHT rates on passive income above the maximum treaty rate for residents defined as such for the purpose of the DTA. Croatia, for instance, will not benefit from its increased domestic WHT rate on dividends from 0% to 12% as of March 2012 with regard to investments routed through the Netherlands, because the Dutch treaty rate is 0%. The same applies to Zambia, whose Ministry of Finance has just decided that dividends should be taxed by 20%. The Dutch and other DTAs stipulate taxation at only 5%. Savior Mwambwa from the Centre for Trade Policy and Development (CTPD) concludes: “The double tax agreements undermine our own finance policies”.[120]

All remaining treaties foresee a reduction in WHT on dividends and interest. Unfortunately, no data were available for Ethiopia or Mongolia.[121] These would have been interesting country studies, given that Mongolia has recently cancelled its treaty with the Netherlands because of the related revenue losses the country incurs, and Ethiopia has recently concluded a treaty with the Netherlands which has unfavourable treaty terms from a revenue perspective and lacks anti-abuse provisions.[122] This is in direct contradiction to the Dutch government’s announcement to follow UN Model treaty terms in negotiations with developing countries and its presentation of DTAs as a development promotion instrument.

The lost revenue from lower WHT rates in countries where FDI data was available was calculated from dividend and interest income reported in the Netherlands from Dutch FDI stock abroad. From that income, pre-tax income levels were calculated, so that the difference between treaty and non-treaty tax income could be identified. Finally, a difference in FDI stock reporting by the IMF and the OECD was used to attribute FDI stock and income to mailbox companies. The OECD, based on DNB data,

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low income, $1,005 or less; lower middle income, $1,006 - $3,975; upper middle income, $3,976 - $12,275; and high income, $12,276 or more. (http://data.worldbank.org/about/country-classifications).

[120] Cited in Swedwatch (2013)

[121] The IMF database on outward direct investment positions specifies that data for these two countries are confidential.

[122] See analysis of the treaty by Tax Justice Netherlands, ‘Belastingverdrag Nederland-Ethiopië. Analyse door Tax Justice Nederland’, January 2013, http://nl.tackletaxhavens.com/wp-content/uploads/2013/01/Belastingverdrag-NL-ETH-Analyse-TJNL.pdf

specifies how much of the reported FDI stock is attributable to SFIs, whilst IMF data does not. This allows for the attribution of the FDI stock and resulting income to the Dutch SFI sector. This differentiation provides insight into the scale of FDI diversion, or rather, the scale of investments made through Dutch (financial) holding companies, which are known to be used for treaty shopping and tax avoidance purposes. Annex 2 provides a more detailed explanation and underlying assumptions of these calculations.

→ Country rankings

The ranking of lost dividend and interest WHT of the following low, lower-middle and high-middle income countries in *absolute* terms is shown in table 1 below. The calculations produced the following results:

- Top of the list is Venezuela, with an annual loss of almost 195 m euro on lower treaty rates for interest and dividend payments, followed by Brazil with 142.7 m euro and Kazakhstan (133.4 m euro).
- The middle range, with a loss ranging from roughly 30 to 70 m euro in 2011 is comprised of Mexico, Indonesia, Argentina, Ukraine and the Philippines.
- Serbia, Malaysia, Egypt and Croatia lose between 16 and 8 m euro every year on lower WHT treaty rates on interest and dividends. As said above, the figures for Croatia will be higher as of March 2012, when an increased domestic WHT rate on dividends from 0% to 12% came into force. The Dutch treaty rate is 0%.
- Between 1 and 3 mi euro are lost by Thailand, Pakistan, Ghana and Belarus.
- Zambia, Moldova, Bangladesh, Bosnia and Herzegovina, Macedonia, Sri Lanka, Zimbabwe, Georgia, Jordan, and Armenia all lose out below one million euro every year, again, only calculating interest and dividends, and not royalties or capital gains.

This ranking is based on lost taxes in absolute terms. When comparing the lost taxes to the treaty partners' Gross Domestic Product (GDP) of the year in question (2011), a different picture emerges.

Table 1: Country ranking comparing lost WHT on interest and dividends to GDP

Treaty partners (x) Low-income *** Lower-middle income ** Upper-middle income	GDP (million EUR)	Tax lost (million EUR)	% to GDP
Ethiopia**	21.742	**no data**	
Mongolia	6.297	**no data**	
Kenya	24.167	**NA (yet)**	
Kazakhstan	135.170	**133**	0,10%
Venezuela	227.487	**195**	0,09%
Serbia	32.935	**16**	0,05%
Ukraine	118.778	**38**	0,03%
Croatia	44.920	**8**	0,02%
Philippines**	161.565	**29**	0,02%
Argentina	320.616	**55**	0,02%
Moldova**	5.032	**1**	0,01%
Indonesia**	608.703	**56**	0,01%
Mexico	829.023	**71**	0,01%
Brazil	1.780.217	**143**	0,01%
Egypt**	164.987	**10**	0,01%
Ghana**	28.177	**2**	0,01%
Malaysia	206.969	**10**	0,005%
Zambia**	13.805	**1**	0,004%
Macedonia, FYR	7.504	**0**	0,003%
Belarus	39.629	**1**	0,003%
Bosnia and Herzegovina	13.002	**0**	0,002%
Zimbabwe***	6.941	**0**	0,001%
Thailand	248.469	**3**	0,001%
Pakistan**	151.103	**2**	0,001%
Georgia**	10.327	**0,09**	0,001%
Sri Lanka**	42.533	**0,18**	0,0004%
Bangladesh***	80.419	**0,34**	0,0004%
Armenia**	7.366	**0,01**	0,0001%
Jordan	20.730	**0,02**	0,0001%

Again, it should be reiterated that these calculations are partial and conservative: neither transfer mispricing nor profit shifting using a reduced royalties or capital gains WHT rate are included here. The ranking might therefore differ considerably when looking at other forms of tax avoidance. At the same time, the percentage of lost revenue compared to GDP will, of course, be much higher if all tax avoidance would be included.

As Table1 above shows, Kazakhstan appears to lose out the most in dividend and interest WHT losses as a result of Dutch treaties. That is not surprising, given the country is heavily dependent on the mineral and natural resource sector, companies of which are known the use the Netherlands as a base for holding companies. Venezuela, which loses out most on WHT on dividends and interest as a result of Dutch treaties, also appears high in the ranking when comparing these losses to the country's GDP.

Venezuela is closely followed by Serbia, Ukraine and Croatia. When comparing the absolute tax losses to the GDP of treaty partner countries, Eastern European countries therefore appear much higher in the ranking. Weyzig[123] has found that next to Kazakhstan, Indonesia also suffers revenue losses:

"Focussing on developing countries, securities data indicate that firms from Indonesia and Kazakhstan had issued by far the largest volume of debt securities via the Netherlands. In 2010, Dutch SPEs passed on €0.6 billion of interest payments from Indonesian firms to holders of debt securities. Due to the tax treaty between Indonesia and the Netherlands, most of these interest flows are free of withholding tax, whereas a rate of 10% to 20% applies to interest paid directly from Indonesia to external creditors in almost all other countries. For Kazakhstan, the Dutch treaty does not specify a lower rate than other tax treaties. Interest payments from developing countries passed on within the group are smaller than interest passed on to external creditors. Thus, the main rate effect of interest channelled through Dutch SPEs concerns a substantial reduction of Indonesian withholding tax revenues."

→ A bad deal for Eastern Europe and Central Asia

The disadvantageous treaty terms of Eastern European and Central Asian, typically former Soviet bloc and former Yugoslav countries are worth mentioning because they are rarely highlighted in the literature on DTAs or media reports on tax avoidance company case studies. Only Serbia, Croatia, Belarus and Bosnia and Herzegovina are mentioned in the calculations of lost WHT revenues here, because many Eastern European countries with which the Netherlands has a tax treaty have joined the EU. This resulted in the maximum WHT rates in Dutch treaties having been superseded by EU Directives abolishing WHT rates on payments within the European Union. The treaty terms for these countries are based on the old Soviet and Yugoslav treaties, which laid down zero or very low WHT rates for passive income. After 1989, not all of these treaties were renegotiated and new countries continued their tax treaty with the Netherlands on old treaty terms.[124]

A review of all Dutch DTAs with Eastern European and Central Asian countries with regard to their following the UN or OECD model and a comparison with domestic WHT rates shows that most treaties were detrimental from a revenue perspective also before EU accession. WHT rates largely ranged from 0% to 5% on all passive income. The following countries have not (yet) joined the EU or are not part of the accession process and continue to experience revenue losses as a result of their Dutch tax treaties: Mongolia (until 2014 when the treaty is no longer in force), Kazakhstan, Ukraine, Serbia, Croatia, Belarus, Moldova, Bosnia and Herzegovina, Macedonia, Georgia and Armenia.

→ Percentage SFIs in total FDI stock – Netherlands: gateway to the world

An analysis of the proportion of Dutch FDI that can be ascribed to mailbox companies shows that on average 85% of so-called Special Financial Institutions, which are typically holding companies, are responsible for Dutch FDI abroad. This is an extremely large portion of investment. In some countries almost 100% of Dutch investment originates from mailbox companies (Ghana and Croatia: 99%, Egypt: 98%, Venezuela and Ukraine: 96%, Brazil: 91%). These high percentages indicate that MNCs

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[123] Weyzig (2013)

[124] The status of negotiations and treaty termans with these countries is detailed in the Dutch government decision 'Verdragsrelaties met voormalige Sovjet- en Joegoslavische republieken', 30.9.2009, http://www.rijksoverheid.nl/documenten-en-publicaties/besluiten/2009/11/18/verdragsrelaties-met-voormalige-sovjet-en-joegoslavische-republieken.html

route their investments in these countries through the Netherlands, enjoying treaty benefits in the process. As mentioned elsewhere in this report, it is possible that treaty partners attempt to attract investments by signing DTAs with conduit countries in the knowledge that investors will engage in treaty shopping. The Indian Supreme court viewed treaty shopping as a ‘necessary evil’ when it ruled in favour of the tax payer in a treaty shopping case involving Mauritius (see chapter 4.6). However, “from a developing country perspective, negative rate effects of conduit structures are usually unintended”.[125] This is confirmed by published case studies and reactions by revenue authorities to individual cases of tax avoidance (see the SABMiller in the next chapter). That treaty shopping is largely viewed as undesirable by treaty partners is also shown by the fact that Argentina is currently reviewing all its treaties for revenue impacts and has cancelled those connected with treaty shopping, and that Mongolia has cancelled its treaty with, amongst others, the Netherlands.

[125] Weyzig (2013).

Table 2: Annual loss in withholding taxes on interest and dividends for Dutch treaty partners (2011) in million EUR

	Interest			Dividends					
Treaty partners Low-income * Lower-middle income** Upper-middle income**	**Treaty rates**	**Domestic rates**	**Lost WHT**	**Treaty rates**	**Domestic rates**	**Lost WHT**	**Total lost WHT**	**Share of SFIs in FDI stock [3]**	**Lost tax attributable to SFIs**
Ethiopia**	5%	10%	-	5%	10%	-	**no data[1][2]**		**-**
Mongolia	10%	20%		0%	20%		**no data[2]**		**-**
Venezuela	5%	34%	67,16	0%	34%	127,48	**194,64**	96%	**187,06**
Brazil	15%	25%	142,72	15%	0%	-	**142,72**	91%	**129,45**
Kazakhstan	10%	20%	38,98	5%	20%	94,40	**133,37**		**-**
Mexico	15%	40%	101,86	5%	0%	-31,07	**70,80**	74%	**52,65**
Indonesia**	10%	20%	20,53	10%	20%	34,99	**55,52**	91%	**50,28**
Argentina	12%	35%	19,42	10%	35%	35,17	**54,59**	80%	**43,42**
Ukraine	10%	15%	9,00	5%	15%	29,05	**38,04**	96%	**36,57**
Philippines**	15%	20%	3,88	10%	30%	24,98	**28,86**	86%	**24,89**
Serbia	0%	20%	6,66	5%	20%	8,97	**15,63**		**-**
Malaysia	10%	15%	10,12	0%	0%	0,00	**10,12**	89%	**8,98**
Egypt**	12%	20%	9,66	0%	0%	0,00	**9,66**	98%	**9,45**
Croatia	0%	15%	8,14	0%	0%	0,00	**8,14**	99%	**8,03**
Thailand	10%	15%	2,68	25%	10%	-	**2,68**	66%	**1,76**
Kenya	15%	15%	0,00	15%	15%	0,00	**NA[1]**		**-**
Pakistan**	20%	30%	1,60	10%	10%	0,00	**1,60**		**-**
Ghana***	8%	8%	0,00	5%	8%	1,51	**1,51**	99%	**1,49**
Belarus	5%	10%	0,31	5%	12%	0,75	**1,06**		**-**
Zambia**	10%	15%	0,14	5%	15%	0,44	**0,58**		**-**
Moldova**	5%	10%	0,12	5%	15%	0,41	**0,53**		**-**
Bangladesh***	10%	10%	0,00	10%	20%	0,34	**0,34**		**-**
Bosnia and Herzegovina	0%	10%	0,27	5%	5%	0,00	**0,27**		**-**
Macedonia	0%	10%	0,09	0%	10%	0,16	**0,26**		**-**
Sri Lanka**	10%	15%	0,18	10%	10%	0,00	**0,18**		**-**
Zimbabwe***	10%	15%	0,04	10%	15%	0,06	**0,10**		**-**
Georgia**	0%	5%	0,09	5%	5%	0,00	**0,09**		**-**
Jordan	5%	7%	0,02	5%	0%	-	**0,02**		**-**
Armenia**	5%	10%	0,00	5%	10%	0,00	**0,01**		**-**
Total lost tax							771,32		554,03

Sources: CBS, IMF, OECD (data on 2011)

(1) Included in the list are Kenya (currently in negotiation) and Ethiopia (signed in 2012). No lost tax is attributed to these two countries yet.

(2) no data: IMF data on investment positions are confidential for these countries

(3) If no percentage is given, OECD data on SFI investment positions is unavailable for these countries

5.5. Case studies

This section reviews a number of case studies and own findings on companies that use the Netherlands for tax avoidance purposes. No in-depth financial analysis was conducted but rather existing case studies are used here as examples to illustrate the above findings.

5.5.1. SAB Miller and the Dutch-Ghanaian DTA

Action Aid published a report in 2011 that scrutinised the role of the Netherlands in tax avoidance in Ghana by SABMiller,[126] a brewing and bottling company headquartered in the United Kingdom. The trademark for many of its African beers is registered in the Netherlands, under the name of SABMiller International B.V., which receives royalty income from African subsidiaries at a reduced WHT rate.

In Ghana, if no treaty exists, dividend and interest payments to residents of other countries are taxed at 8% and royalties at 10%; management and technical service fees are taxed at 15%[127]. Under the double taxation treaty with the Netherlands, signed in 2008, the WHT on royalties and technical service fees are reduced to 8 per cent. According to Action Aid, a senior official in Ghana's Ministry of Finance acknowledged that tax treaty negotiations had not fully taken into account that tax treaties could allow certain jurisdictions to act as conduits for tax avoidance. He was referring to Switzerland and the Netherlands. The tax losses incurred from a lower WHT rate are outlined below.

→ Estimated revenue loss resulting from the Dutch-Ghanaian DTA

From 2007 to 2010, Accra Breweries (SABMiller's Ghanaian brewery) paid royalties of GBP 1.33 million, amounting to 2.1% of turnover to SABMiller International B.V..[128] Action Aid has examined the four financial years and concludes that the arrangement appears to have saved Accra Brewery GBP 210.000 in corporate income tax, which in Ghana is charged at 25%[129]. From 1 January 2009, the Ghanaian WHT on royalty payments was reduced from 10% to 8% under the new Dutch DTA. Applying the new WHT rate to 2010 royalty payments, the annual cost to the Ghanaian government can be expected to be GBP 52.000.

Action Aid clarifies that the Dutch royalty route can be observed in the accounts of SABMiller's subsidiaries right across Africa. South African Breweries Ltd., for instance, one of SABMiller' largest operating companies, pays GBP 18 million each year in royalties to SABMiller International B.V. registered in the Netherlands. Whereas the South African Breweries Ltd. pays an average of GBP 110 million a year in corporation tax, it saves an estimated GBP 5.1 million through royalty payments which flow through the Netherlands.

What appears a small amount with view to SABMiller's turnover or the Netherlands' annual GDP, is a serious tax loss to a developing country, especially when considering that this is only a single case through one conduit country. For SABMiller, this type of tax planning could be observed in the accounts of SABMiller's subsidiaries right across Africa. When extrapolating these tax losses to other industries and MNCs, the losses are enormous.

5.5.2. Extractives companies using reduced WHT

In 2011, the NGO *Publish What You Pay Norway* reported that more than a third of the subsidiaries owned by major energy and mining companies are based in "secrecy jurisdictions" where company

[126] Action Aid (2011)
[127] On a gross base.
[128] Ibid.
[129] On a net base.

accounts are not publicly available.[130] The report singled out the Netherlands as the second favourite home for extractive industry companies, which the authors explain by the existence of fiscal benefits through intra-group financing arrangements ('debt shifting') in the Netherlands, but also by the lack of transparency regulation. The reports states that "[a]mong the 358 Netherlands subsidiaries belonging to the world's most powerful extractive industry companies are subsidiaries whose names suggest their physical assets are held in a country which is not the Netherlands".[131]

Recent investigations by SOMO on extractives companies located in the Netherlands indicate that these companies enjoy tax benefits by basing their holding companies in the Netherlands, and that they use reduced WHT rates in their tax avoidance schemes.

→ Example: reducing source tax in Africa

A European energy giant researched by SOMO[132] has a Dutch holding company which owns 59 exploration and production companies, 27 oil refineries and marketing companies, 6 international transport companies and 2 financing companies. Most of the profit paid out from these subsidiaries originates from Africa (USD 2,6 billion in 2011). Dutch tax treaties with Africa countries ensure that these profits are subject to little income tax. The company invests via the Netherlands in Uganda and Tunisia. Since 2006, the Dutch-Uganda DTA is in force which reduces the WHT rate on dividends from 15% to 0%. The same reduction applies in the Dutch-Tunisia treaty, which has a rate of 20% without a treaty. Because of the above-mentioned participation exemption and lack of WHT on dividends in the Netherlands, the tax base remaining in the Netherlands is small, so that the company pays little tax in the Netherlands as well.

→ Example: reducing source tax in Latin America (Argentina)

The significance of the Dutch-Argentinean DTA is illustrated by the fact that the Netherlands holds almost 9% of Argentina's total FDI stock, following Spain (28%) and the United States (17%). It is thereby the 3rd biggest foreign investor with an FDI stock of 6.652 m USD in in 2009. Oil, mining and quarrying are, amongst others, the main sectors of Dutch investments in Argentina.[133] Given these industries are known to use Dutch holdings companies for tax avoidance purposes, and with view to the large levels of Dutch investment, it can be assumed that most of the investments are routed through the Netherlands for tax purposes. Indeed, the calculations presented above show that 80% of Dutch FDI in Argentina is attributable to mailbox companies, indicating the Netherlands is a conduit country for tax avoidance by global business investing in Argentina.

A Canadian company researched by SOMO[134] has at least two subsidiaries incorporated in the Netherlands that together own around USD 315 m in assets. One of these financial holding companies channels loans worth USD 175.4 m from a subsidiary in Barbados (Barbados Corp.) to its Argentinean subsidiary (Argentina S.A.). It is likely that the company uses the Netherlands to avoid WHT on interest. According to publicly available information, if the Barbados entity were to lend money directly to its Argentinean subsidiary, a 35% WHT on interest payments would apply on all outgoing payments in Argentina[135] (no taxation treaty exists with Barbados[136]). Under the Dutch-Argentinean DTT, this tax

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130 PWYP Norway (2011) *Piping Profits. Mapping the 6,038 subsidiaries owned by ten of the world's most powerful Extractive Industry giants and the quest by Latin American journalists to find out more*, p. 8, available at http://www.publishwhatyoupay.org/sites/publishwhatyoupay.org/files/FINAL%20pp%20norway.pdf

131 Ibid.

132 Report forthcoming.

133 'Argentina: A Strategic Investment Destination to Meet the Demand of Global Markets', presentation by Cecilia Nahón, Argentinean Undersecretary of Investment Development, Ministry of Foreign Affairs, June 2011, http://www.agentschapnl.nl/sites/default/files/bijlagen/Presentatie%20Holanda%20C%20Nahon.pdf.

134 Report forthcoming.

135 There are certain exceptions, not applicable in this case. See Deloitte tax guide 2012.

is reduced to 12%. Although the Argentina-Canada DTT also stipulates a lower WHT rate on interest (12.5%), payment directly to Canada would result in income tax paid by the Canadian parent.

This interest income is taxed very little in the Netherlands: although interest income from Argentina is subject to tax, the interest payments to Barbados are tax deductible. The company therefore pays a relatively small amount of corporate income tax in the Netherlands ($ 14.278) after the payments to Barbados have been deducted. As a tax haven, Barbados also does not levy tax on interest between foreign corporations,[137] so that the interest income probably remains largely untaxed.

Assuming an interest rate of 5%, simple extrapolation shows that Argentina probably suffers an annual revenue loss of at least $ 2 million:

Table 3: Tax losses incurred as a result of Dutch-Argentinean DTA

USD	Type
175,400,000	Loan
8,770,000	Interest (5%)
3,069,500	WHT on interest (35%)
1,052,400	DTT WHT rate (12%)
2,017,100-	Difference (revenue loss)

Further research is needed to confirm these preliminary findings. Taxation of natural resources and therefore extractive industry is complex and linked with favourable income tax treatments and special contracts.[138] Also, not just the rate of taxation but the structure of how taxes are calculated (e.g. whether via royalties or income taxes) are relevant. However, the overall picture – namely that a Barbados entity lends to an Argentinean subsidiary through a Dutch subsidiary – indicates the company enjoys a reduced interest rate under a Dutch treaty and does not pay tax on outgoing interest to Barbados due to the lack of WHT rates in the Netherlands. Furthermore, the fact that the holdings do not employ staff and have no material activities in the countries beggars the questions whether Argentina intended companies residing outside of the Netherlands to route their investments via the Netherlands and enjoy treaty benefits.

Considering that all major extractives companies use the Netherlands for similar holding activities and that many other avoidance mechanisms are being used by MNCs, the annual loss calculated for this example would probably indicate a loss to Argentina amounting to millions of USD at an annual level. Indeed, it is estimated that in 2011 alone, unintended use of Argentina's DTA with Chile led to a revenue loss of USD 75 m and the DTA with Spain was estimated to cost the country over USD 60 m (see box below).

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[136] Ernst & Young (2013) 'Argentina terminates three tax treaties', http://tmagazine.ey.com/insights/argentina-terminates-three-tax-treaties/

[137] Tax exemption is available for foreign corporations paying dividends and interest to other foreign subsidiaries or residents outside Barbados, see http://www.taxrates.cc/html/barbados-tax-rates.html

[138] Boadway and Flatters (1993) explain that *"[n]atural resources are typically subject both to taxation under the income tax system and to special resource taxes. Properly designed income taxes attempt to include capital income on a uniform basis. But in most countries the income tax treats resource industries more favorably than most other industries - through favorable treatment of such capital expenses as depletion, exploration and development, and the cost of acquiring resource properties.".*

DTA impact assessment for Argentina

The Argentinean government instituted a “Double Taxation Evaluation and Review Commission” which assessed the country’s DTA network from a revenue perspective, which has led to the termination of DTAs with Austria, Chile, Spain and Switzerland. The Latin American civil society network Latindadd has recently published a DTA impact assessment on Argentina, Colombia, Ecuador, Nicaragua, Uruguay and Venezuela. The research analyses the impact of DTAs on the governments’ financing systems and the tax structures in Latin America.[139]

Regarding Argentina, the Latindadd research found no systematic public and/or academic studies on the effects of DTAs on tax revenues. A partial analysis based on public information, however, revealed that tax avoidance via Chile represented a **USD 75 m loss for Argentina in 2011**. Furthermore, total tax loss through avoidance through the unintended use of the **DTA with Spain was estimated at over USD 60 m only in 2011**, which accounts for more than 8% of the annual revenue in that period from taxes on personal assets.

Among the companies that used the formula to avoid paying taxes, the “Commission” report mentioned firms such as the French company Danone, the US supermarket Wal-Mart, the Chilean supermarket chain Cencosud, the Brazilian oil company Petrobras, the car manufacturer General Motors, the Swiss cement company Holcim, the US chemical company Monsanto and large Argentine groups like the steel company Techint and the food company Aceitera General Deheza.

5.5.3. If the Netherlands signs a treaty with Peru or Kenya

The above examples show that extractive industry MNCs use Dutch holding companies, leading to a reduction of source taxation. A Dutch treaty with Peru (approached for negotiations) and Kenya (still in negotiation) is therefore likely to lead to a direct reduction in tax revenue in those countries.

One example is Pluspetrol S.A., a private Argentinean extractive company set up in 1976 and by now one of the largest oil companies in South America. Once a treaty with Peru is in force, any possible lower withholding tax rates will be apply to Pluspetrol Resources Corporation N.V., which owns 55% of its Peruvian subsidiary Pluspetrol Norte S.A.. The company mainly operates in Latin America (Bolivia, Chile, Columbia, Peru, and Venezuela) but also in Africa. In December 2000, the company shifted its registered head office from Argentina to the Netherlands. Given the lack of substance of the Dutch office, the motivation for this shift is most likely the beneficial Dutch fiscal climate and investment protection.[140] The example of Pluspetrol raises serious questions with regard to the recent claim by the Finance State Secretary Weekers that Dutch substance rules are sufficient to fight treaty abuse: In 2010, Pluspetrol had three Dutch legal entities, but no material substance in the country. None of the Dutch entities had any employees, nor were any of the directors domiciled in the country (except a Dutch trust office).

Similar case studies are sure to exist for Kenya, and should be analysed for a DTA impact assessment by the Kenyan government and civil society organisations. If Kenya would negotiate a 10% WHT rate on dividends and interest in its treaty with the Netherlands, for instance (compared to its domestic rate on this income of 15%), it would lose almost 1 million euros instantly in lower WHT.

5.6. Conclusion

[139] Double Taxation Agreements in Latin America. Analysis of the links among Taxes, Trade and Responsible Finance’, Executive Summary, Latindadd, April 2013 (publication forthcoming).

[140] Pluspetrol, together with 7 other extractives companies, initiated legal action against the Bolivian government in 2005 after the new Hydrocarbons law was signed in May that year, stating that the new law undermined its investors’ rights outlined in the Dutch-Bolivian Bilateral Investment Treaty. The case, however, never went to court as the companies settled with Bolivia on the nationalisation and increased tax plans.

The calculations using data on Dutch FDI stock abroad, together with the company case studies, show that the Netherlands is structurally used for treaty shopping by large MNCs. Investing through the Netherlands and enjoying reduced WHT rates on passive income results in massive revenue losses for many Dutch tax treaty partners. Indeed, the above calculations are merely partial, and revenue losses from other tax avoidance routes are not included. Where data on investments routed through SFIs existed, the calculation showed that the proportion of investment that could be ascribed to mailbox companies ranged from 66 to 99%, indicating that companies use the Netherlands to route their investments through to enjoy favourable tax conditions.

Latin American countries such as Venezuela and Brazil lose out most in reduced WHT treaty rates on interest in dividends in absolute terms. Kazakhstan also appears high in the ranking of absolute WHT losses. However, the calculations and case studies show that all regions and business sectors are subject to treaty shopping and tax avoidance. Asian countries such as Indonesia, the Philippines and Malaysia are also shown to suffer unnecessary revenue losses. Eastern Europe also has very disadvantageous treaty provisions, leading to high revenue losses, especially when compared to the countries' GDP.

These findings should have consequences in the Netherlands as well as treaty partner states. Despite the claim that the Dutch government aims to supports developing countries' economic independence by helping to attract FDI into these countries by expanding its treaty network, its treaties continue to offer little benefit to capital-importing countries. Existing tax treaties should therefore be reviewed with regard to their negative impact on revenues. Furthermore, to ensure policy coherence for development, treaties currently in negotiation should be subject to a prior comprehensive impact assessment.

6. Conclusions and recommendations

Tax treaties have always played a central part in the international tax system, initially as necessary bilateral agreements not only to avoid international double taxation, but also to enforce tax compliance by states in dealing with internationally operating businesses. Treaties helped signatory states to apply common definitions and concepts, exchange information necessary for tax compliance and provide administrative assistance to each other in tax matters. However, as this report shows, tax treaties have also become core instruments of international tax avoidance, because they provide MNCs with zero or no withholding tax rates on passive income, which is used for profit shifting on a massive scale.

Recent research has shown that there are clear signs that the Netherlands - like other jurisdictions with favourable domestic tax regimes and a large bilateral DTA network - is used for treaty shopping. MNCs set up mailbox companies in resident countries, leading to reductions of tax payments by large multinational corporations in source countries that are unintended by treaty partners. Conduit jurisdictions therefore increase the burden of revenue loss without enlarging the invested stock of capital as they are merely used as a conduit.

This report shows that one of the main arguments in favour of signing DTAs, namely, that there is a positive correlation between tax treaties and FDI, is not confirmed by econometric studies, which provide mixed results and are non-conclusive. Furthermore, the positive impact of increased FDI on government revenues is dependent on a number of factors, in particular the level of capital flight out of developing countries. Given that DTAs facilitate profit shifting from operating subsidiaries in these countries to tax havens, tax treaties cannot be said to stimulate economic development as a whole.

Another common problem of tax treaties signed between developed and developing countries is that they are asymmetric, in that one state is generally the investor state and the other is the receiver of investments. Yet DTAs are only beneficial to both signatory states when there are reciprocal levels of investment. Hereby the reduced taxing rights of source states on passive income resulting from investments from resident states are traded off with the other treaty partner, who also has reduced taxing rights on that income in a ‘zero-sum game’. In addition, the argument that the tax losses incurred by capital-importing state as a result of lower withholding tax rates are offset against increased levels of investment are unconvincing, for reasons outlined above.

In 2012, the negative impact of DTAs on developing countries has resulted in the closer scrutiny of their tax treaty network by some countries. Argentina and Mongolia have cancelled a number of tax treaties, among which the Dutch DTA with Mongolia. The Latin American civil society network Latindadd has conducted an impact assessment of DTAs in 6 countries and found a clear negative impact on government revenues due to treaty shopping and tax avoidance. In the Netherlands, the Dutch treaty network has also been discussed in the context of policy coherence for development, with demands for an impact assessment growing. In 2012, the Ministry of Trade and Development has announced to conduct an impact assessment together with the Dutch Ministry of Finance, reviewing a number of ‘old treaties’ with developing countries.

However, as the analysis and impact assessment of the Dutch treaty network in this report shows, the problem is much broader than a number of least developed countries. More than 66% of the non-EU Dutch network comprises low-income to upper-middle income countries. Of the 36 countries for which Dutch FDI stock data was available, 28 experience revenue losses as a result of lower withholding tax rates in Dutch treaties, amounting to an annual revenue loss of 771 million euro on dividend and interest income alone. The actual figure will be much higher, given that tax avoidance through lower WHT treaty rates on royalties and capital gains, which are not included in the calculations, are a common feature in tax planning techniques. Of course, the total loss of each signature state resulting from its whole treaty network will be even higher. According to Latindadd, Argentina lost USD 60 million as a result of the DTA with Spain alone in 2011. Ecuador lost USD 290 million as a result of its DTA network between 2009 and 2011.

Regarding the Dutch DTA network, from the countries where data was available, Latin American countries such as Venezuela and Brazil are found to lose out most in reduced WHT treaty rates on interest and dividend income in absolute terms. Kazakhstan also appears high in the ranking of absolute WHT losses. However, the calculations and case studies show that all regions and business sectors are subject to treaty shopping and tax avoidance. Asian countries such as Indonesia, the Philippines and Malaysia are also shown to suffer unnecessary revenue losses. Eastern Europe also has very disadvantageous treaty provisions, leading to high revenue losses, especially when compared to the countries' GDP.

In the face of these obvious disadvantages tax treaties have for developing countries, civil society organisations are starting to demand a change in developing and developed countries' tax treaty strategy. Governments in the global North and South should change their treaty system so as to protect revenue bases and policy space. Depending on the national and bilateral level, actions that should be taken might range from not signing treaties with particular countries at all, to renegotiating them, or negotiate alternative agreements to regulate certain elements within treaties - such as information exchange - necessary to enforce tax compliance.

Given the Netherlands is used by a staggering amount of MNCs for treaty shopping, and that this results in unintended revenue losses through reduced WHT rates, developing countries should carefully consider signing treaties with the Netherlands at all. They should be critical of lower withholding tax rates in treaties, consider the issue of policy space when agreeing on maximum rates and demand for effective anti-abuse provisions to be included to fight treaty shopping.

Latindadd's recent impact assessment has led to a detailed set of recommendations for the Latin American region, which is also relevant to other developing countries. Some of these are outlined in the box below.

6.1. Recommendations

The Netherlands in turn should change its current policy approach to include the following:

- **Impact assessment.** Institute a comprehensive impact assessment on the impact of DTAs on developing countries before entering negotiations. The definition of developing country should at least include all low-middle-income countries such as India and Indonesia. Inform developing countries wishing to negotiate tax treaties about the conduit role the Netherlands fulfils in the international investment flows.
- **WHT.** Refrain from negotiating low WHT rates on passive income in tax treaties and generally follow alternatives and source-bias as presented in UN Commentaries to the UN Model Tax Treaty.
- **Explore alternatives to DTAs.** Seek alternatives for state coordination, tax compliance and harmonised definitions through automatic information exchange agreements, for instance.
- **Offer renegotiation of DTAs** for developing countries wishing to do so, applying source-bias principles in negotiations.

Specifically, the Netherlands could curb tax avoidance by MNCs resident in its jurisdiction by implementing the following measures:

- **End harmful tax regime structures**, by:
  - making payments to low-tax jurisdictions non-deductible
  - abolishing the participation exemption for non-EU entities
  - introducing *effective* substance rules
  - not providing ATAs or APAs to artificial arrangements (without economic base)
- **Transparency.** Increase transparency in the Netherlands by requiring companies to report their profit and losses by country, and disclose their beneficial ownership structures from at least 10% onwards. This would enable better empirical evidence to detect potential treaty shopping and tax avoidance and evasion.
- **Support the UN Tax Committee.** To ensure the interests and specific problem of developing countries are reflected in international agreements and model treaties, the UN Tax Committee should become the main forum for standard setting. The Dutch government should take appropriate steps in international fora, such as the OECD Tax Committee, to increase the UN's role.

Latindadd public policy recommendations[141]

- The contradictions and disadvantages of the OECD Model Tax Convention for developing countries should be recognised and the UN Model should be strengthened. Recommendations and standards should be drafted on issues such as the permanent establishment definition in treaties, the fight against capital flight, tax evasion and avoidance, international cooperation in fiscal areas and the strengthening of tax administrations in developing countries.
- Tax administrations should carry out a regular annual revision of DTAs with reference to the fiscal planning strategies developed by the companies involved. That is, the regular revision of the content of DTAs should be adjusted to the effective results derived from tax practices, so that the agreements to "avoid double taxation" do not end up leading to a "double non-taxation" or eroding the tax bases of developing countries.
- The regular revision of the impact of DTAs on Latin American tax structures must be understood as an initial step to debate the set of regulations and international treaties that protect foreign investment, such as the need (or not) to continue with bilateral investment treaty (BITs), the use of capital movement controls, and other legislation on FDI. Therefore, it is necessary to make headway with a comprehensive tax reform that should modify the essentially regressive structure of today, the general architecture of which has been maintained without substantial changes since the neoliberal decade of the 90s.
- Study the feasibility of proposing a customs and tax information agreement model, with the support of social organizations, not only to offer an alternative tool in the event DTAs were cancelled, but also to overcome the major limits and restrictions to information transparency.
- Tax and fiscal policies should become essential tools for the wealth and income redistribution processes, as well as for the financing of development and social infrastructures; they should not 9 turn into vehicles for higher concentration and exclusion that lead to increasing social unrest. However, for any change and transformation to be introduced, full citizenship should be exercised in areas and issues such as taxes, fiscal policy and fiscal justice.
- This implies that the following must be ensured:
  - Conditions of transparency
  - Access to information
  - Participation in the drawing up of public budgets

These measures are a prerequisite for the development of effective monitoring and evaluation processes by civil society and its different organizations, as well as for the construction of truly fair and democratic fiscal systems.

[141] Double Taxation Agreements in Latin America. Analysis of the links among Taxes, Trade and Responsible Finance', Executive Summary, Latindadd, April 2013 (publication forthcoming).

6.2. Research agenda

Finally, the literature review and impact assessments presented in this report highlight the need for further research. Many issues were not addressed in this report, such as the need for information exchange or capacity building of tax administrations to improve enforcement. Furthermore, every bilateral setting has particularities that require specific solutions or approaches to the issue of cross-border taxation. Specific FDI flows and sectoral developments, broader policy settings and the interaction between investment and tax policies are all issues that need to be analysed on a country by country basis.

However, whilst country-level analyses are necessary, they are not sufficient. To address international capital flight, tax avoidance and tax evasion, regional and global solutions are needed. Research on the impact of tax treaties should therefore also explore alternatives to DTAs, such as regional model treaties and information exchange agreements. The feasibility of using the 1988 OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters as a global solution should be assessed. But most importantly, the UN should become the standard setting forum for international taxation. In this context, the UN Model Convention should be critically scrutinised and alternatives that truly reflect the needs of developing countries should be put forward at UN level.

Annex 1: Model Tax Treaties – explanatory note

Most tax treaties today are based on the *OECD Model Double Taxation Convention on Income and Capital* and its commentaries,[142] which gives residence states the primary right to tax passive income. The only 'rival' Model that gives more rights to source taxation is the *United Nations Model Double Taxation Convention between Developed and Developing Countries*, which was published in 1980.[143] As outlined in chapter 3, although the UN Model largely follows the OECD Model in that it also shifts taxing rights from source to residence states there are some significant differences that are relevant to developing countries in their treaty negotiations with developed countries.

UN and OECD Model Conventions

Nine Articles of the UN Model grant more rights to source states,[144] namely, Articles 5 (Permanent establishment), 7 (Business profits), 9 (Associated enterprises), 10 (Dividends), 11 (Interest), 12 (Royalties), 13 (Capital gains), 14 (Dependent personal services) and 21 (Other income). Some of the main differences with regard to source and residence taxation are:

- In the UN Model, a permanent establishment is defined more broadly and attributes profits to that establishment more easily, giving rise to more situations where the source country gains taxation rights on active income.
- The UN Model notably does not suggest specific rates for withholding taxes and leaves these to be settled in bilateral negotiations and provides for a shared taxing right and broader definition on royalties, whereas the OECD Model gives sole royalty taxing rights to residence states.
- Ownership definitions in the allocation of taxing rights on capital gains from the alienation of shares are also more favourable to source states in the UN Model, as is Article 21 on other income.

An analysis of the Dutch treaty network shows it is difficult to determine whether an existing treaty follows one specific Model. Even though some concessions are made by residence state towards sources states in the form of higher withholding taxes, the central problem of residence taxation taking precedence, and other disadvantages of tax treaties as outlined in chapters 4 and 5 persist also under the UN Model.

Standard Articles in tax treaties

Chapter 3 already outlined the effect of tax treaties, in that they allocate taxing rights between countries by reducing the applicable rates of tax on certain incomes in either country (e.g. withholding taxes at source on passive income) and defining a 'permanent establishment' to which business income can be allocated, for example. Furthermore, tax treaties determine who may enjoy treaty benefits by defining who is a resident for treaty purposes and who is the beneficial owner of the

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[142] The Convention was drafted in 1963, revised in 1977 and subsequently updated in 1992, 1994, 1995, 1997, 2000, 2003, 2005, 2008 and 2010.

[143] Following OECD updates to its Model, a new UN Model was published in 2001 and updated in 2011. See Kosters (2004) and Lennard (2009) for detailed examinations of the UN vis a vis the OECD Model.

[144] Kosters (2004) provides a detailed outline of the differences between the 2001 UN Model and the 2000 OECD Model. Lennard (2009) compares the 2001 UN Model and the 2008 OECD Model, whereby additional Articles are examined, namely, Articles 16 (Directors' Fees), 18 (Pensions), 25 (Mutual Agreement Procedure), 26 (Exchange of Information) and 27 (Mutual Assistance, at the time not included in the UN Model).

income covered by the treaty. Tax treaties also agree on measures to avoid double taxation and to facilitate tax administrations to enforce tax compliance. Increasingly, tax treaties also include anti-treaty shopping provisions.

Below is an explanation of the standard Articles contained in tax treaties that regulate the above treaty goals. Rather than listing the Articles in numerical order, the purpose and effect of the provisions is used as a categorisation. Because the OECD and UN Model follow the same structure and Article numbering since the 2011 revision of the UN Model, no differentiation is made between the two models here below. Any differences in wording between both models are outlined above, and generally have no substantive impact on the principles and effect of treaty provisions.

Allocating taxing rights

Tax treaties allocate taxing rights on business income, income from moveable property and from immovable property.[145] Generally speaking, source countries are limited to tax business profits of the local subsidiary (defined as permanent establishment), whilst residence countries of parent companies or investors are given the right to tax global income, subject to at least a credit (or exemption) for valid source taxation. The allocation of taxing rights therefore goes hand in hand with laying down rules on avoiding double taxation by exemption, credit or tax sparing method.[146]

Tax treaties by and large lay down that:

- (Active) Income from the business[147] may only be taxed in the source state if it is attributable to a fixed place of business, i.e. a ‘permanent establishment’[148] (often abbreviated PE) in the source state.
- The source state generally is given the right to tax a non-residents’ income from immovable (real) property.[149]
- Income from movable property such as dividends[150], interest[151] and royalties[152] are primarily taxed in the residence state, but the source state may impose a reduced tax, depending on negotiations.

As outlined in chapters 3 and 4, the definition and classification of types of income covered by the treaty is therefore crucial to the allocation of taxing rights of developing countries.

[145] Article 2. Social security and payroll taxes are not covered by treaties.
[146] Article 23
[147] Article 7
[148] Defined in Article 5
[149] Article 6
[150] Article 10
[151] Article 11
[152] Article 12

Passive vs. active income[153]
For the purpose of taxation one must distinguish between different types of income, namely, active, passive, and portfolio income (a form of passive income) and capital gains. These categories of income are important because of the different ways in which they are taxed and offset against each other (e.g. losses in passive income generally cannot be offset against active or portfolio income).

Active Income
A compensation (income) for which (active or material) services have been performed
Some examples of active income are:
- Income from businesses in which there is material participation.
- Wages
- Salaries
- Commissions

Passive income
Passive income refers to wealth generated without active participation, e.g. from a venture. Passive income is taxable but is often treated differently than active income. Investors are limited in their deduction of passive losses against active sources of income, such as wages, salaries, and pension income.
Some examples of passive income are:
- Dividend income from owning securities, such as stocks and bonds, and interest income from debt claims is usually referred to as portfolio income[154]
- Royalties from publishing or from licensing a patent or other form of intellectual property
- Capital gains
- Earnings from internet advertisements on websites
- Rent from property
- Pensions

Capital gains
Another type of income that could be classified as passive income but which differs from the above types of passive income is capital gains, which is a one-time payment received from an investment because it has increased in value (settling stocks, property or material goods at a profit). In tax treaties, taxation of income is dealt with in Chapter 3, whilst taxation of capital is outlined in Chapter 4.

→ Limiting taxing rights to business income of the permanent establishment (PE)

Given that the right of the source state to tax business profits is restricted in tax treaties by stipulating[155] that profits can only be taxed if they are connected to a PE, the latter's definition is central to the treaty because it gives the source state the right to tax the active income of a subsidiary of a foreign-owned business.[156] Article 5 defines a PE as a fixed place of business through which business of an enterprise is carried on.[157]

In the OECD Model, the qualification threshold for a permanent establishment is set high because the Model represents developed countries' interests in reducing source-based taxation of capital-exporting enterprises. Thus in the OECD Model, a construction facility or an oil drilling facility must be in the country for more than twelve months to be taxed, but in the UN model only for six months. The OECD

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[153] Overview generated from dictionary definitions, cited at http://financial-dictionary.thefreedictionary.com (4.11.2011)
[154] Some countries (e.g. United States) do not consider portfolio income a form of passive income, in which case companies cannot offset their portfolio income with their passive activity loss (http://www.irs.gov/publications/p925/ar02.html, 4.11.2011).
[155] Article 7
[156] For a detailed description of Articles 5 and 7 OECD Convention, see Uckmar (2006:166-168). As outlined in chapter 2.2, tax treaties lay down the method of attributing profits to the PE as transfer pricing.
[157] A place of management, branch, office, factory, any place of extraction of natural resources, building site, a construction, assembly or installation project (for the latter, only if activities last more than six (UN Model) or twelve months (OECD Model) months), and services (including consultancy services), but only if activities continue for a period or periods aggregating more than six months within any twelve-month period (UN Model).

article also includes a long list of exceptions and a specific bar against force-of-attraction rules, which the UN Model (Article 7(1)) does include. The force of attraction rule grants source taxation on some types of business profits that are not necessarily attributable to a permanent establishment.[158]

→ Reducing source-based taxation on passive income

Articles limiting the right of a source state to tax passive income (such as dividends, interest, royalties and capital gains) are at the heart of a tax treaty.[159] They are the reason why developing countries lose out when signing DTTs with developed countries, because of the asymmetry between capital-importing and capital-exporting economies regarding passive income. The OECD model permits limited source taxation on dividends[160] and interest[161] but not on royalties. The UN Model accepts a limitation of source taxation on passive income but does not set percentage limits (the percentage to be established through bilateral negotiations), and allows for limited source taxation on royalties.

→ The right to tax real (immovable) property

Taxation of immovable property (land, houses)[162] is considered a valid source taxation in both Model Treaties.

Applicability and anti-avoidance: defining who can(not) enjoy treaty benefits

Treaties define who may or may not benefit from the provisions therein by stipulating that treaty benefits apply only to residents of both contracting states.[163] In both Model Conventions, applicability is defined with the definition of who is a resident for treaty purposes, by laying down that limited withholding tax rates only apply to the 'beneficial owners' of the concerned passive income, and in very few cases, by explicitly limiting the benefits of the treaty in different ways (limitation on benefits provisions).[164]

→ Defining a resident for purposes of taxation

Treaties also determine the applicability of treaty benefits by defining who qualifies as a resident of each signatory state for treaty purposes, which is therefore also a potential anti-abuse measure. Article 4 of both Models stipulates that only residents liable to tax qualify to benefit from a treaty, i.e. enjoy lower withholding taxes on passive income in a foreign country or seek relief from double

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[158] Avi-Yonah (2007:7). The rule allows source taxation of certain profits (not attributable to the PE) that relate to sales of similar goods or merchandise in the source country, as well as other business activities of the same or similar kind carried on by the enterprise in the source country. For example, when the head office provides goods or services directly to the customers in the source country and the PE in the source country is also involved in the same line of activity, the profits earned by the head office directly shall be taxed as a profits attributable to the PE. The rule is limited to business profits (not applicable to passive income); it also excludes sales through independent commission agents nor purchase activities (Lennard, 2009:7)

[159] Articles 10 (Dividends), 11 (Interest), 12 (Royalties), 13 (Capital gains), 18 (Pensions).

[160] Limiting source taxation to 5 per cent of the gross amount of the dividends if the beneficial owner is a company that holds at least 25 per cent of the capital of the company paying the dividends; and 15 per cent in all other cases.

[161] Limiting source taxation to 10 per cent of the gross amount of the interest.

[162] Including "accessories" such as livestock and equipment used in agriculture and forestry (Article 6).

[163] Article 1

[164] The OECD has attempted to deal with treaty abuses through amendments to the Commentary on Article 1 of its Model Tax Convention, which it revised in 2003. The UN commentary largely copied the 2003 OECD commentary, which suggests various ways to avoid treaty abuse by further specifying (i) use of the concepts of place of effective management and permanent establishment (para. 10.1- 10.2), (ii) a comprehensive limitation-of-benefits provision (para. 20), (iii) provisions which are aimed at particular types of income that is subject to low or no tax under a preferential tax regime (para. 21-21.2), (iv) anti-abuse rules dealing with source taxation of specific types of income (para. 21.3-21.4), (v) provisions which are aimed at preferential regimes introduced after the signature of the convention (para. 21.5), (vi) provisions for 'remittance based taxation' (para. 26.1), and (vii) provision for 'procedural issues of source taxation' (para.26.2). The 2003 update also includes the further clarification of the concept of "beneficial ownership" in Commentaries on Article 10 (para. 12-12.2), 11 (para. 9-11) and 12 (para. 4-4.2).

taxation from his or her resident state. If a person is resident in both the contracting states, there are provisions to assign a single state of residence to her/him for purposes of the treaty through so-called tie-breaking rules.[165] According to both Model conventions residents for tax purposes must be "liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature".

Given the widely-used practice by non-contracting states' businesses of using conduit structures to benefit from treaties, the definition of a resident corporation is central to tax treaties. Yet both Model treaties fail to include a test to qualify a corporation (or other legal entity) to treaty benefits, for example, by including "any reference to the residence of the controlling shareholder or shareholders or any requirement that the corporation must itself carry on business in whole or in part in the country of residence or that the corporation must not be merely an investment holding company not carrying on business at all."[166]

→ Beneficial owner

Since 1977, the OECD Model only grants reduced holding tax rates on dividends, interest, and royalties if the 'beneficial owner' of the same is a resident of the other contracting state. Just like the permanent establishment and resident definitions, the definition of beneficial owner is an anti-abuse tool because it limits the applicability of the treaty. In particular, ''beneficial ownership'' is a specific anti-avoidance concept to prevent treaty shopping through conduit entities.[167]

Eliminating Double Taxation vs. granting tax concessions

Tax treaties specify that (where exclusive tax jurisdiction over certain income is allocated to the country of source) the initial onus to prevent double taxation is on residence countries by granting their residents an exemption[168] or a foreign tax credit[169] (or a combination thereof), depending on existing domestic policies and tax systems. Given that tax concessions are often granted to investors by developing countries in the hope of attracting foreign direct investment, double taxation prevention methods by residence countries are also some of the most contentious negotiation points for developing countries. This is because the exemption method has no effect on tax concessions provided to investors in source countries, whilst the credit method effectively remunerates the residence state, rather than investor, when concessions are given:

→ Exemption Method

The exemption method entails a residence country altogether excluding foreign income from its tax base, with the source country being given the exclusive right to tax (complete exemption). Exemption in the residence state can therefore lower the overall tax rate for the investor, if tax concessions are granted by the source country.

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[165] Tax residents can be individuals (whereby residency might be defined on grounds of length of stay within a given year) or companies, which might be deemed residents in the country in which they are incorporated (US position) or controlled (UK position) Avi-Yonah (2007:6)

[166] Ward (2008:4)

[167] See Ward (2008:6) or Krishna (2009:540). The introduction of the concept of beneficial owner excluded from treaty benefits an "intermediary such as an agent or nominee" and limited the treaty beneficial rates of withholding tax on dividends and interest and royalties to those amounts that are paid either directly to the beneficial owner who is resident in the other contracting state or to an intermediary if the beneficial owner is a resident of the other contracting state.

[168] Article 23 A

[169] Article 23 B

→ Credit Method

The credit method entails the resident remaining liable in the country of residence on its global income. However, a credit for tax paid in the source country is given by the residence country against its domestic tax, as if the foreign (source) tax were paid to the country of residence itself. The credit method leads to a stable tax rate, as any lowering of tax rates in the source state is calculated against the resident state's tax rate, leading to one tax rate for the investor. It also leads to a revenue shift from source to residence country, as the investor effectively pays any tax concession received in the source country to the residence country.[170]

→ Tax Sparing

In order for tax incentive measures not to be cancelled out by the domestic tax policies of the other signatory state, developing countries can negotiate "tax-sparing" credits in bilateral treaties. Tax sparing entails capital-exporting country granting a credit not only for the tax paid but for the tax spared (annulled or reduced) in source countries with the aim of providing incentives for investments. Tax sparing credit is therefore an extension of the regular tax credit.[171]

Tax sparing represents a departure from Article 23 of both OECD and UN Models, which lay down that a foreign tax credit should be "equal to the [capital or income] tax paid in that other State". Exceptions are therefore made by some developed countries[172] when signing treaties with developing countries. The Netherlands has announced to refrain from including tax sparing provisions in future negotiations and phase out existing tax sparing provisions during renegotiations (see below) The tax sparing debate is contentious and touches upon the central question of whether tax incentives are necessary to attract foreign direct investment.

Exchange of information and administrative cooperation: enforcing compliance

Exchange of information and administrative cooperation between tax authorities are preconditions for detecting tax avoidance and are therefore central to tax treaties as well.[173] Indeed they are often a central motivation for states to enter into tax treaties in the first place.[174] Whilst Article 26 (exchange of information between tax authorities) has always been a standard feature of tax treaties, until 2002, the OECD Model failed to include any provision on mutual assistance in the collection of taxes.[175] In 2003, a new Article 27 on assistance in the collection of taxes was added to the OECD Model Tax Convention, which the UN subsequently included in its Model in 2011.

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[170] The UN Commentaries on Article 23 (United Nations, 2001) reflect developing countries' rejection of the foreign tax credit method because special tax concessions granted by them "may in large part be to the benefit of the treasury of the capital-exporting country rather than to the foreign investor for whom the benefits were designed. Thus, revenue is shifted from the developing country to the capital-exporting country".

[171] It should also be mentioned that even if no tax sparing clause is signed, "tax holidays usually benefit taxpayers even without tax sparing" due to the "availability of deferral and averaging (cross-crediting between high and low tax jurisdictions)" (Avi-Yonah, 2007:12).

[172] Germany and Japan, for example, give credit for taxes that would have been collected at source from a permanent establishment or a subsidiary except for a tax holiday, whilst the U.S. Senate has been insistent that it will never ratify a tax treaty that provides for tax sparing, because it can result in double non-taxation (Avi-Yonah, 2007:11-12). The Netherlands has announced the same intention in 2011 (see chapter 5.7).

[173] Articles 26 (Exchange of information) and 27 (Assistance in the collection of taxes).

[174] In fact, the U.S. refused to sign a tax treaty with Israel for almost 20 years because of the latter's refusal to cooperate in information exchange (Avi-Yonah 2007).

[175] Uckmar (2007:178)

Anti-treaty shopping provisions

Most tax treaties do not contain specific provisions dealing directly with treaty shopping, although these are increasingly being included in treaty negotiations.[176] Treaty shopping occurs when a resident of a third (non-treaty) country takes advantage of a fiscal treaty between states, typically by setting up a conduit or base company or permanent home in one of the contracting states solely for the purpose of enjoying the benefit of a particular treaty rule.[177]

Despite early attempts by the OECD to develop anti-abuse measures,[178] both the OECD and UN Models fail to include specific anti-abuse articles in the actual model treaty text (although they discuss treaty abuse at length in their commentaries to Article 1).[179]

States have introduced different avoidance measures, either domestically, in treaties or as a result of court judgements, such as a legal entity having to show economic substance over form in the country to qualify as a resident, domestic general anti-avoidance rules (GAARs), or through more technical and specific concepts included in treaties, such as the beneficial ownership concept[180] and limitation on benefits provisions, which limit the applicability of the treaty.[181]

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[176] Dunbar (2010:447)

[177] The OECD commentaries define a conduit as "using artificial legal constructions to benefit both from the tax advantages available under domestic laws and the tax relief provided for in double taxation conventions. This would be the case, for example, if a person (whether or not a resident of a Contracting State), acts through a legal entity created in a State essentially to obtain treaty benefits that would not be available directly. Another case would be an individual who has in a Contracting State both his permanent home and all his economic interests, including a substantial share holding in a company of that State, and who, essentially in order to sell the shares and escape taxation in that State on the capital gains from the alienation (by virtue of paragraph [6] of Article 13), transfers his permanent home to the other Contracting State, where such gains are subject to little or no tax."

[178] Extensively discussed in two reports by the Committee on Fiscal Affairs from 1987 entitled "Double Taxation Conventions and the Use of Base Companies" and "Double Taxation Conventions and the Use of Conduit Companies" (OECD, 1987). See Ward (2008) for a discussion and summary of the main points of both reports.

[179] In particular the 2003 revision of the OECD commentaries (specifically paragraph 20 of the 2003 OECD Commentary on Article 1) introduces an extensive discussion on possible measures to avoid treaty abuse and contains a model limitation of benefits article. Ward (2008) provides an extensive outline of the OECD commentaries and discusses the effectiveness of specific anti-abuse provisions, such as general anti-avoidance rules (GAARs) and beneficial ownership definitions.

[180] As mentioned above, double tax conventions therefore typically restrict their benefits to residents of the states that are parties, and when a resident of one state claims relief in respect of income derived from the other state, the claimant must ordinarily be "beneficially" entitled to the income in question. The definition of resident and beneficial ownership are therefore also anti-abuse provisions.

[181] See Ward (2008) for a detailed outline of possible anti-avoidance rules and a discussion on their effectiveness.

Annex 2: Calculations lost tax revenue

Table 4: Calculating dividend and interest tax revenue losses that occur as a result of lower withholding tax rates in Dutch tax treaties

Step 1 Interest and dividend flows per country							Step 2 Pre-tax interest and dividend flows			
Treaty partners (x) Low-income *** Lower-middle ** Upper-middle income	Outward Direct Investment Positions from NL to x	% of total outward direct investment	Interest income attributable to X	Dividend income attributable to X	WHT rate interest (treaty)	WHT rate dividends (treaty)	WHT paid on interest	WHT paid on dividends	Total pre-tax interest flow	Total pre-tax dividend flow
	a	b	c	d	e	f	g (e * i)	h (f * j)	i (100/(100-e)*c)	j (100/(100-f)*d)
	m EUR	%	m EUR	m EUR	%	%	m EUR	m EUR	m EUR	m EUR
Argentina	5.051	0,171%	74,29	126,61	12%	10%	10,13	14,07	84,42	140,68
Armenia**	3	0,000%	0,04	0,07	5%	5%	0,00	0,00	0,04	0,07
Bangladesh***	120	0,004%	1,77	3,02	10%	10%	0,20	0,34	1,97	3,35
Belarus	405	0,014%	5,96	10,15	5%	5%	0,31	0,53	6,27	10,68
Bosnia and Herzegovina	183	0,006%	2,69	4,59	0%	5%	0,00	0,24	2,69	4,83
Brazil	82.478	2,787%	1213,11	2067,49	15%	15%	214,08	364,85	1427,19	2432,34
Croatia	3.690	0,125%	54,28	92,50	0%	0%	0,00	0,00	54,28	92,50
Egypt**	7.226	0,244%	106,28	181,14	12%	0%	14,49	0,00	120,78	181,14
Ethiopia**					5%	5%				
Georgia**	126	0,004%	1,86	3,16	0%	5%	0,00	0,17	1,86	3,33
Ghana***	1.909	0,065%	28,08	47,86	8%	5%	2,44	2,52	30,53	50,38
India**	5.835	0,197%	85,83	146,27	15%	15%	15,15	25,81	100,97	172,08
Indonesia**	12.563	0,424%	184,78	314,92	10%	10%	20,53	34,99	205,31	349,91
Jordan	78	0,003%	1,15	1,96	5%	5%	0,06	0,10	1,21	2,06
Kazakhstan	23.850	0,806%	350,79	597,84	10%	5%	38,98	31,47	389,76	629,31
Kenya	417	0,014%	6,14	10,46	15%	15%	1,08	1,85	7,22	12,30
Macedonia	65	0,002%	0,95	1,62	0%	0%	0,00	0,00	0,95	1,62
Malaysia	12.380	0,418%	182,10	310,34	10%	0%	20,23	0,00	202,33	310,34
Mexico	23.546	0,796%	346,33	590,24	15%	5%	61,12	31,07	407,44	621,30
Moldova**	154	0,005%	2,27	3,87	5%	5%	0,12	0,20	2,39	4,07
Mongolia					10%	0%				
Morocco**	739	0,025%	10,87	18,52	25%	10%	3,62	2,06	14,49	20,58
Nigeria**	12.799	0,432%	188,26	320,85	12,50%	12,50%	26,89	45,84	215,15	366,68
Pakistan**	871	0,029%	12,81	21,82	20%	10%	3,20	2,42	16,01	24,25
Philippines**	4.484	0,152%	65,96	112,41	15%	10%	11,64	12,49	77,60	124,90
Russian Federation	44.763	1,512%	658,39	1122,09	20%	15%	164,60	198,02	822,99	1320,11
Serbia	2.265	0,077%	33,32	56,78	0%	5%	0,00	2,99	33,32	59,77
South Africa	23.823	0,805%	350,40	597,18	0%	5%	0,00	31,43	350,40	628,61
Sri Lanka**	221	0,007%	3,25	5,53	10%	10%	0,36	0,61	3,61	6,15
Thailand	3.285	0,111%	48,32	82,35	10%	25%	5,37	27,45	53,69	109,79
Turkey	15.444	0,522%	227,16	387,14	15%	15%	40,09	68,32	267,25	455,46
Ukraine	11.008	0,372%	161,92	275,95	10%	5%	17,99	14,52	179,91	290,47
Venezuela	14.958	0,505%	220,00	374,95	5%	0%	11,58	0,00	231,58	374,95
Vietnam**	925	0,031%	13,60	23,18	10%	5%	1,51	1,22	15,11	24,40
Zambia**	167	0,006%	2,45	4,18	10%	5%	0,27	0,22	2,72	4,40
Zimbabwe***	46	0,002%	0,67	1,14	10%	10%	0,07	0,13	0,74	1,27

	Step 3 WHT without DTA				Step 4 Lost tax due to DTA		Step 5 extrapolating lost tax accountable to SFIs				
Treaty partners (x) Low-income * Lower-middle ** Upper-middle income**	**DWHT rate interest**	**DWHT rate dividends**	**Interest income (no treaty)**	**Dividend income (no treaty)**	**Lost WHT on interest**	**Lost WHT on dividend**	**Total lost WHT**	**FDI positions excluding SFIs**	**FDI positions by SFIs**	**Share of SFIs in total FDI position**	**Lost tax attributable to SFIs**
	k	**l**	**m (i * k)**	**n (j * l)**	**o (m - g)**	**p (n - h)**	**q**	**s**	**t (s - a)**	**u**	**v**
	%	**%**	**m EUR**	**m EUR**	**m EUR**	**m EUR**	**m EUR**	**m EUR**	**m EUR**		**m EUR**
Argentina	35%	35%	29,55	49,24	19,42	35,17	**54,59**	1.034	4017,30	80%	**43,42**
Armenia**	10%	10%	0,00	0,01	0,00	0,00	**0,01**				**-**
Bangladesh***	10%	20%	0,20	0,67	0,00	0,34	**0,34**				**-**
Belarus	10%	12%	0,63	1,28	0,31	0,75	**1,06**				**-**
Bosnia and Herzegovina	10%	5%	0,27	0,24	0,27	0,00	**0,27**				**-**
Brazil	25%	0%	356,80	**NA**	142,72	-	**142,72**	7.670	74807,52	91%	**129,45**
Croatia	15%	0%	8,14	0,00	8,14	0,00	**8,14**	50	3640,63	99%	**8,03**
Egypt**	20%	0%	24,16	0,00	9,66	0,00	**9,66**	161	7065,06	98%	**9,45**
Ethiopia**	10%	10%			-	-	**no data**				**-**
Georgia**	5%	5%	0,09	0,17	0,09	0,00	**0,09**				**-**
Ghana***	8%	8%	2,44	4,03	0,00	1,51	**1,51**	26	1883,54	99%	**1,49**
India**	0%	5%	0,00	8,60	-	-	**NA**	1.867	3967,72	68%	**NA**
Indonesia**	20%	20%	41,06	69,98	20,53	34,99	**55,52**	1.186	11376,94	91%	**50,28**
Jordan	7%	0%	0,08	0,00	0,02	-	**0,02**				**-**
Kazakhstan	20%	20%	77,95	125,86	38,98	94,40	**133,37**				**-**
Kenya	15%	15%	1,08	1,85	0,00	0,00	**NA**				**NA**
Macedonia	10%	10%	0,09	0,16	0,09	0,16	**0,26**				**-**
Malaysia	15%	0%	30,35	0,00	10,12	0,00	**10,12**	1.393	10987,41	89%	**8,98**
Mexico	40%	0%	162,98	0,00	101,86	-31,07	**70,80**	6.034	17511,84	74%	**52,65**
Moldova**	10%	15%	0,24	0,61	0,12	0,41	**0,53**				**-**
Mongolia	20%	20%					**no data**				**-**
Morocco**	10%	10%			-	-	**NA**	90	648,97	88%	**NA**
Nigeria**	10%	10%	21,52	36,67	-	-	**NA**	6.336	6463,89	51%	**NA**
Pakistan**	30%	10%	4,80	2,42	1,60	0,00	**1,60**				**-**
Philippines**	20%	30%	15,52	37,47	3,88	24,98	**28,86**	617	3867,60	86%	**24,89**
Russian Federation	20%	15%	164,60	198,02	-	-	**NA**	4.687	40075,97	90%	**NA**
Serbia	20%	20%	6,66	11,95	6,66	8,97	**15,63**				**-**
South Africa	0%	0%	0,00		-	-	**NA**	1.124	22699,06	95%	**NA**
Sri Lanka**	15%	10%	0,54	0,61	0,18	0,00	**0,18**				**-**
Thailand	15%	10%	8,05		2,68	-	**2,68**	1.129	2156,49	66%	**1,76**
Turkey	10%	15%		68,32	-	-	**NA**	2.896	12548,17	81%	**NA**
Ukraine	15%	15%	26,99	43,57	9,00	29,05	**38,04**	426	10582,15	96%	**36,57**
Venezuela	34%	34%	78,74	127,48	67,16	127,48	**194,64**	582	14375,45	96%	**187,06**
Vietnam**	10%	0%	1,51		-	-	**NA**				**NA**
Zambia**	15%	15%	0,41	0,66	0,14	0,44	**0,58**				**-**
Zimbabwe***	15%	15%	0,11	0,19	0,04	0,06	**0,10**				**-**
Total lost WHT							**771,32**				**554,03**

NA: in some cases revenue losses are not applicable, namely, when the treaty stipulates the same or higher WHT rates in treaties than domestic tax rates. The countries that negotiated, from their perspective, favourable WHT rates are: India, Morocco, Nigeria, Russian Federation, South Africa and Turkey.

Methodology

The Dutch Central Statistics Bureau (CBS) reports every year how much capital income the Netherlands receives from its FDI stock abroad from withholding taxes on incoming interest and dividend payments. Amongst others, it distinguishes between interest income and dividend income. It also classifies income that can be attributed to Special Financial Institutions (mailbox companies) separately. The interest and dividend income recorded by the CBS can be used, together with data from the OECD and the IMF, to make a rough calculation of how much a Dutch tax treaty partner loses as a result of lower (or gains as a result of higher) treaty withholding tax rates on dividend and interest income.

The difference between domestic and treaty tax revenue losses calculated here only concerns interest and dividend income. Other forms of tax avoidance, such as transfer pricing (which reduces the taxable income base in a source country) or lower treaty WHT rates on royalties are not included. Finally, the lost revenues are only attributable to the Dutch treaty network; lost revenues from other treaties are therefore not included. Whilst the estimated revenue loss on lower WHT rates presented here is a maximum estimation (see assumption 4), the results presented here can thus still considered to be partial and conservative.

A number of assumptions are made in the calculations below.

Assumption 1
Empirical evidence shows that no automatic positive correlation exists between the existence of a DTA and investment levels; i.e. tax treaties are not shown to lead to a growth in foreign investment. At the same time, it has been shown that the Netherlands is used for treaty shopping. See chapter 4.5 of this report for references to relevant literature.

Assumption 2
The profit of Dutch Special Financial Institutions (SFIs, or mailbox companies) is proportional to the FDI stock of these SFIs. That means it is assumed that every euro of investment leads to the same amount of profit. On the basis of this assumption, we can posit that x% of FDI stock equals x% of the total profit of the total FDI stock.

Assumption 3
The proportional relationship between interest income and dividends in the capital income that SFIs report in the Netherlands is the same in every country.

Assumption 4
In calculating the difference between domestic and treaty withholding tax rates on proportional Dutch FDI stock per treaty country, we assume that if investments would be made directly rather than through a Dutch SFI, the domestic withholding tax rate applies. In reality, however, FDI from other countries is also subject to reduced WHT rates under other treaties. This qualification, however, cannot be calculated because publicly available data does not specify countries of origin of FDI stock.

1. Calculating ratios of interest and dividend income from FDI stock abroad

Table 4 above provides figures on Dutch FDI positions abroad per treaty partner country and calculations of lost tax revenue as a result of lower WHT rates in Dutch treaties. Only treaty partners that classify as low income, lower-middle income and upper-middle income countries were included in the calculations.

The following methodology explains these calculations with the example of Argentina. The following table 5 details the data and formulas referred to in table 4 and in the methodology below.

Table 5: Legend explaining data types and formulas used in Table 4

a	Outward Direct Investment Positions from NL to country X (IMF data)
b	% of total outward direct investment from NL to country X
c	Interest income attributable to country X (CBS data)
d	Dividend income attributable to country X (CBS data)
e	WHT rate on interest in DTA
f	WHT rate on dividend in DTA
g (e * i)	WHT paid on interest
h (f * j)	WHT paid on dividend
I (100/(100-e)*c)	Total pre-tax interest stock
j (100/(100-f)*d)	Total pre-tax dividend stock
k	Domestic WHT rate on interest
l	Domestic WHT rate on dividend
m (i * k)	Interest income without DTA
n (j * l)	Dividend income without DTA
o (m - g)	Lost WHT on interest
p (n - h)	Lost WHT on dividend
q	Total lost WHT
r	FDI positions excluding SFIs from NL to country x (OECD data) – USD
s	FDI positions excluding SFIs from NL to country x (OECD data) – EUR
t (s - a)	FDI positions by SFIs - IMF data minus OECD data
u	Share of SFIs in total FDI position
v	Lost tax attributable to SFIs

1. The Dutch Central Statistics Bureau (CBS) only reports the total capital income that results from Dutch FDI stock abroad (incoming interest and dividend payments) and does not provide country-level data. In order to allocate the interest and dividend capital income to a particular country, we therefore need to calculate the percentage of Dutch FDI stock in that country with regard to the total Dutch FDI stock abroad. This is possible by using IMF data, which provides us with a total Dutch FDI stock abroad, specified by country.
2. In order to calculate the percentage of the total outward direct investment (FDI stock) from the Netherlands to country x, this FDI stock is divided by the total (world) outward direct investment position of the Netherlands. For example, the Dutch FDI stock in Argentina is € 5.051 million. This stock divided by the total outward direct investment position of the Netherlands (€ 4.117.806 million) results in 0.171%. This is the Argentinean share of the total Dutch FDI stock abroad.
3. This percentage (0.171%) is then multiplied by, respectively, the reported dividend and interest income of that year as reported by the CBS. For Argentina, this results in € 74,29 million in interest payments to the Netherlands and € 126,61 million in dividend payments to the Netherlands in 2011.

2. Calculating before tax position

4. In order to calculate the difference between treaty and non-treaty tax income from dividend and interest income, we need to know the taxable base of this income, i.e. the amount of outgoing interest before tax is levied.
5. This is done by adding the withholding tax paid on the interest and dividend stock in country x to the income reported in the Netherlands. It is assumed that Argentina levied 12% WHT **(e)**

on outgoing interest. The incoming interest of €74.2 million **(c)** is therefore treated as 88% of the total pre-tax interest paid out of Argentina. 100% of this is €84.82 million **(i)**, so that Argentina levied €10.13 million **(g)** in 2011 on the outgoing interest payments to the Netherlands.

3. Calculating domestic WHT on interest and dividends (without a treaty)

6. The pre-tax interest and dividend income in country x are now used to calculate the tax income with and without existence of a treaty on the basis of domestic and treaty withholding tax rates.
7. On a pre-tax amount of € 84.42 million **(i)**, Argentina would have levied a 35% domestic WHT **(k)** on interest if no treaty existed with the Netherlands, amounting to €29.55 million **(m)**.

4. Calculating lost revenue as a result of lower treaty WHT rates

8. The difference between the tax income resulting from different WHT rates under the Dutch treaty can now be calculated. Argentina levied 12% (€10.13 million **[g]**) of €84.42 million **(i)** and could have levied 35% (€29.55 million **[m]**), resulting in a loss of €19.42 million **(o)**.
9. When copying the above steps for dividends, the lower treaty withholding tax rate for outgoing dividends under the Dutch Argentinean treaty results in €36.58 million **(p)**.
10. Together, Argentina can be said to have potentially lost € 55.99 million.

5. Calculating lost revenue accountable to treaty shopping by mailbox companies (Special Financial Institutions)

11. To calculate unwanted tax revenue loss through treaty shopping we use OECD data (which excludes SFIs) and IMF data (which includes SFIs) on bilateral FDI positions. In 2011, the Netherlands reported an outward FDI stock of €1.034 million to Argentina to the OECD, excluding SFIs **(s)**. This amount is subtracted from the Dutch FDI stock in Argentina including SFIs **(a)**. In the case of Argentina, this would leave a Dutch FDI stock of € 4017.3 million **(t)** attributable to SFIs, which is 80% of all Dutch FDI stock in Argentina **(u)**.
12. If 80% of the difference between domestic and treaty WHT rates on interest and dividend payments calculated above **(q)** is attributable to SFIs, this amounts to €44.54 million lost interest and dividend tax revenue **(v)** as a result of Dutch treaty shopping for Argentina.

Data gaps:

Ethiopia and Mongolia: no IMF data exists on the Dutch outward direct investment position, so that no calculations could be made on lost tax revenue. Ethiopia has signed a treaty with the Netherlands in 2012. Although calculations on the basis of 2011 data would not have been applicable in practice, they would have indicated the potential loss Ethiopia will suffer as a result of the Dutch treaty as of 2013 onwards. Mongolia cancelled its treaty with the Netherlands end of 2013; it will remain in force until January 2014.

In the case of the following countries, no data bilateral OECD data attributing FDI to SFIs existed, so that the percentage of the total lost tax revenue attributed to SFIs could not be calculated: Armenia, Bangladesh, Belarus, Bosnia and Herzegovina, Georgia, Jordan, Kazakhstan, Kenya, Macedonia, Moldova, Mongolia, Pakistan, Serbia, Sri Lanka, Vietnam, Zambia, and Zimbabwe.

Annex 3: Overview Dutch DTA and BIT treaty network

	Income classification	Tax treaty partner countries	Dutch BIT
1	3	Albania	x
	3	Argentine	x
	2	Armenia	x
	4	Australia	
	4	Austria	
	3	Azerbaijan	
	4	Bahrain	x
	1	Bangladesh	x
	4	Barbados	
10	3	Belarus	x
	4	Belgium	
	4	Bermuda	
	3	Bosnia-Herzegovina	x
	3	Brazil	x
	3	Bulgaria	x
	4	Canada	
	3	China	x
	4	Croatia	x
	4	Curacao	
20	4	Czech Republic	x
	4	Denmark	
	2	Egypt	x
	4	Estonia	x
	1	Ethiopia	x
	4	Finland	
	4	France	
	2	Georgia	x
	4	Germany	
	4	Greece	
30	2	Ghana	x
	4	Hungary	x
	4	Iceland	
	2	India	x
	2	Indonesia	x

	Income classification	Tax treaty partner countries	Dutch BIT
	4	Ireland	
	4	Israel	
	4	Italy	
	4	Japan	
	3	Jordan	x
40	3	Kazakhstan	x
	4	Korea	x
	1	Kyrgyzstan	
	4	Kuwait	x
	3	Latvia	x
	3	Lithuania	x
	4	Luxembourg	
	3	Macedonia	x
	1	Malawi	x
	3	Malaysia	x
50	4	Malta	x
	3	Mexico	x
	2	Moldova	x
	2	Mongolia (terminated)	x
	2	Morocco	x
	4	New Zealand	
	2	Nigeria	x
	4	Norway	
	4	Oman	x
	2	Pakistan	x
60	3	Panama	x
	2	Philippines	x
	4	Poland	x
	4	Portugal	
	4	Qatar	
	3	Romania	x
	3	Russian Federation	x
	4	Saudi-Arabia	
	3	Serbia	
	4	Singapore	x
70	4	Sint Maarten	
	4	Slovak Federal Republic	x
	4	Slovenia	x
	3	South Africa	x

	Income classification	Tax treaty partner countries	Dutch BIT
	4	Spain	
	2	Sri Lanka	x
	3	Suriname	x
	4	Sweden	
	4	Switzerland	
	4	Taiwan	
80	3	Thailand	x
	3	Tunisia	x
	3	Turkey	x
	2	Turkmenistan	
	1	Uganda	x
	2	Ukraine	x
	4	United Arab Emirates	
	4	United Kingdom	
	4	United States	
	2	Uzbekistan	x
90	3	Venezuela	x
	2	Vietnam	x
		Zambia	x
93		Zimbabwe	x
Total			**58**

(1) low income: 6
(2) lower-middle income: 18
(3) upper-middle income: 25
(4) high income: 44

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Should the Netherlands sign tax treaties with developing countries?

There is growing concern about the negative impact taxation treaties can have on the domestic revenue of developing countries. This report discusses the Dutch tax treaty network in the context of international economic justice. As recent media reports highlighting corporate tax evasion have shown, there is an urgent need to review Dutch fiscal policy with view to poverty alleviation in developing countries, but also with view to the current austerity measures and new poverty levels hitting developed economies. This report analyses substantive articles of the OECD and UN Model tax treaties as well as looking specifically at Dutch DTAs and their impact on developing economies. Firstly, the report presents a literature review on DTAs and their relation to foreign direct investment (FDI) as well as the phenomenon of treaty shopping. The literature indicates that the Netherlands is used for treaty shopping and therefore FDI diversion, which results in tax revenue losses in signatory states. Secondly, the report presents new calculations of revenue losses in form of lower withholding tax rates in Dutch DTAs for poor countries who have signed a treaty with the Netherlands. Finally, the paper illustrates these findings with some existing case studies. The report concludes with recommendations to the Dutch government on how it can end its harmful tax regime to ensure policy coherence for development is guaranteed. Amongst others, the government should increase financial transparency, reform specific domestic tax rules, include effective anti-abuse clauses in domestic law and all its DTAs and initiate an ongoing and comprehensive DTA impact assessment. Recommendations for developing countries from a recent DTA impact assessment by the civil society network Latindadd are also included.

This paper is part of series of publications analysing the impact of Dutch foreign and economic policy on sustainable development and public interests. The series is part of a project entitled 'Private Gain, Public Loss' in which policies aiming to attract foreign business or investment to or through the Netherlands (the so-called 'vestigingsbeleid', or business location policy) is analysed in the framework of development policy and human rights coherence.