Series of Lectures by Prof Sol Picciotto on International Taxation Law on 7 and 8 May 2019

Professor Sol Picciotto gave a series of lectures at the Institute for Judicial and Legal Studies on ‘The Interactions of National and International Tax Law’, and ‘The Impact of Multilateral Instruments on Tax Treaties’ on 7 and 8 May 2019 respectively. More than 120 law practitioners as well as justices of the Supreme Court and magistrates from the intermediate court attended the lectures of Prof Picciotto. He is emeritus professor of Lancaster University, Senior Fellow at the International Centre for Tax and Development, a Senior Adviser of the Tax Justice Network, and coordinator of the Base Erosion and Profit Shifting (BEPS) Monitoring Group. He has taught at the Universities of Dar es Salaam (1964-8), Warwick (1968-1992), and Lancaster (1992-2007); and was Scientific Director of the Oñati International Institute for the Sociology of Law (2009-2011). He is the author of *International Business Taxation* (1992), *Regulating Global Corporate Capitalism* (2011), several co-written books, and numerous chapters and articles on various international tax issues and other aspects of international business and economic law.

In his first lecture, he retraced the different modes of legal interpretation of the law. Legal principles are essentially indeterminate, because of the social character and hence context-dependent of language, and the necessarily teleological nature of interpretation of norms. He further highlighted how all countries have a legal foundation, generally consisting of a founding document, such as a constitution, and the laws passed by the national legislature and other levels of lawmaking authority. These laws function in a hierarchy, which determines how they rank in authority and how the authority and scope of each level is derived from the constitution. The hierarchical structure varies from country to country, and depends on the form of government. However, there are general principles that are common to most countries and are key to determining the purpose of each piece of law within a legal and regulatory framework, and ultimately enforcing their authority and validity. There are two main systems through which treaties may be transplanted into a domestic legal order: monist and dualist systems. In its most straightforward form, monism holds that international law and domestic law form part of a single universal legal system. On the other hand, a dualist system such as Mauritius treats the international and domestic systems of law as separate and independent. The validity of international law in a dualist domestic system is determined by a rule of domestic law authorising the application of that international norm. Notwithstanding the different domestic legal incorporation methods, both systems require legislative approval for a treaty to have effect as domestic law. For instance, section 76 of the Income Tax Act of Mauritius provides that the Minister may enter into arrangements with the government of a foreign country with a view to affording relief from double taxation in relation to foreign tax imposed by the laws of that country and taxes of every kind and description covered under the arrangement or for the exchange of information…

He further gave an illustration of a conflict between domestic law and treaty based on the 2012 Kenya-Mauritius tax treaty. The said treaty, purportedly ratified by legal notice and published in the Kenya Gazette in May 2014, became the subject of a lawsuit brought by Tax Justice Network Africa, the first such challenge to a tax treaty in Africa. That treaty never entered into force because Kenya did not notify Mauritius of the completion of the ratification procedures. On 15 March 2019, Kenya’s High Court concluded that the 2012 tax treaty was invalid, agreeing with Tax Justice Network Africa that the Kenyan government did not follow ratification procedures required by law because the agreement was not properly laid before Parliament. In its suit, Tax Justice Network Africa also advanced that the earlier treaty was harmful to Kenya because it reduced the withholding tax on services, management fees, and insurance commissions to zero percent from its current rate of 20 percent and, moreover, because Kenya gave away its right to tax capital gains from stock sales of Kenyan companies to Mauritius, which does not charge any capital gains tax. The group said that the 2012 tax treaty would be abused in the same manner that the India-Mauritius tax treaty had been abused. However, the High Court did not address this aspect of Tax

Justice Network Africa's arguments. The Double Taxation Agreement was however signed again on 10 April 2019. Closer reflection on the nature of these types of conflicts reveals that there is a patent disregard of the rules applicable to the interpretation of treaties in the Vienna Convention of 1969.

In his second lecture, Prof Picciotto focused on the allocation of income of multinational enterprises (MNE) for tax purposes. He explored the issues raised for international tax rules of explicitly treating multinational enterprises (MNEs) as single or unitary firms. First, he briefly explained why reform of international corporate taxation is important particularly for developing countries, then he outlined the flaws in the current system. He discussed the impetus created for reforms, and the political and institutional dynamics of the tax treaty system. An evaluation was provided of the results of the G20/OECD project on BEPS, focusing essentially on the extent to which they moved towards a unitary approach, and the problems created by their continued adherence to the independent entity principle. He outlined several proposals which, in different ways, would apply a unitary approach to MNEs. He provided a broad overview of the transactional approach of the arm's length principle in relation to transfer prices which refers to the allocation of profits for tax and other purposes between parts of a multinational corporate group. Transfer prices are useful in several ways. They can help an MNE identify those parts of the enterprise that are performing well and not so well. And an MNE could suffer double taxation on the same profits without proper transfer pricing.

In a bid to avoid such problems, current OECD international guidelines are based on the arm's length principle – that a transfer price should be the same as if the two companies involved were indeed two independents, not part of the same corporate structure. The arm's length principle (ALP), despite its informal sounding name, is found in Article 9 of the OECD Model Tax Convention and is the framework for bilateral treaties between OECD countries, and many non-OECD governments, too. The OECD Transfer Pricing Guidelines provide a framework for settling such matters by providing considerable detail as to how to apply the arm's length principle. transfer pricing has gained wider attention among governments and NGOs because of another risk: that it could be used to shift profits into low tax jurisdictions even if the MNE carries out little business activity in that jurisdiction. This leads to trade distortions, as well as tax distortions. No country – poor, emerging or wealthy – wants its tax base to suffer because of transfer pricing. That is why the OECD has spent so much effort on developing its Transfer Pricing Guidelines (TPG). While they help corporations to avoid double taxation, they also help tax administrations to receive a fair share of the tax base of multinational enterprises. But abuse of transfer pricing may be a particular problem for developing countries, as companies might take advantage of it to get round exchange controls and to repatriate profits in a tax free form. The OECD provides technical assistance to developing countries to help them implement and administer transfer pricing rules in a broadly standard way, while reflecting their particular situation. Applying transfer pricing rules based on the arm's length principle is not easy, even with the help of the OECD's guidelines. It is not always possible – and certainly takes valuable time – to find comparable market transactions to set an acceptable transfer price. A computer chip subsidiary in a developing country might be the only one of its kind locally. But replacement systems suggested so far would be extremely complex to administer.

Prof Sol submitted that there is, however, a new approach that can be implemented. The administrative burdens of applying the TPGs have led some countries to adopt various kinds of 'safe harbour' rules which can be applied automatically. Although these run counter to the emphasis on individual audit, the OECD amended the TPGs in 2013 to permit them, but only provided they

are voluntary for taxpayers, and where necessary agreed with other relevant countries. Hence, under the TPGs they have limited scope, mainly consisting of exemption from documentation obligations and for small firms. These do not seem relevant for developing countries, where MNEs are generally large taxpayers. Some leading developing countries have sought more effective simplification. Brazil has gone furthest, with detailed regulations dating back to 1996. These are based on three of the approved OECD methods, but apply fixed profit margins to all taxpayers within each specified category, dispensing with the need for individual audit. This has the merit of being easy to apply and providing certainty, but is a broad-brush approach, taking no account of differences between firms especially of profitability. Although compatible with tax treaties, it disregards the TPGs' requirements for individualised evaluation. India enacted rules based on the TPGs in 2001 and experienced an enormous growth in disputes. Consequently, regulations in 2013 specified 'safe harbour' transfer pricing methods for approved firms in specified sectors (mainly out-sourced software and component manufacture). In compliance with the TPGs, these were voluntary, but this resulted in low take-up, and revisions made in 2017 seem unlikely to improve this. Other countries have also designed sectoral schemes, e.g. Mexico for sub-contract manufacturing for export ('maquilas'), and the Dominican Republic for the package hotel sector. These seem more successful since they apply automatically to designated taxpayers; opting out is possible but involves a burden of proof. Safe harbours may therefore be helpful for sectors with many similarly-situated firms, and on an opt-out rather than opt-in basis. If targeted at firms attributing profit inappropriately to affiliates in non-treaty jurisdictions they do not need to be agreed bilaterally.

More radical methods have been proposed which could help protect the tax base of poor countries while being simple to apply. Some countries have a minimum tax, calculated for example on sales revenue, or using several methods (which allows for different company characteristics). Such a tax is payable if the normal profits tax liability is lower, or is treated as a non-refundable credit against profits tax. Michael Durst also has proposed a 'shared net margin method', which would require the local affiliate to earn a benchmark profit margin in proportion to that of the corporate group as a whole (Durst 2016). An extension of this would be to establish a benchmark on a formulary basis, by allocating a proportion of the TNC's global income to the local entity, based on factors reflecting its presence in the jurisdiction, such as employees, assets and sales. This would revert back to the fractional method which was historically in widespread use, and which continues to be permitted for attribution of profits to permanent establishments in most existing tax treaties. This runs counter to the transactional approach in the TPGs, which explicitly reject formulary apportionment. However, it could be applied in a way which is compatible with the TPGs, using the framework of an Advance Pricing Arrangement, preferably on a sectoral basis to achieve the aim of simplicity. He ended his lecture on the future developments regarding base erosion and profit shifting.

The series of lectures given by Prof Sol Picciotto were a resounding success insofar as they have shed light on the position of Mauritius with regard to its obligations under international law and how we can tax the income of multinational companies operating within our borders. These have profound implications for development because corporate taxes represent a large potential source of additional revenue in the face of substantial limitations on our ability to raise revenue from broad-based taxes like personal income tax and value added tax.