

Focus on the content of OECD and UN work (29th November 2023)

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DOI: 10.54103/milanoup.243.c495

Abstract

While international cooperation in tax matters continues to face both technical and political challenges, the OECD plays a leading role in global tax governance, particularly through its Model Tax Convention and the BEPS project, promoted by the G20 to enhance transparency and fairness in the global tax system. The comparison between the OECD and UN models highlights the different approaches of these two organizations regarding the allocation of taxing rights, with significant implications for the relationships between developed and developing countries.

Keywords: BEPS, OECD, UN, model tax convention, transparency, double taxation, global minimum tax.

[Prof. Russo]

Good afternoon, everyone. It's nice to be here in presence after the first two lectures online. So going back to today's presentation, we focus on the content of the OECD and the UN. So first, I would like to talk a little bit of how the work is actually carried out, who are the people that actually carry out this work and in which form in both organizations and then look at the key outputs of both organizations and then try to understand the difference between these outputs. So how do they function? First of all, you remember that we said the OECD was founded after World War Two, before it was called OEEC and was meant to administer, manage the Marshall Plan. And standards of the OECD apply in the area of taxation but apply in many different areas. There are, for example, standards regarding corporate governance, there are standards regarding the functioning of financial markets, the standards on anti-money laundering which are developed by the Financial Action Task Force, which is a subsidiary body of the OECD, and there are standards in the area of taxation.

Now, what is the structure of the OECD. At the top you have the Council and each member country of the OECD has an ambassador. They fundamentally set the strategic direction of the organization, and this strategic direction is then implemented via the Secretariat of which I was part, and the secretariat is composed by people like me, like you, hopefully one day in the future that go and work for the organization, without representing any member countries. So even though I am an Italian national, I was not representing the interests of Italy, but I was doing the groundwork in order to do what? To allow the committees to discuss and agree on a given topic. So, the role of the Secretariat is very important because as you may understand, the way you frame a question, the way you frame a topic, the way you frame a discussion may have an influence on the answer to the question, on the solution to the problem that has been presented. You know, Einstein used to say, if I had one hour to solve the problems of the world, I will spend 59 minutes identifying the problem and one minute identifying the solution. Well, that's the role of the Secretariat and that's very important because if you imagine, just put, you know, 40 of you around the table and you have to decide what to have for dinner. It's not going to be an easy exercise because maybe someone wants to eat meat, someone wants to eat fish, someone is vegetarian, and the role of the secretariat is to try to frame the discussion in a way that could be conducive to results. And these results are then approved by committees, and depending on the topic, there are a number of committees. The committee that is of relevance for us is the Committee on Fiscal Affairs. So usually what you see there is country representatives that traveled to Paris or in COVID times and post COVID, those that also online and meet with their counterparties in order to agree on a given topic. Who are these people? Usually, it's the Director General of Finance, the Director of International Affairs, in the US it is the Deputy Assistant Secretary for International Taxation, in France it is the Director General for International Taxation. It varies depending on the organization of the country. Now, already here, you may see some tensions, because usually, like you have one seat at the tables and therefore you have to decide who is going to be sitting at the table, is it going to be the minister? Or is it going to be the revenue agency? Obviously, the committee is at the level of the directors general, usually are the last step in the approval process. Because under the committee, there are a number of so-called working parties, working parties that are, as regards the Committee on Fiscal Affairs, structured in this manner. You have the Forum on Tax Administration that gets together the Commissioners, the Director General of the Revenue Agencies of the IRS, of the Spanish Revenue Agency, *etc.* Then you have a working party that is in charge of the model tax convention. So, tax treaty is working party one, working party two is in charge of tax policy analysis and statistics. Working Party six is on the taxation of multinational enterprises, which is a bit of a misleading title because effectively all the working parties

affect, all the working parties' outputs affect the taxation of multinational enterprises. What really working party six is in charge of is the transparent pricing guidelines, it is the guidelines that establish how transactions between different parts of the same multinational group are priced in order to avoid base erosion and profit shifting. Working Party nine works on consumption taxes, VAT, and the like. Working Party ten is the one in charge of exchange of information and tax compliance. So, Working Party then is the one that developed the common reporting standards that we discussed briefly the other day, the standard under which bank account information is shared annually by financial institutions with the local tax administration, and then the local tax administration sends it over to the tax administration of the countries of residence of people that have bank accounts in. Working Party eleven which I have to say I contributed to setting up on aggressive tax planning. This is, I'll open a parenthesis here, so when I started at the OECD in 2007, I had just published a book, which was called the *Fundamentals of International Tax Planning*, and I wrote it with a number of very skilled practitioners. And the idea was, you know, just to show to the public that certain things were going on and were used effectively to minimize tax liability in a number of high tax jurisdictions. So, when I arrived at the OECD with a group of colleagues, we said, well, why don't we try to reproduce what happens in the private sector in the public sector. So, in the private sector, usually when you have an idea, or when you have a transaction that has to be made and you're thinking how to structure the transaction in a tax efficient manner, you usually call colleagues, partners, partner firms in other countries and say, hey, how does this work in your country? Is this something that can be done? And we tried to do the same at the level of revenue agencies. So once tax administration found out a specific scheme, a specific structure that they thought created concerns, either according to the existing rules or from a policy perspective, so something that was allowed under the existing rules but seemed to be wrong in terms of the policy result that was achieved by that structure, we developed a sort of standard form that each tax administration could send them, and then we developed a sort of database of schemes. And we were doing that in a confidential manner, obviously, everything was anonymized. So, we didn't know who were the taxpayers involved, but we knew about the scheme. And that's where some of the early reports that were issued, there was a Report on Hybrid Mismatch Arrangements, there was a report on, at that time, there were huge losses in financial institutions because of the crisis and there was a lot of trading going on with these losses. We did the report on after tax hedging that is probably one of the most complex things I've ever looked at in my life. But we sort of started to develop some know-how about a number of structures that we saw as increasingly common. And then, as Giuseppe was saying, the scandals were thrown out to the public, and everyone was like, oh, what do

we do? That's when we launched the BEPS project and we formalized this work into a real working party with representatives of all countries concerned.

The other relevant working groups are the so-called Forum on Harmful Tax Practices which basically looks at the legislations of countries to ensure that they meet certain standards that fundamentally try to avoid that the legislation of one country damages the tax revenues of another country. The task force on the digital economy, that I also, let's say, contributed to set up because that was a working group that we set up when we launched the BEPS project, whose first action was addressing the challenges of the digital economy. And there, again, was 2012, so it was 10 years ago and many of the things that today we know were not really known, but what was clear to a number of us was that these issues were actually cutting across all the different topics that I just described. And this taskforce effectively brought together experts on tax treaties, experts on transfer pricing, experts on anti-avoidance rules, experts on reporting obligations, experts on VAT and indirect taxation, trying to address the issues in a holistic manner rather than going straight into one specific problem. And then, in this one too, I have to say I contributed to set up, was the taskforce on tax crimes and other crimes that basically gets together here the criminal tax investigators. In Italy will be the tax police, in the US will be the IRS, criminal investigation division. So, in a number of countries, you have within the tax administration or outside of the tax administration a specific group of people that deals with structures that clearly are not within the law and therefore are illegal. And so here we are really, we're not talking about planning, we're not talking about avoidance, we're really talking about tax fraud. Even though, even that, in some cases it may be difficult to find the dividing line between one and the other. If you think about, I don't know, if you heard about the scandal, the so-called Cum-Ex scandal, which was basically a structure that had been put in place by many investment banks that fundamentally was something like this. Say, you knew that at certain point in time during the year there was the season of dividend payments from listed companies, and obviously if the company pays these dividends to the shareholders, depending on where the shareholders were, there will be a withholding tax. So, what this scheme implied was that just a day before the payment of dividend, the shares were loaned to someone that was entitled to a 0% withholding tax rate. At that point, that person would receive the dividends tax free and then would repay them back to the lender of the shares as so-called manufactured dividends. So, it was an agreement purely based on the tax saving and probably at the time when people were putting that in place, it was considered more in the space of avoidance. Today, there are a number of people that are either in jail or under criminal investigations because of these schemes. Just for you to know that sometimes these categories can be blurred, and obviously they change from a legal system to another, and they also change from a certain period of time to another depending on legislative

development. So, this is, in a nutshell, the, let's say, inner cuisine of the OECD work. So, the UN, as we discussed yesterday, is different because effectively there is a group that works on international tax matters at the level of the UN, but that group is composed of experts that act in their personal capacity. So, they do not represent the governments that have appointed them. And obviously that makes a huge difference because they did the Vienna Convention on the Law of Treaties. But fundamentally, because of the international public law rules that apply in the interpretation of international treaties, when, let's say, something is agreed at the governmental level, it obviously has more influence in the interpretation than something that is written by someone acting in a personal capacity, which may also be relevant as can be relevant to an Article written by Giuseppe Marino when deciding a certain case or taking a position, but it's different from something that has been agreed by those that represent governments in their functions. In the group of experts at the moment that are 25 experts, but then there are also a number of observers and you can also observe if you want, you register and you get the link and you can listen to the discussion. So, if you're passionate about this, I strongly suggest you to try to do that. And it's a fascinating exercise because in a way you see how the sausages are made but you know what Bismark used to say, never show people how sausages are made. I mean, when you get really into the inner cuisine, and you probably better understand also why certain results are then put out in the public. The expert group basically does works on the UN model convention, works on a number of practical guidance, manuals, however you want to go them. And also, together with the OECD, together with the IMF, together with the World Bank, it is involved in so-called capacity building. So, strengthening the skills of tax officials, in particular of developing countries. Now, if you look at the key outputs of both organizations, OECD model tax convention, we discussed that yesterday, it's a model that now it's updated every two or three years. And as I was telling you, why is this model so relevant? Because the model comes with a commentary, and the commentary explains the provisions of the model tax convention. So, once you are faced with the interpretation of an actual treaty, and that actual treaty follows the model tax convention, the logic assumption is that the countries that agreed to use that model provision agreed with the interpretation of that model provision. And that's the relevance of the model, and that's also one of the reasons, in my view, why as from 92, it has been updated every two or three years. Because obviously, cross border trade and investments have increased over time, and many issues that were not taken into account when the model was developed had to be addressed by way of interpretation.

I remember when I started, the first job I had was about the application of the model tax convention in the case of satellite operations. Now, so someone from the Secretariat writes a note and says, you know, this is the issue, these are

the rules, these are the possible interpretations, and then the committee, then the note gets sent to the, in this case, Working Party number one on the model tax convention, you get comments from different countries, you will elaborate on these comments, you provide a revised note, and then once you are ready you submit it for approval. Approval happens in which way? This is very important, applies under the rule of so-called consensus. Consensus is different from unanimity in the sense that consensus means that no one has objected to the approval, which also means that if you have only one country saying I disagree, it's not passed. But that's if you want the beauty and the strength of the guidance once it is agreed because it means that effectively everyone agrees. Or in the specific case of the model tax convention, if there is a disagreement, either with the provision of the model or with the interpretation included in the commentary, countries can launch a reservation on the model tax convention, or an observation on the interpretation that is given. So, I don't agree with this, or I will never put a provision like this into my treaties. So, in a way it's meant to increase transparency regarding the position of different countries.

[Prof. Russo]

So, I repeat the question for those that are online. So, the question is can country slot reservations that are against the object and purpose of the model tax convention and therefore the treaties that follow them? I would say in principle, yes, because there are no limitations to the reservations that you can make.

[Prof. Marino]

Could you explain better the difference between the so-called consensus versus the unanimity?

[Prof. Russo]

Unanimity, you have to vote yes. Consensus, you don't have to vote no. That is the difference between the two models. So, in a way, it's a bit less than unanimity. But in practical terms, if someone disagrees, then there is no consensus. However, if there is disagreement, but we are talking about the model tax convention, there is the possibility still to approve, but with the reservation of certain countries. For example, when Switzerland, Austria and Luxembourg had bank secrecy in their domestic law, when Article 26 of the model said, you know, you have to exchange information also if you have bank secrecy, they had the reservation saying we cannot apply this provision because under our domestic law we have bank secrecy. So, it's a sort of balancing act. And in a way, if you ask me, it is also a reflection of the fact that while way back in the past, the position of the country members of the OECD were more aligned, over time, differences started to emerge more clearly. And second, very important point, as from a certain point in time, also non-member countries that were participating in the work as invitees were allowed to launch their position on the

model tax convention. That's why if you open the model tax convention today, you also see the positions of China, you see the positions of India, you see the positions of Brazil. And again, it's a matter of transparency. Then what happens is that sometimes some of these non-member countries become members of the OECD. I worked, for example, on the accession of Israel into the OECD, and in order to become a member of the OECD, you have to adopt the so-called OECD *acquis*, in the French word. So, you have to sort of respect the standards that have been agreed by the organization. And therefore, once this happened, when there are the standards, countries have to change their position. And is there anyone from Brazil? Wow, three, okay, so that's the case as regards Brazil because as you may know, Brazil has started the accession process to the OECD. And it's no coincidence that one of the first thing that Brazil has done has been to change its transfer pricing legislation, because Brazilian transfer pricing legislation until last year was very peculiar and considered by many not to be in line with the transfer pricing guidelines of the OECD, and now Brazil has amended.

[Student]

In relation to Article nine?

[Prof. Russo]

Yes, in relation to Article nine, yes. But funnily enough, they don't exist in relation to the transfer pricing guidelines. And I think we can have, like, the educated guess is that it was also discussed whether observations or reservations or positions should have been put forward also on the transfer pricing guidelines, but the decision was no. And I have to say, if you read the transfer pricing guidelines, you realize that in many instances they are the result of a compromise. And every time there is a compromise, there is less clarity than if there was a straightforward decision. But this is the other key output of the OECD, and these were the key outputs for 50 years, or as I wrote in an Article that possibly is going to be published tomorrow, the transfer pricing guidelines on one hand and the model tax convention on the other hand, in my view, at least have been like the engines of globalization, have allowed cross-border trade and investment to be magnified. Also thanks to the technological revolution of which we are all part now. But these guidelines are very important. Why? Well, because once you will start working in practice and you will have to determine whether the entity in your jurisdiction has been remunerated as if it was an independent party from its fellow subsidiaries, you will have to apply the transfer pricing guideline. And this is, let's say, the strength of multilaterals to have one standard that all different countries can apply. And that also means that taxpayers will have to comply with one standard rather than many different rules and standards in many different countries in which they operate.

Then, we go to the BEPS project and I go back to the question of Alberto before. As I told you, the BEPS project was, so, this was a very distinct moment, and it was actually the Article about the Double Irish and the Dutch sandwich that was published on Bloomberg. And this Article was actually published the day when there was a meeting of the Committee on Fiscal Affairs, actually of the Bureau of the Committee on Fiscal Affairs, which is like the inner body that organizes the work and takes strategic decisions. So once this Article was published, and you had all these government officials in the room, and then everyone was reading it, because obviously it went viral and then like we started discussing, okay, but you know, what is the problem here? And one person said, well, the problem is because, anyone from the United States? You're from the US? Great, you know what subpart F is? Subpart F is basically the US controlled foreign company rules. These are rules that basically say, if someone who is resident in my country has a controlling interest in an entity which is subject to low taxation or is subject to low taxation and only derives passive income, I basically tax that income upfront at the end of each year so that you cannot use what were called tax havens to postpone indefinitely your tax liability. And people said, well, you know, these schemes work because there is a loophole in the US CFC rules. Other people said well, but actually all these schemes are based on hybrid mismatch arrangements. So, arrangements that smart tax planners develop to basically make use of the arbitrage that exists between different tax systems. So, assume that Alberto is in France and I am in Italy, and I have to give some money to Alberto for him to do something. I give him a loan, he pays interest, right? He pays interest and deducts the interest and I am taxed on the interest. But I can also give him, make an equity contribution to Alberto Corporation. If I make an equity contribution, he will pay dividends. So, he will not be able to deduct the dividend and usually I will benefit from a preferential treatment on the dividends. So, in a way, you see that there is some symmetry, deduction, taxation, no deduction, no taxation. Then a smart tax planner like Marco sitting on the first row and working with me says, well, but why don't you do profit participating loan? Because if you do a profit participating loan, effectively France treats it as a loan, and therefore the payment is treated as an interest and is deductible. But Italy doesn't look at the label loan but looks at the substance and says well, but in effect, this is an equity contribution, it's a capital contribution, and therefore what you're receiving is a dividend which is exempt. So, what you get? You get a deduction in France and an exemption in Italy, and many of the, let's say, large part of the structures that are used, that were used, or probably, I don't know if they're still used. But that was clear in the Article that was published was based on this hybridity, on these arbitrage opportunities. So, people were saying the problem is hybrids. Then other people said, the problem is that general anti avoidance rules don't work. Others said the problem is that we don't have enough information because we

would like to know, you know, how many employees there are in each country, how much revenue is allocated to that country, what's the value of the assets that are in that country. Others said, and this was also the very strong position of the NGOs, the problem is transfer pricing. So, the transfer pricing guidelines from a tool meant to prevent tax avoidance were framed as a tool that would allow tax avoidance. And so, the solution of the NGOs was, we have to move to formulary apportionment, because the arm's length principle is rotten, doesn't work, it's too easy to abuse *etc.* So, imagine this situation, imagine that we had the database on aggressive tax planning schemes, and then we said look, if you close one hole but you'll leave another one open, everything will go out from that one. So, either we addressed this holistically or we're never going to solve problem.

[Prof. Russo]

All of them, all of it. For them, it was the arm's length principle in itself that is the cause or was the cause of the problem. Now, there are different methodologies through which you can determine the price of a transaction between two related parties. But for them, they were all wrong, or they were all too easy to abuse. Alberto, I was expecting you because Alberto is a transfer pricing guru. So, I was expecting him to say something.

So, I repeat for those that are online, I paraphrase, so basically, some people like Alberto said, well, but you cannot do this under the transfer pricing guidelines already today because it's also, everything is subject to interpretation. So, if you take a formalistic approach, some people were taking that approach, I think Alberto is usually taking a substantial approach being an economist. And so, you know, the bottom line is, if I have a company in Cayman Island that has no employee, no one, it's managed by a service provider, but it has the legal ownership of the trademark, whatever trademark you want, and receives royalties from all over the companies around the world. Is this something that according to the arm's length principle, is something that could be done and could be priced? This was ultimately the question. And some people said, well, already now, we think you cannot do that, other people say by now you can do that, because you know, you have to look at the legal reality and the legal reality says that they are the owner of the intangible. I am oversimplifying it, but so, at that point in time, we decided to launch the BEPS project, and we said, in order to do this we need first of all, to do a proper assessment of the situation, what we called the diagnosis. And we were given three months to do the diagnosis, which it's doable. If you tell me Raffaele, write the diagnosis in three months, I had already written the book so I was facilitated by that. But that was not the problem, the problem was that you had to do it in three months and get the 40 plus countries that were participating in the work to agree that that was the right analysis. And that was challenging to say the least. Then we issued this

diagnosis, and we thought, okay, now we can go back to our normal way of working and you know, at a more relaxed life and at least enjoy the families or friends during the weekend. But then the G20 came and said, you know what, we need an action plan and we need it in two months. Okay, let's start all over again, and that's when we developed the 15-point action plan on BEPS. So, we basically tried to identify the causes of base erosion and profit shifting and tried to tackle all of them. And these are the 15 actions which were organized around three main concepts, coherence, coherence meaning coherence among the different tax systems. And in fact, all the actions that you see there are actions related purely to domestic legislation, but it's domestic legislation that has an impact, that has an effect on the legislation of other countries. The second one was substance. So, how do I avoid that artificial arrangements are used in order to erode the taxable base and shift profits to low tax jurisdictions. And these are the actions in the space of tax treaties and transfer pricing. And then there was the third concept which was the one of transparency. So, first of all, well, let's gather the data and let's see how much profits are shifted. And to me when I looked at the data, that's when I realized that something was fundamentally wrong with the system. It's an interesting report, the assessment report, it's an interesting one to read, because nowadays we go so fast that we always look at the present. But I remember there is something that if you look, anyone from China? But tell me who are the five biggest investor countries in China? Or who were in 2012? I don't know now, the five biggest investors into China in terms of countries, have a guess, imagine from what you read on the newspapers and everything else.

[Students]

USA, Russia, New Zealand, India, Australia.

[Prof. Russo]

None of these, it was BVI, Cayman, Hong Kong, Netherlands and Singapore. So, in fact, after we published this report, also the statistics on FDI, on foreign direct investments changed, because they started to compute separately all the investments via hubs to use a neutral terms and real investment. So, we also realized that all our data on FDI were polluted by these schemes.

What is new about this is that the BEPS project was launched at the request of the G20, and within the BEPS project, the countries of the G20 participated on an equal footing with OECD member countries. So, it was the first time that China, India, Brazil, South Africa, Russia were sitting at the table with the same rights and obligations as of member countries. And nowadays, it seems like a given, at that time it was a very difficult choice to make. But many of us were convinced that in order to do things properly, you needed to have at least all the G20 countries around the table, and at the same time try to involve as

many countries as possible, also outside of the G20. And that's the inclusive framework on BEPS that was constituted after that.

The other two or three items on which I wanted to focus your attention are the work on harmful tax practices, because that has been having a massive impact on the way countries design their tax legislation. And I'm not talking only about tax havens, you know, at that time, there was a new legislative development that basically started out in the UK and the Netherlands and then started mushrooming all around the world and was called the Patent Box. So, it was basically a preferential tax treatment of certain income from intellectual property. And what this Forum on Harmful Tax Practices did said, well, you just cannot do that, because you are attracting artificially profits that belong to someone else, and if you want to do a preferential regime on intellectual property, you have to do it according to certain criteria. And even countries like Italy, like France, they had to change their Patent Box regime in order to meet these criteria. And the other thing that the new work on harmful tax practices did was to force countries to exchange rulings that they issued to taxpayers, that may be relevant to other countries. Why? Because in a number of jurisdictions, there was, sometimes there is the law, but then you can go to the tax administration and agree on something different. Or there is the law and you can go to the tax administration and agree on the interpretation of what's written there.

You may have heard that some of these rulings, in particular, issued by Luxembourg or by Ireland, have also been the focus of state aid investigations at the level of the EU, and cases are currently pending before the European Court. So, the idea was, if you give a ruling to a company saying, well, effectively, you know, you can get all the income here but we're not going to tax it, you are obliged to exchange that ruling with the tax administration of the other country concerned. So that tax administration can be in the position to do something about that. And the other item that was upgraded in this work was the so-called the substantial activities required. So, you can provide for a preferential tax treatment, but you only can do that in relation to substantial activities. Well, usually substance is seen as based on employees and physical assets, rather than intangibles and cash that are obviously much easier to move than a factory or than two hundred people. Tax transparency, this we discussed it yesterday. So, the standards on exchange of information and the standards on exchange of information on request. And finally, the two pillars and here is the point.

Well, because you are providing transparency to the tax administration of the country of residence of the person that has, in this case, the bank account abroad. So, while before they will be in the dark, now they can see. I guess that will be, but can you tell me, what is your doubt?

So, you are talking about Action 14 dispute resolution, why is it under transparency? Because the feeling was that there is also to be more transparency in the process related to the mutual agreement procedure. Now, for those of you

that have never heard this word, the mutual agreement procedure is a procedure according to which, if I think that I am being subject to taxation, not in accordance with the treaty, the example of the satellite. Imagine now that country says, you have to pay taxes here because the satellite is beaming into my territory. And then I will say, well look, but why, this is not a permanent establishment, so I shouldn't pay taxes here. They say we don't care, you have to pay taxes. Then I go to my resident country, and I say, can you give me a credit for the taxes that they have paid in the other country? And my resident country says, forget about it, why did you pay taxes, you shouldn't have paid taxes there, you should have paid taxes only in my jurisdiction, resulting in double taxation. And in this case, the taxpayer can go to the tax administration and say, can you please talk to your colleagues of the other country and solve this issue? Now, the tax administration is not obliged to solve the issue but is obliged to try to find a solution. And that is now changed because now following the BEPS project, there is a provision that says if after two years, the two tax administrations have not agreed on how to solve the problem, then the taxpayer can ask that the problem is solved by an arbitration committee. So, you appoint three people, Alberto, Giuseppe and Raffaele, you submit the case to these three people, and they decide. Plus, there have been a number of standards in the way that the mutual agreement procedure is to be carried out, such as that they are more transparent *vis-à-vis* taxpayers. But your point is taken, the bottom line is that we didn't know where to put it so we put it there. But this also forces me to say something else, that this was also, in the entire plan, it was the only action that was in favor of taxpayers.

Or in other words, it was the carrot which came with 14 sticks. But it was also a recognition of the fact that because of the complexity, also of the new rules that were being introduced, disputes will increase, the number of disputes will increase. And therefore, there was a need to ensure that the only mechanisms that exist to solve the dispute cross-border will be strengthened and would work better and in a more transparent way.

Now, let's move to the two pillars because that's the point of Alberto. After the BEPS project, it was decided to set up the so-called Inclusive Framework on BEPS. Why? Well, first, because if you look at this chart, you'll see that there are lines in relation to Action 5, Action 6, Action 13, and Action 14. Why? Because these are so-called minimum standards, so standards that countries within the project committed to implement and also committed to be checked by other countries on whether they had effectively done what they were supposed to do. And in order to engineer this process where, you know, you say, okay, it's true, I will amend my pattern box legislation in order to make it compliant. But then who checks that? And these checks were done at the level of this new body, the Inclusive Framework on BEPS, which in a way is parallel, but also together with the structure of the working parties that we have seen. So, the inclusive

framework now is a sort of super committee of fiscal affairs. And then there are certain parts of the Committee on Fiscal Affairs that are still carried out only for the members. But in effect, the entire infrastructure is an infrastructure where all countries are on an equal footing, on an equal footing meaning that if they object, the decision is not taken. If they have to contribute financially to the work because obviously you have to pay for the Secretariat, you have to pay for the expense. So, they are really on an equal footing even though they are not members of the OECD. And at the moment, I think there are around 140 countries that are members of the Inclusive Framework on BEPS. The other thing that the Inclusive Framework on BEPS had to do was to continue to carry out the work that had not been finalized within the BEPS project. And one of these items was actually the one on addressing the tax challenges of the digital economy. When the Biden administration came in, they fundamentally made the link between the work on the taxation of the digital economy and the work on the so-called Global Minimum Tax. And they said, we will agree on what is done in relation to the taxation of the digital economy if everyone agrees to do the Global Minimum Tax. So, they sort of created the political dynamic according to which these two pillars, as they're called today, were politically linked, and that's how the work continued. And that's how the work then resulted in what we have today as the Global Minimum Tax as regards pillar two, and the so-called multilateral convention as regards pillar one. The difficulty is that the multilateral convention needs to be signed by countries and needs to be ratified by national parliaments. And the US Congress has been extremely clear that they will never do that. So that's where we are today. At the same time, Europe, and a number of other countries said, okay, but let's start with the minimum tax and let's do it. And in fact, within the EU the decision was blocked for almost one year by Hungary because Hungary said, we're not going to do the minimum tax unless there is also pillar one. But then, at the end, there was a political agreement which related to the recovery plan of Hungary, and Hungary decided to agree and so we have a directive in the EU on the minimum tax, and actually we are implementing it these days in most jurisdictions including the one where we are now.

[Prof. Marino]

Raffaele, may I ask you a question. What is the inclusive framework? And what is the, I would say, legal qualification of the inclusive framework of the OECD versus the European Union versus the United Nations. How do we identify the inclusive framework within the international tax chess?

[Prof. Russo]

There is no answer. Well, the best possible answer is that it is a group of countries that is larger than the OECD, it's about 140, it's almost the entire

world. It is in technical terms of part two program of the OECD. So, it's a program of the OECD where also nonmember countries can be part of and can sit in there on an equal footing with member countries. But it does not have legal personality, it's not an international organization by itself. It remains a group of public officials, but in a way, it's also the consequence of our times because it's the same, the exactly the same issue arises with regards to the G20. What is the G20? What is the legal value of a G20 declaration? No, but it is very influential.

[Prof. Marino]

This is true, but for the G20 I can assume that in any case it is just a combination of the most powerful countries, while 140 countries is a number that is closer, for example, to the United Nation. So, the question is why the inclusive framework has not grown within the United Nations.

[Prof. Russo]

Well, that's what we will discuss tomorrow. But fundamentally because people at the OECD are better, no, I'm joking. I'm joking but I'm not joking, it's true. I fundamentally believe that for three reasons. First, because there are many more people in the OECD Secretariat than in the UN Secretariat on tax matters. Second, because different from many other international organizations, including the EU, the Commission, the selection process is very target. Now why if you want to work for the commission, you do a general application and then you may end up doing agriculture, taxation, competition, and sometimes you also have to rotate. Within the OECD, you usually hire people that have tax expertise, competition expertise and work on that field. And when I started in 2007, within the Secretariat, we were 25 people. Today, there are about 200 people. We were working in an apartment in Paris, in a small apartment in a residential building close to the OECD. And we 20 of us and then, because you know, we launched a number of new projects, we put forward new proposals and new ideas, we got more funding, and we are in more people. We got more funding and we are more people, we are more people and we launch new projects. All these projects take time, take resources, you have people that think about that, think about the design, think about the government, think about the content of the rules.

[Prof. Marino]

Raffaele is just describing the future by looking at the past because when he was saying that the OECD is growing from the ashes of the OEEC monitoring the Marshall Plan transformed into a better organization, it is exactly what is happening now. We are affecting the base through a number of people for something other than the OECD itself. And we have a question mark on how

to name each other. Today is the inclusive framework, who knows what is coming after the inclusive framework.

[Prof. Russo]

We focus a lot on this tomorrow, but you have the inclusive framework for BEPS, but now you also have the inclusive framework on carbon pricing. You also have the Global Forum on Transfer Pricing and Exchange of Information. And these are all similar in terms of the legal nature. So, they effectively, they are not an international organization. But the rules of functioning are those of the OECD, they are served by the OECD Secretariat. But all member countries are on an equal footing and that also means that people from Brazil can now apply to work for the ICT Secretariat if the work is related to the work of the inclusive framework. So, there is this, if you want the enlargement, and again, you know, 10 years ago when we started this, I was always fully convinced and I'm still fully convinced. There were people that said, no, we shouldn't do that, you know, we should be only among ourselves, you know, Western countries with similar mindset, we shouldn't open up because otherwise we will not be able to agree on anything and we ended up like the UN. Because this is also the other legitimate question. Yes, certainly, the UN is very representative, but can you tell me what's the most relevant thing that they have done in the last five years? It's a question mark. So, there is this balance between being inclusive but also getting things done. Because the world moves on in an era where, by the time you have identified the problem, the problem has already changed, by the time you have identified the solution you have another problem, by the time the solution is implemented you have another problem. That's what we're seeing today. When we started on the digital economy, artificial intelligence didn't exist, the Metaverse didn't exist. So, you know, assume this case, you have a provision in the treaty that says that if you do work on an oil rig in the territorial waters of the country for more than two weeks, that is deemed to be a permanent establishment. There are provisions like that in treaties. So, you have a problem on an oil rig, you take the engineer, you send him in business class to the country, go to the hotel, go to the rig, do all the work there for two three weeks, solve the problem, get paid a lot of money and then go home. And in that case, taxation in that country because the treaty so allowed. Nowadays, that engineer to put the fancy suit and you just have a robot on the oil rig that basically does the same thing that the person is doing in Italy or in France. Who is going to tax that? So, you see we cannot tell the word, well, wait because we need time to decide. The world goes on, technological developments happen every day. And that's the difficulty we all face and if you're doing this course because one day you want to go into policy, this is probably the most important thing to focus on. What is the trick if you want? Well, to try to look ahead and identify problems before they are problems, build solutions and then once the problem

arrives and all the politicians say what should we do, that's what you should do and guarantee that they will take it. That was BEPS with the aggressive tax plan.

[Student]

So you have 140 countries in tax inclusive framework agreement and 193 countries in UN organization. Now what I understand is that other than being representative of the higher number of countries, what matters for you is the quantity of tax experts that can be appointed in one rather than another organization, that matters in the end in order to drive a tax policy worldwide, is this correct?

[Prof. Russo]

So, the question is so for you it is all about money and depending on how many people either the OECD or the UN can hire, one or the other would win. I would say it's an oversimplification, but fundamentally yes. You know, you always need money to do things in the world in which we live. But certainly, one of the things that, maybe Prof. Marino can ask to Michael Lennard on Friday, because we will have the chair of the Secretariat of the UN Tax Committee with us on Friday. They have always been complaining about the fact that they don't have enough resources.

So now the sound is better, we can move on. So where were we? We were talking about the UN, OECD, the different legal frameworks, the different bodies that exist. But that's more for tomorrow. Today, I wanted to focus more on the content and show you what has been done by the OECD, and what has been done by the UN. So, the UN now, certainly the Model Tax Convention, which I told you has a different legal nature compared to the OECD Model Tax Convention, at least in my view. And also, this model is now being updated more frequently, and what I would like to do between now and the end of the presentation is just to look at the two models and see what are the main differences and see what is the impact of these differences on a number of real life cases. But before doing that, let me tell you that the UN has also developed a manual for negotiation of double tax treaties which is not model rules and interpretation, but it's more like a guidance on how to do negotiations and what issues to take into account when negotiating with another country. And they have also done the practical manual on transfer pricing which is, in many different instances, different from the OECD transfer pricing guideline. So, we have already been confronted since 2013 with the coexistence of different pieces of guidance in relation to the same standard, which is the arm's length principle. And this is not something that makes life easy for those that work in practice, both from the perspective of the tax administration and from the perspective of taxpayers. But now let's go to the content of the two treaty models.

What are the main differences, definition of permanent establishment, attribution of profits to a permanent establishment, the taxation of so-called passive income, the taxation of services, the taxation of independent personal services, and the taxation of all the other items of income that are not covered by other provisions of the treaty. Now, what does this mean in practice? Take this for example, definition of permanent establishment. The UN model says you have a permanent establishment if you have a building site or construction or installation project that lasts more than six months in my country. If you look at the OECD model, the OECD model says you have a PE if the construction site, building site, installation project *etc.* lasts more than 12 months. So, if you have a construction project that lasts, say, nine months, if the treaty is based on the OECD model, the only country that will be able to tax the profits derived from that activity is the country of residence, because there is no permanent establishment in the other country, and therefore the income shall be taxable only in the resident state. But if the treaty instead follows the UN model, the source country, the country where the building site or construction project is, will be able to tax it, and the resident country will either exempt the income or will tax it but giving a credit for the tax that has been paid in the source state. So, you see that, from the perspective of the taxpayer, particularly if the rates and the basis are similar, there is not such a big change. But from the perspective of the countries concerned, in one case you pay to the residence country, in the other case you pay to the source country. And this, in relation to the UN model, is the usual situation. So, the UN model tends to grant more taxing rights to the source state than what the OECD model does. But as I told you, I think yesterday, if you look, for example, at treaties concluded by New Zealand, you will see that they depart from the OECD model in many instances and seek to additional source taxation. So, the point is not the model, the point is your capacity to negotiate the introduction of these provisions into the treaty. Because as, is there anyone from Argentina? But it takes two for a tango, you cannot conclude a treaty with yourself, like because I want to tax it so I'll put construction site PE after three months, but you need the other country to agree. And that's usually a negotiation that is also affected by wider economic implications. Maybe, you know, the resident country has a large company based in its jurisdiction that does one a very large contract in the other jurisdiction to build a dike to produce electricity, and that enterprise goes to the government and says, why don't you conclude the treaty with the other country? And then the government goes to foreign affairs and says, can you start contact with the ambassador of the other country because we would like to conclude a treaty. And then they have a meeting, they start with each other's model, and they start to negotiate.

The other big difference, look at it, this is fantastic. I would like to have your interpretation of this provision because this is another provision that it's creating a lot of tensions. Why it's creating a lot of tensions? Because the UN has

put out certain documents according to which a certain interpretation of the UN provisions is possible. Now, it's about the taxation of services. So, services in general terms under the OECD model fall within the concept of business profits, which means that they are taxable in the source state only if they are attributable to a permanent establishment. So, the permanent establishment, you can take it as a threshold. Once you pass that threshold, you pay taxes in the other country. And there was not a single provision on services in the OECD model until a provision was inserted, not in the model, but in the commentary as an alternative provision. In the commentary, it was inserted an alternative provision, because, again, a number of OECD countries wanted to include a service fee provision. New Zealand and Australia are some of the countries that regularly include the provision in their treaties, but there was also a feeling that the drafting of the UN model was a bit clumsy. And therefore, you see the provisions on services, permanent establishment in the OECD model commentary as an alternative for countries that would like to use it. Now, look at the UN model, look at this provision, please read it carefully for one minute and then I will tell you the case and you tell me which country should tax. All of you, because I will ask you to raise your hand. So don't get distracted now, you can get distracted later or before but not now. The furnishing of services including consultancy services by an enterprise through employees or other personnel engaged by the enterprise for such purpose constitutes a permanent establishment, but only if such activities continue within a contracting state for a period or periods aggregate in more than 183 days in any 12-month period. So, if these conditions are met, there is a service permanent establishment in the source state and the source state is allowed to tax the profits that are attributable to this permanent establishment. Now, let's assume that Alberto is working for a company resident in state A, or let's say state S, and I am a company resident in state R. And Alberto says, Raffaele, I need you to review all my tax control framework, to take a topic that is near to Prof. Marino, and provide me with your advice on that. I say, Alberto, fine, I can do that, I will do that from state R and it will take eight months. Okay, we signed the contract. How much do you want to pay me? 1 million. I worked for eight months, and I then sent them my paper on what they should do on the tax control framework, which got me paid 1 million. Let's say my expenses are 300,000 so I make a profit of 700,000. Who should tax this 700,000? Country S or country R? Who thinks that under the rule it should be country S? No one. Who thinks that it should be country R? So, the majority, and the others, they don't know. You don't know because you don't know or you don't know because you're lost? Because if you're lost, we repeat it, don't be shy. The information is the work lasts for more than 183 days in any 12-months period. I told you eight months and the work is entirely carried out in state R.

[Prof. Russo]

So, you are saying that because the rule says that the activities of that nature need to continue within state S, in this instance, as I am not in state S for more than 183 days, then state S cannot tax, it's 100% correct in my view. But there are countries that have been saying, wait a moment, it's written nowhere that you have to be present there for 183 days. It says that you have to be furnishing these services for 183 days, and because it lasted 8 months then in this case you have a permanent establishment in state S, and you should pay taxes there. It's completely crazy but that's what several countries were doing. And I can complicate because I can also add that maybe I went to state S for two weeks in total. But this is to give you an example of how, when you have competing standards, you may have competing interpretations, and I'm not sure that is a good thing.

No, state S taxes, then you get into the point of starting a mutual agreement procedure and hoping that the two countries will find a solution and shall resolve the double taxation by mutual agreement. And if they don't, and the treaty provides for arbitration as the new OECD model, you can submit the provision of arbitration.

In this case, yes, because to me it was very clear the intention of the drafters of this rule, which was, if you are present in this country for more than a certain period of time then you pay taxes.

The other difference between the OECD and the UN model is the so-called force of attraction. So, according to the OECD model, you can only tax the profits that are attributable to a permanent establishment. According to the UN model, this also extends to profits that are derived from sales in that country, in the country where there is a permanent establishment of goods or merchandise of the same or similar kind. So, assume that I. So, according to the UN model, there is the so-called force of attraction principle, which means that once you have a permanent establishment in a country, not only the profits that are attributable to that permanent establishment, but also the profits that are attributable to sales that are made directly from the head office of same or similar goods are attracted within the permanent destination. Imagine you have, where are you from? Denmark, assume you have a Lego, Lego as a shop in Cameroon where they sell the Lego bricks. That shop is no doubt a permanent establishment. The UN rule tells you that if Lego sells online directly to customers in Cameroon, the profits derived from the sales of the bricks online are attracted and therefore taxed at the level of the permanent establishment. Again, it's a way to enlarge the cake that the source country can eat. Passive income, this is where it is very visible because if you look at the OECD model, there is the possibility to tax at source dividends and the interest, but only up to a certain amount. Instead, if you look at the Article on royalties, it is stated in the OECD model that they can only be taxed in the resident state, so the

source state cannot tax at all. And that's where I say, you know, sometimes there are inconsistencies because then you look at the reservations on that part, effectively almost all OECD countries also want to tax royalties and so on. But the UN model provides for both dividends, interest, and properties the possibility to tax them at source without setting a limit and saying this is discussed bilaterally. Again, a way to enlarge source taxation. And this is the new one. So, the new one is these two new Articles that were included in the UN model. And in particular the first one, 12A is heavily based on the treaty practice of India. India has been taxing fees for technical services, Brazil has a lot of issues with fees for technical services. I just brought, how many pages was it again? 60-page opinion on the application of the treaty between Brazil and Argentina on fees for technical services, fascinating. But basically, under the UN model there is an additional provision that says I don't care about the service PE discussion that we had before furnishing service and present. When we are talking about technical services, they are taxable at source, anytime someone in my country is paying. And the rationale is different, the rationale is because the person in my country is paying, and therefore it's getting a deduction for that payment, I want to tax that payment at source. Now, it's a very legitimate position. I have always gone out saying you know, fine, if you find agreement with the other country, but at the same time you have to take into account the economic effects of something like this. Because what happens in this case, particularly if I know that Italy will not give me a credit or Italy will not exempt the income, is that I will tell the client, okay, fine, it was 1 million, now it's 1 million grossed up for the amount of tax that I have to pay in your country. Because for me, what matters is what I get into the pocket. The reasoning that has to be made in respect of the application of taxes at source on certain payments is the fact that this may increase the cost for the local taxpayers but doesn't mean that you cannot.

12B instead is revolutionary because it talks about automated digital services and within automated digital services there are a number of services, including cloud, cloud space. And the reasoning is the same, I don't care whether you are physically in my country or not, what I want to do is to tax something that is deductible at the level of the person that is paying it. This is relatively new, as far as I know, it's in the UN model but it's not in a single treaty. And here the competition is with the pillar one of the OECD because pillar one of the OECD does sort of, as we were saying, formulary apportionment of part of the profits of large multinationals, which is extremely complicated. And the UN said, look, the developing countries, we need to do something easy, let's just apply a withholding tax, maybe at a low rate, and off we go. And then you have people like me that says, forget about option one and option two, just do a digital service tax and move on. Someone is upset with what I'm saying.

Concluding remarks, which are more questions for you to reflect upon, and which link with what we will be discussing tomorrow, which goes back to the

more geopolitical side of things. But I wanted to do at least one presentation where we discuss a little bit of real-life issues. First of all, what is in your view a developing country? Can anyone give me a definition of a developing country?

[Student]
Ukraine.

[Prof. Russo]
Ukraine is a developing country, why?
So, you see the word developing as improving, but many countries, I would say, are improving, even the United States is improving its IP skills on chips, on cloud computing, so I'm trying to look for criteria.

[Student]
Non-industrialized countries.

[Prof. Russo]
Non-industrialized, so a country that lives on agriculture.

[Student]
Low human developing index.

[Prof. Russo]
Low human developing index. Okay let me rephrase the question. I think there is no definition. You can look at, you know, the definition of GDP per capita, you can look at the definition, you can look at the numbers regarding education, regarding unemployment. But if I ask you, who are you from? Brazil. Is Brazil a developing country? You think it is? So, you see, she thinks Brazil is a developing country. When I was in Brazil and there were elections, I thought how long do we take in order to get to the results of the election? 24, 48 hours? In Brazil 5 minutes. But that's not really what you would expect from a developing country. Do you know how long it takes to download the cargo in Brazil at customs? 0 seconds because it's done online with an online scan. What I'm trying to tell you is that I think very often, the word and the concept of developing country is used and abused in order to support certain points of view, and to me there is a question about least developed countries and for me it's the countries that don't even have electricity in the tax administration that have to work with the generator. And there are countries like that, but beyond this notion of developing countries, you have countries like Brazil, like China, like India, that in my view, are all but developing countries in this sense. What are the concerns? Well, the concerns of the least developed country that I was mentioning before is probably to have electricity. The concern of a country

like India, like China, like Brazil, like transition economies, is probably different than having electricity. The concerns of countries in Western Europe that we call developed, but frankly if you come to some areas of the south where I am, I don't think they are more developed than several areas in other developing countries or transition economies. So, to me, this is a fake debate and I think rather than using labels developed and developing, because this is what you see and what you will hear tomorrow, OECD, the rich countries club, the developed countries that want to impose their views on the poor developing countries. Developing countries, we want to have a voice, we want to say something. Do you think that when China is negotiating a treaty with Peru or with Cameroon or with Egypt, they are acting as they are both developing countries? Not sure.

If you look at the debate today and we will talk about this tomorrow, it's polarized, developed, developing. And what I'm saying is these categories don't mean much in reality. Because within the so-called developed economies, you have many countries that need support in terms of their tax administration, in terms of their capacities, their skills, their IT. And within the developing countries you have countries that have very different needs among themselves. And if we don't, it's the Einstein thing, if we don't identify well the problem we can't identify well the solution. And what I see is that we're not identifying well the problem, we're just going into something. Are there developing countries in the OECD? What do you think? Is Turkey a developing country? Is Poland a developing country? Again, it depends on what is your definition. But at the end of the day, the questions that are in front of us are the last two, who should develop global standards? And should there be global standards or different global standards depending, for example, on the level of development of the country concerned? This is the topic of today, this is what is on the table because of what has been happening at the UN and the resolution that was approved on the 22nd of November, and that's what we will be discussing tomorrow, the geopolitics and what will happen in the near future. So, for today, thank you very much also for those that are screaming into the mic, and we see each other tomorrow at the same time.

[Prof. Marino]

We wait for you tomorrow.

[Prof. Russo]

Thank you very much.