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Paradigm Shift: International Taxation's Move from Double Taxation Remedies to the Battle Against Aggressive Tax Planning

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Abstract: The globalization of the economy has sparked a tax competition among nations, leveraging low tax rates to attract investments and inadvertently fostering international tax avoidance and transfer pricing. This dynamic, intensified by the digital economy's ascent, has inflicted economic losses on both resident and source countries. The conventional "permanent establishment" criterion, now rendered obsolete by online business operations, facilitates tax evasion by international corporations. Recognizing the urgency for change, the international tax system has shifted focus from eliminating double taxation to confronting aggressive tax planning. This essay critically analyzes this paradigm shift, primarily emphasizing the move from preventing double taxation to avoiding double non-taxation. Two pivotal considerations drive this transformation: equitable sharing of benefits from multinational corporations among involved countries and collaborative efforts to prevent dual taxation. Delving into Tax Challenges Arising from the Digitalization of the Economy, including Global Anti-Base Erosion Model Rules (Pillar Two) and the OECD/G20 Inclusive Framework on BEPS, the essay examines causes and consequences of double taxation and scrutinizes reasons and repercussions of double non-taxation resulting from aggressive planning. The analysis unveils the main elements and impacts of the international tax system reform, shedding light on both its strengths and shortcomings. This essay provides a concise yet comprehensive understanding of the evolving global economic landscape and the imperative changes in international taxation, offering insights into the critical nuances of the reformed framework.

Keywords: Double Taxation, Against Aggressive Tax Planning, Tax Competition

1. Introduction

Due to the globalization of the economy, countries compete in taxation to their advantage by introducing low tax rates to attract investment, which has led to international tax avoidance, transfer pricing, and other practices. This has resulted in losses for both the resident and the source countries. The rise of the digital economy has aggravated these issues in recent years. The traditional tax control criterion of a "permanent establishment" is no longer relevant as enterprises relocate their production activities online. This has made it simpler for international corporations to avoid paying taxes. As a result, reforming the international tax system is critical. The essential issue of international taxation is the allocation of taxes between countries and the coordination of taxes between countries. There are two main considerations. The first one is that the countries involved should fairly share the benefits derived from Multinational corporations. The second one is that countries should collaborate to avoid double taxation of the same firm. In the past few years, the international tax system has evolved dramatically, with the primary focus shifting from eliminating double taxation to combating aggressive tax planning. The reform is mainly about Tax Challenges Arising from the Digitalization of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) and OECD/G20 Inclusive Framework on BEPS. This means a shift in emphasis in the international tax system from avoiding double taxation to avoiding double non-taxation. This phenomenon has significant implications for the global economy's development. This change will be analyzed critically in this essay. This essay will analyze the International Tax Reform from the perspective of double taxation and double no-taxation. Firstly, it will analyze the causes of double taxation, the consequences of avoiding double taxation. Furthermore, this essay will discuss the reasons and consequences of the double no-taxation caused by aggressive tax planning. Finally, the paper will analyze the main elements and impacts of the reform of the international tax system, as well as the shortcomings.

2. How Double Taxations Work

When two or more countries impose the same or comparable taxes on the same taxpayer or the same object of taxation on different taxpayers, this is called double taxation [1]. There is an overlap between the territorial jurisdictions of the two nations or between the resident jurisdictions when the same income is considered to be originated in both countries or when the same taxpayer is determined to be resident in both countries. This is a cross-over of the same tax jurisdiction in both nations, and is mainly the result of conflicting principles of source or resident of the country involved. As a result, in order to avoid double taxation caused by overlapping tax jurisdictions of the same kind in two countries, the international community has imposed certain restrictions on each country's tax jurisdictions, preventing two countries from exercising both resident and territorial rule over the same resident or the same income of domestic source under their respective tax laws.

3. The Effect of Double Taxations

Double taxation has a few negative effects for the international tax system. Firstly, double taxation is against the principle of tax equity and tax neutrality. An essential function of taxation is to adjust income distribution and make society more equitable [2]. Furthermore, double taxation limits the development of international trade to some extent. Double taxation is likely to increase the tax burden on investors, who will likely cancel their overseas investment plans and choose to increase domestic investments to save money, which will have a negative impact on transboundary movement of funds. Finally, international double taxation has a negative effect on balance of the various interests between countries. Because nations focus on their own interests and attempt to maximize their own benefits. International double taxation can lead to conflicts of taxation rights and interests between countries, which maybe affect economic cooperation relations between countries and cause serious constraints on the normal development of international relations [3]. In conclusion, the introduction of measures and tax treaties by countries and international organizations to address double taxation was the key to the old international tax system.

4. The Methods of Avoid Double Taxation

The main approach to solving double taxation can be summarized as countries with resident jurisdiction recognize the source country's priority tax position and use their taxing authority to reduce or avoid double taxation [3]. The current solutions to avoid double taxation is both bilateral and unilateral. The unilateral approach means a country states in its tax law measures to reduce double

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taxation [3]. The unilateral approach means that two or more countries have entered into an agreement to avoid double taxation.

5. Problems of The Methods of Avoiding Double Taxation

The methods of double taxation reduction used by national tax laws and international tax treaties are deduction method, credit method, exemption methods and foreign tax as cost. However, these methods could reduce double taxation to a certain extent but could not remove it completely. Deduction method, for example, this method means that "the residence country allows its taxpayers to claim a deduction in computing income for taxes, including income taxes, paid to a foreign government in respect of foreign source income [1]." Although this method significantly removes double taxation, it is not helpful to national multinationals' overseas investments, particularly those from high-tax nations. It seems that multinational corporations will transfer their permanent establishment to low-tax nations in order to increase their profits. This will not only result in a loss of funds from high-tax countries, but multinational corporations may be able to avoid double taxation through aggressive tax planning.

6. International Tax Treaty

In terms of preventing double taxation, since both source and resident countries can tax the same income, a lack of coordination may result in such income being overtaxed for cross-border taxpayers, leading to a reduction in cross-border trade and investment and, ultimately, a reduction in the global economy. Under normal circumstances, the country's tax policies will not be inherently detrimental [4]. However, when governments' tax policies are no coordinated with each other then it may be damaging. Generally, signing an agreement on the allocation of taxation rights, such as a tax treaty, is a solution to this problem. The OECD Model [5] and the UN Model [6] are the most used models for tax treaties internationally. However, multinational companies may use tax treaties for double non-taxation purposes through aggressive tax planning.

The reasons why tax treaties lead to double non-taxation are as follows. Firstly, under the paradigm and principles of the OECD Model, there is a preference for resident tax jurisdiction in the allocation of taxing rights [7]. It may be that a taxpayer is a resident of a country which has an exclusive right to tax under an agreement, but the domestic law of that country excludes the income from taxation, resulting in the taxpayer's income not being taxed in both the source and resident countries [8]. In addition, certain tax treaties allow resident countries to use tax exemptions to avoid double taxation, meaning that a resident taxpayer's income derived from the source country is not taxed in the resident country. However, if the source country's domestic law states that the income is not taxable, the result would be double non-taxation. It is clear that the above two types of double non-taxation result from the design of the framework of tax treaties, the allocation of tax rights and the tax exemption laws. However, this double non-taxation effect has led a number of taxpayers to engage aggressive tax planning. They use differences between domestic laws and international tax treaties to obtain tax advantages that would not be available to them otherwise.

Secondly, many tax treaties are no longer adapted to the current economic development. With the developments of technology and the emergence of new economic types, such as cross-border e-commerce, new issues appear that are not explicitly regulated by tax treaties [9]. For example, the global growth of the digital economy can lead to base erosion and profit shifting (BEPS), which can be damaging to the tax benefits of some countries, especially developing countries. According to the UN Model and the OCED Model and as examples, if the non-resident enterprise does not constitute a permanent establishment in the source country, the resident country should have the exclusive right

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to taxation [10]. But with cross-border e-commerce it is possible to avoid tax by not setting up a PE in the source country by using internet technology.

Finally, tax treaties offer many benefits to multinational companies and some multinational companies engage in aggressive tax planning through tax treaties for their own benefit. Transfer pricing is one method often used by multinational companies. Multinational companies achieve international transportation of funds, organize tax avoidance and protect the overall interests of the company by applying prices used to provide products, services or technology between parent and subsidiary companies and between branches within the multinational company [11]. Clearly, this is a method used by multinational companies to achieve aggressive tax planning by using tax treaties that result in double non-taxation.

7. Double Non-taxation

Double non-taxation, like double taxation, is a cross-border taxpayer and cross-border income-related international tax phenomenon. And the taxpayers often achieve double non-taxation by aggressive tax planning. Aggressive tax planning is an arrangement by which a taxpayer reduces his tax liability in a way that may be legal but contradicts the intent of the law [12]. ATP take advantage of gaps in the tax system and the mismatch between tax systems leading to double non-taxation [12]. Consequently, measures to prevent double non-taxation are the same as essential as those to avoid double taxation.

7.1. What causes double non-taxation

There are two main reasons for double non-taxation. The first is international tax competition. The second is the multinational companies using the weakness of tax treatise under the rise of digitalization. Firstly, countries seek to attract investment through tax calculation, which means that government tax calculation leads to tax avoidance by taxpayers [13]. This is because if all countries and regions tax the same tax, it is difficult for taxpayers to avoid tax through the cross-border movement of people or finances. Due to the differences in taxation between countries, some with high tax rates and others with very low tax rates, or even countries and territories that do not imposes income tax at all, this allows taxpayers to avoid tax by shifting their income from a high tax country to a low tax country. This is a way of aggressive tax planning, and it leads to double non-taxation. Furthermore, at the national level, competition in the taxation field is intensifying, as income tax and transfer tax rates decline, and countries compete to increase tax exemptions or establish low tax zones or even tax-free zones [14]. Some countries even impose vicious tax competition policies in order to seize tax sources, particularly the more flexible tax sources. Some governments have also provided varied degrees of concessions and compromises to cross-border companies income shifting, which assists taxpayer tax avoidance. With international tax competition, it makes it harder for countries to freely choose the tax policy that is most advantageous to their economic development [15]. Such unreasonable international tax competition may reduce countries' tax bases and damage national taxation authority. If all countries participate in tax reduction competition without restraint, highly adaptable economic activities may disappear from the tax base of each country in the future. This will result in the erosion of the worldwide tax base, which in turn will weaken the global fiscal function, making it difficult for countries to meet their public needs and eroding national tax sovereignty.

With the development of cross-border e-commerce, it is easier for these multinational companies to achieve tax avoidance. As described earlier under the template of an international tax treaty, if the non-resident enterprise does not constitute a permanent establishment in the source country, the resident country should have the exclusive right to taxation. In a traditional cross-border trade situation, company A from country A will establish a branch in country B and conduct business

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transactions with consumers there. As a result of the PE, the tax authorities in country B are authorised to tax the income of company A from its commercial transactions in country B. However, developments in information and telecommunications technology, particularly the internet, have made it possible for company A to deal with consumers in country B in a way that does not involve a permanent establishment. In the case of Netflix, Netflix did not have a PE in the UK. Netflix would not have accounted for the revenue it received from subscriptions through its local subsidiary [16]. When the company started selling subscriptions in the UK in 2012, it did so through a Luxembourg company, Netflix Luxembourg [16]. Netflix Luxembourg, which did not have any customers in Luxembourg when it was set up at the end of 2011, published its accounts in pounds sterling [16]. By exploiting this loophole, Netflix was able to avoid tax.

8. International Tax Reform

As stated before, the previous international tax system's main target was to reduce double taxation, but taxpayers could take advantage of its shortcomings through aggressive tax planning to achieve double non-taxation. The OECD has released 15 action items to address the main areas where they believe companies are most active in achieving such profit transfers - addressing the digital economy, treaty abuse, transfer pricing issues [17]. Firstly, in order to solve the problems of the digital economy and to prevent artificial avoidance of PE, BEPS (2015) has expanded the definition of PE and some institutions that were previously not part of PE are now defined as PE [18]. ln addition, the OECD recommends that countries include a more general anti-abuse rule in their tax treaties in order to address other tax treaty abuses [18]. OECD has recognized the limitations of traditional anti-abuse tax treaty rules and is actively attempting to adopt the limitation of interest clauses developed by the United States. BEPS recommends that limitation of interest clauses be incorporated into the OECD Model in the future and has prepared a draught text and related annotations for the incorporation of limitation of interest clauses into the OECD Model Tax Treaty [18]. These measures are intended to avoid aggressive tax planning by taxpayers through the abuse of tax treaties.

This international tax system reform also includes a two-pillar model, and it has two pillars. Pillar one is to ensure a more equitable distribution of profits and taxation rights between countries in relation to multinational companies. Even if a multinational corporation does not have a permanent establishment or a fixed place of business in a country, that country has the right to participate in the profit distribution and apply tax authority [19]. This means that the basic rule of identifying whether a country can participate in the distribution of profits as the rule to exercise tax jurisdiction by the presence or absence of a permanent institutional body has changed. It becomes a method to redistribute tax authority and profit-sharing rights between countries in terms of where value is created. Pillar II limits tax competition between countries by imposing a global minimal tax rate, which establishes a tax competition floor [19]. This means that if the actual tax rate of a multinational enterprise in the source country does not meet the minimum tax requirement, it will be back-taxed in its residence country. If this policy can be effectively implemented, global tax revenue will increase annually. However,the main weakness with this method is that the Pillar II program focuses on developed countries' interests. Pillar II is derived from the US Global Intangible GILTI and BEAT (Base Erosion and Anti-Abuse Tax) regime, specifically GILTI, which serves a similar purpose [20]. So to a certain extent the system may ignore the interests of developing countries

This international tax reform will impact the fundamental principles of international taxation for over a century. In some ways, it builds an international tax law for the digital economy, which will have long-lasting effects on the international tax allocation landscape and multilateral governance of taxation. In the short terms, this will have new consequences. Affected by the COVID-19, countries must urgently increase revenue to restore their budgets, and the tax increase will be likely to assist countries in accelerating economic development. Second, this international tax reforms changes the trend of the previous year, which was dominated by tax cuts, resulting in a greater tax burden for businesses, particularly large corporations. However, there are no detailed proposals for implementing these systems. There are no clear answers to the issues of what would be in the unilateral interest of nations and what each nation would gain from cooperation. These deficiencies must be remedied at a later date through application rules.

9. Conclusion

A key principle of international tax law is the principle of single taxation, which seeks to eliminate both double taxation and double non-taxation. Unfortunately, for the last hundred years many governments and multinational corporations have fought against double taxation but have ignored the dangers of double non-taxation. Since the main barrier to international trade and investment is double taxation, the theme of traditional international tax law has been the remove of double non-taxation. But the overkill of double non-taxation has followed. With the development of the digital economy and the intensification of tax competition between countries, double non-taxation caused by over-aggressive tax planning is currently the focus of tax system reform. After several years of revision, an international system to prevent double non-taxation has been developed, but it will take a long time to improve this system due to the lack of practice.

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