Allocation of Rights to Tax Active Business Income and Inter-Nation Equity (INE)
An analysis from the Perspective of the BICs (Brazil, India, and China)
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Existing framework for allocation of taxing rights between countries

- OECD Model Tax Convention (OECD Model) – Allocates greater taxing rights to home countries.
- UN Model Tax Convention (UN Model) – Seeks to achieve a compromise between host and home country taxing rights by allocating comparatively greater taxing rights to the host countries.
- Network of more than 3000 bilateral tax treaties based on these Models.

The Question - Does this framework represent a ‘fair’ allocation of taxing rights between countries?

Existing Understanding in International Taxation Law Literature

- Existing concept of fairness in the allocation of taxing rights - ‘Inter-Nation Equity’ – International taxation law literature relates INE to the scope of the host country's right to tax.
- Covers only fairness in outcome. No mention of fairness in the process of formulation and development of the rules for allocation of taxing rights and how that may influence these rules.

Understanding of fairness outside International Taxation Law Literature

Fairness in process
Fairness in outcome
Participation in the rule-making process
Effectiveness of participation

Fairness in the process of formulation of the existing rules for allocation of taxing rights between countries and their continuing development

Formulation of rules
Fiscal Committee of the League of Nations
Drafting of the OECD Model
Drafting of the UN Model

Participation of the BIC Countries
No involvement in drafting of the LONs’ Model Conventions. Limited presence at different times in the process of approving them.
No participation when the Model was drafted. In 1997 positions of non-members were added. Now China and India regular Observers on Committee on Fiscal Affairs. Full participation under discussion.
Representatives from India and Brazil involved in drafting of the UN Model. China (and also Russia) involved since 1980.

Effectiveness of participation
Mexico Model? – Key differences between the Mexico Model and the League’s final London Model.
Further entrenchment of a position favouring home countries. Recent developments at the OECD level and prospects for the future – BEPS and beyond.
Recent developments in the UN Tax Committee – Indications of a strong BIC influence?

Fairness in the outcome or the rules themselves

The OECD Model and the UN Model’s scheme for allocation of rights to tax active business income

Step I
Determination of the right to tax active business income

Step II
Apportionment of profits between countries

Findings
BICs’ changing notion of when can a host country tax – Taxing not only on the basis of being the place where the income producing activity takes place but also the place of demand or consumption.
BICs’ changing notion of ‘how much’ of a non-resident’s profits can a host country tax – Diverging from the existing transfer pricing rules for reasons such as seeking recognition of the unique value added by these countries.

Working towards a solution

- Facilitating BICs’ effective participation in the process of development of the rules for allocation of taxing rights.
- ‘Parameter-based approach’ to fairness in division of taxing rights - Recognising countries' role in the income generated by cross-border activities of INE. Countries to check double taxation and to ensure certainty and stability in their tax policies. Improvement over the existing concept of INE that revolves around the scope of the source country’s right to tax, which this thesis establishes is a part of the concerns in relation to a fair division of rights to tax active business income.
- Analysis of the proposed alternatives for their ability to advance such a notion of fairness.
- The larger question – What does this mean for the other developing countries? – Could an alternative assessed on such an approach lead to a fairer framework for allocation of taxing rights from the perspective of other developing countries as well.