Globalization and Its Tax Discontents

Tax Policy and International Investments

ESSAYS IN HONOUR OF ALEX EASSON

Edited by Arthur J. Cockfield

UNIVERSITY OF TORONTO PRESS
Toronto Buffalo London
Preface xiii

PART I: DESIGNING TAX RULES FOR FOREIGN DIRECT INVESTMENT

1 Introduction: The Last Battleground of Globalization 3
ARTHUR J. COCKFIELD

1.0 The Battle for International Investments 3
2.0 The Increasing Sensitivity of Cross-border Investment to Tax 5
3.0 The Need for Diverse Scholarly Tools to Address Policy Concerns 7
4.0 Outline of the Book 9
   4.1 Designing Tax Rules for FDI 9
   4.2 The Impact of Globalization 10
   4.3 The Impact of Tax Treaties 12
   4.4 Taxing Cross-border Services and Service Providers 13

2 Taxing Foreign Direct Investment in a Non-cooperative Setting:
Contributions by Alex Easson 18
ARTHUR J. COCKFIELD

1.0 Introduction 18
2.0 Policy Implications of a Non-cooperative Setting 19
   2.1 Evaluating Tax Reform Proposals Given Existing Political Constraints 19
2.2 How Should Rules Promote Neutral Tax Treatment of Cross-border Investments? 20

3.0 Designing Tax Incentives in a Non-cooperative Setting 23
  3.1 Tax Incentives and FDI: Theoretical and Pragmatic Considerations 23
  3.2 Targeting and Designing Tax Incentives 25

4.0 Collective Action Responses 28
  4.1 External Constraints on Tax Incentives 28
  4.2 Evaluating the Collective Action Responses 29

5.0 Conclusion 30

3 China’s Tax Incentive Regime for Foreign Direct Investment:
An Eassonian Analysis 35
ANDREW HALKYARD AND REN LINGHUI

1.0 Introduction 35
2.0 China’s Tax Incentives Prior to 2008 37
  2.1 The Origin of China’s Tax Incentive Regime: From the Early 1980s to 1991 37
  2.2 Tax Incentive for FDI under the FEITL from 1991 to 2007 38
3.0 The Tax Incentives Regime in the 2008 EIT Law 40
  3.1 The Law’s Major Changes 40
  3.2 The Effects of Changes to the Tax Incentive Regime on FDI in China 43
  3.3 Will the New Regime Help China to Attract and Retain the FDI It Wants? 44
    3.3.1 The Use of Tax Holidays 44
    3.3.2 A Reduced Enterprise Income Tax Rate 47
    3.3.3 Accelerated Depreciation 47
    3.3.4 Reinvestment Incentives 48
    3.3.5 Favourable Deduction Rules 48
  3.4 Summary 49
4.0 Conclusions 49

4 Outbound Direct Investment and the Sourcing of Interest Expense for Deductibility Purposes 60
TIM EDGAR

1.0 Introduction 60
2.0 Behavioural Margins Implicated by an Unrestricted Interest-Expense Deduction 62
3.0 National Welfare, Ownership Neutrality, and Interest Deductibility 64
4.0 The ‘Middle Ground’ Appeal of a Thin-Capitalization-Deductibility Restriction 69
5.0 Conclusion 75

5 Assessing the Foreign Direct Investment Response to Tax Reform and Tax Planning 84
W. STEVEN CLARK
1.0 Introduction 84
2.0 The Basic Approach to Assessing the FDI Response to Tax Reform 87
3.0 Cross-border Financing Developments 91
4.0 Cross-border AETR/METR Analysis: A Focus on Tax-Planning Effects 93
   4.1 Base Case Results 94
   4.2 Thin Capitalization of High-Taxed Subsidiaries 96
   4.3 Double-Dip Financing 98
   4.4 A Hybrid-Instrument Financing Structure 100
   4.5 A Triangular Financing Structure 101
   4.6 A Hybrid-Entity Financing Structure 104
5.0 Factoring Tax Planning into Assessments of the FDI Response to Tax Reform 106

PART II: THE IMPACT OF GLOBALIZATION

6 Improving Inter-nation Equity through Territorial Taxation and Tax Sparing 117
JINYAN LI
1.0 Introduction 117
2.0 Inter-nation Equity 118
   2.1 The Concept 118
   2.2 Tax Entitlement and the Allocation of the International Tax Base 119
   2.3 Inter-nation Redistribution 121
3.0 Why Should Equity Be Taken Seriously Now? 121
   3.1 Important Policy Criteria 122
   3.2 Equity as a Benchmark for Reducing International Tax Inequities 123
3.3 An Opportune Time 124

4.0 Tax Reforms towards Inter-nation Equity 125
  4.1 The Role of High-Income Countries 125
  4.2 Territorial Taxation of Business Income 126
  4.3 Tax Sparing as a Mechanism of International Redistribution 128

5.0 Conclusions 129

7 Harmonizing Corporate Income Taxes in the United States and the European Union: Legislative, Judicial, Soft-Law, and Cooperative Approaches 138
CHARLES E. MCLURE, JR

1.0 Introduction 138
2.0 Corporate Tax Harmonization in the EU 139
  2.1 Potential Means of Harmonization 139
  2.2 Prospects for Enhanced Cooperation 141
    2.2.1 Business Support 141
    2.2.2 Revenue and Other Effects 142
    2.2.3 The Dynamics of Enhanced Cooperation 144
3.0 Corporate Tax Harmonization in the United States 144
  3.1 Substantive Issues 145
  3.2 Means of Coordination 146
4.0 Summary Comparison and Commentary 147

8 Missing Women: Gender-Impact Analysis and International Taxation 153
KATHLEEN LAHEY

1.0 Finding Women in International and Tax Law 153
2.0 The Gender Impact of Overseas Development and Aid Programs 154
  2.1 Gender-Based Analysis in Development Programs 155
  2.2 Gender-Based Analysis in Private and Voluntary Development 156
3.0 Domestic Taxation of Outward FDI 157
  3.1 Domestic Tax Benefits for Outward FDI 158
  3.2 The Gender Impact of Taxation of Outward FDI 162
4.0 Developing-Country Taxation of Inward FDI 163
  4.1 Developing-Country Tax Benefits for Inward FDI 163
4.2 The Gender Impact of Tax Benefits for Inward FDI 164
5.0 Conclusions 165

9 Globalization and the Hong Kong Revenue Regime 171
RICHARD CULLEN AND ANTONIETTA WONG

1.0 Introduction 171
2.0 The Evolution of Hong Kong’s Political Structure 172
   2.1 Colonial Power within the British Empire 172
   2.2 The Crown Colony of Hong Kong 173
   2.3 The Governance Structure of the HKSAR 174
3.0 Revenue Regime Development in Hong Kong 174
   3.1 The Initial Phase 174
   3.2 Overview of the Current Revenue Regime 175
   3.3 The Fiscal Firewall 178
4.0 Conclusion 178

PART III: TAX TREATIES

10 Canada’s Evolving Tax Treaty Policy toward Low-Income Countries 189
KIM BROOKS

1.0 The Importance of Tax Treaty Design for Low-Income Countries 189
2.0 Alex Easson’s Assessment of Canada’s Tax Treaty Policies to 1988 192
3.0 Canada’s Tax Treaty Policy toward Low-Income Countries since 1988 195
   3.1 Expanding the Scope for Source Taxation of Business Income 195
      3.1.1 Lowering the Threshold for a Permanent Establishment 195
      3.1.2 Expanding the Profit Allocated to Entities with a Permanent Establishment 199
      3.1.3 Allowing for the Taxation of Technical Fees 200
      3.1.4 Allowing for Taxation on the Alienation of Real Property 200
   3.2 Permitting Higher Withholding Tax Rates for Passive Income 201
11 Tax Treaties and the Taxation of Non-residents' Capital Gains  212
RICHARD KREVER

1.0 Introduction  212
2.0 Why Land?  214
3.0 Gains and Capital Gains  217
   3.1 Sale of Real Estate Inventory  218
   3.2 Capital Gains that Are Not Business Profits of an Enterprise  221
4.0 Real Property  223
5.0 Interposed Entities  226
   5.1 Looking through Tiers  227
   5.2 Forms of Interposed Entities and Interest  228
   5.3 Measuring Gains on the Disposal of an Interest in an Interposed Entity  230
6.0 Applying Pre-capital Gains Treaties  231
7.0 Looking Forward  233

12 Tax Treaty Templates  239
VICTOR THURONYI

1.0 Introduction  239
2.0 Problems with the Current Tax Treaty Network  239
   2.1 Difficulty of Amendment  240
   2.2 The Role of Commentary  240
   2.3 Verbiage  240
3.0 A Possible Solution  241
   3.1 Restatement  241
      3.1.1 The General Approach  241
      3.1.2 An Example  243
      3.1.3 Participation  248
      3.1.4 Language  249
13 Tax Discrimination and Trade in Services: Should the Non-discrimination Article in the OECD Model Treaty Provide the Missing Link between Tax and Trade Agreements? 257

CATHERINE BROWN

1.0 Overview 257
1.1 Why Did This Happen? 257

2.0 Trade Agreements 259
2.1 The GATS 259
2.2 Most-Favoured-Nation Treatment 260
2.3 National Treatment 260

3.0 The Non-discrimination Article in the OECD Model 262

4.0 The Interaction of Tax and Trade Agreements: The Bottom Line 264
4.1 Legitimate Expectations 264
4.2 Differing Levels of Protection 264
4.3 Does the Matter Fall within the Scope of a Tax Treaty? 265
4.4 The Exception from the National Treatment Obligation in Article XIV(d) of the GATS 265
4.5 Other Direct Tax Measures that Might Violate the National Treatment Obligation 266
4.6 Circumventing Non-discrimination Obligations 267

5.0 Proposed Solution: Expand the Non-discrimination Article 267
5.1 Which Economic Actors? 268
5.2 What Is the Appropriate Standard of Treatment? 269
5.2.1 The GATS Standard 269
5.2.2 Fair and Equitable Treatment 269
5.2.3 The Treaty Establishing the European Community 270
5.2.4 A New Tax Treaty Standard 270
5.3 Dispute Resolution 271
5.4 Grandfathering Provisions 271
6.0 Other Reasons Not to Expand the Non-discrimination Article 272
7.0 Conclusions 272

14 The New Services Permanent Establishment Rule in the Canada-United States Tax Treaty 280
BRIAN J. ARNOLD

1.0 Introduction 280
2.0 The Services PE Rules in the United Nations and OECD Model Conventions 281
3.0 Article V(9) of the Fifth Protocol 283
3.1 General Comments 283
3.2 The Relationship between the Services PE rule and the Construction Site PE Provision 285
3.3 The Two Aspects of Article V(9) 286
3.3.1 Services Performed by a Single Individual: Article V(9)(a) 287
3.3.2 The Gross Revenue Test in Article V(9)(a) 290
3.3.3 Services Generally: Article V(9)(b) 293
4.0 Conclusion 298

15 Consumption Taxation of Cross-border Trade in Services in an Age of Globalization 305
WALTER HELLERSTEIN

1.0 Introduction 305
2.0 Taxation of Goods 307
3.0 Taxation of Services 308
3.1 The Problem 308
3.2 Approaches to the Problem 309
3.2.1 OECD E-Commerce Initiatives 309
3.2.2 The OECD’s International VAT/GST Guidelines 312
3.2.3 The EU’s Response to Increased Cross-border Trade in Services 316
4.0 Conclusion 318

Contributors 329
Index 331