Tax Neutral Jurisdictions Overview

November 2021

Tax Neutrality is a globally responsible tax model that is simple and transparent and efficiently supports the global free flow of investment capital and financing without posing tax harm to other countries' tax bases.

Importance of Global Cross-Border Economic Activities

Supporting cross-border economic activity between countries with similar or differing tax systems is essential to the economic success of developed and developing countries. The European Union recognises the importance of cross-border economic activity and has established oversight for national tax rules and policies to ensure the free flow of goods, services, and capital.

Double Taxation Poses a Significant Obstacle to Global Cross-Border Economic Activities

Tax conflict arises when the two countries involved in the cross-border activities both have domestic tax laws and rules that would result in the same income or profit being taxed twice, once in each country. This tax conflict is generally referred to as "Double Taxation" and is considered by the United Nations, OECD and others as a significant barrier to beneficial cross-border economic activity.

Easing of The Double Taxation Burden is a Goal of Most Nations' International Tax Policy

Double Taxation Treaties (or Double Taxation Agreements) and Tax Neutrality are important tax policy models for effectively addressing double taxation. Double Taxation Treaties are generally modelled under the United Nations Model Double Taxation Convention or the OECD Model Tax Convention.

The main objective of tax treaties is to seek to alleviate double taxation by allocating taxing rights between the two countries. In addition, tax treaties may also contain provisions for tax conflict mediation and sharing of tax information to address tax evasion and aggressive tax avoidance.

Almost all EU Member States pursue the benefits of easing of the double taxation burden through the use of Double Taxation Treaties. Some EU Member States have in excess of 70 double taxation agreements or treaties.

Concerns Regarding the Abuse of Double Taxation Treaties and Treaty Shopping

Double Taxation Treaties are by nature complex and less transparent, and therefore sometimes pose a risk of abuse for tax evasion or aggressive tax avoidance.

According to the European Commission, "some companies avoid taxes by 'treaty shopping' i.e. by setting up artificial structures to gain access to the most beneficial tax treatment under various tax agreements with other Member States or third countries." This practice is widespread enough that the EU has had to take measures to combat the abuse.

An IMF Working Paper ['The Cost and Benefits of Tax Treaties with Investment Hubs: Findings from Sub-Saharan Africa'] did "not find that the tax treaties increase Foreign Direct Investment (FDI) in the treaty partner countries. The study does indicate however that there are revenue losses in source countries after they have concluded a treaty with Mauritius and with investment hubs more generally."

These could indicate that concluding a tax treaty gives rise to rerouting of investment and income flows, and potentially increases incentives for base erosion and profit shifting, rather than increasing the overall investments made.

Tax Neutral Policy

Tax Neutral jurisdictions pursue easing of the double tax burden through a policy of Tax Neutrality, which means investors in these jurisdictions are still subject to their home countries' tax requirements, but Tax Neutral jurisdictions do not add an additional layer of taxation on to the proceeds from their investments.

This straightforward policy allows Tax Neutral jurisdictions to achieve the same objective as countries with double tax treaties but with similar or stronger safeguards against abuse.

"The use of collective investment funds domiciled in locations such as...[Tax Neutral jurisdictions] is legal, common and widely considered best practice portfolio management," the manager said. "The collective investment fund provides a tax-neutral jurisdiction to ensure its collective income does not pay a second layer of foreign tax in relation to income on which all applicable taxes have already been paid at source." [Managers of New Zealand's €21.7bn NZ Super Fund]

Tax Neutrality Is Supported By UN, OECD Model Conventions

While the OECD Model Convention gives guidance on the use of Double Taxation Treaties to address the burden of double taxation on cross border economic activities, it also recognises alternative tax policy models for addressing double taxation, tax conflict mediation and tax information sharing to protect against tax evasion and aggressive tax avoidance. Tax Neutral regimes meet the criteria of an alternative tax policy model.

Cross-border economic transactions involving Tax Neutral jurisdictions do not require tax treaties as there is no tax conflict and no risk of double taxation. In addition, cross-border transactions between Tax Neutral jurisdictions and other countries do not require tax treaties for the purpose of administrative assistance (such as the ability to exchange tax information) because Tax Neutral jurisdictions would have in place numerous bilateral tax information exchange agreements (TIEAs), and some are covered by the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

Transparency

Tax Neutral jurisdictions support a level of transparency that arguably make them better at combatting tax evasion and aggressive tax avoidance than those that rely on the often-opaque system of Double Taxation Treaty Networks.

Top Tax Neutral jurisdictions are transparent, cooperative and already meet or exceed the full range of globally accepted standards for transparency and cross-border cooperation with law enforcement and tax authorities.

Tax Neutral jurisdictions should also have world class verified ownership regimes in place.

Tax Neutral jurisdictions are not tax havens and meet none of the accepted definitions of a 'tax haven.' Unlike countries with Double Taxation Treaty Networks or other domestic tax incentives, Tax Neutral jurisdictions do not have different headline versus effective tax rates.

Automatic Exchange of Tax Data Enables Tax Collection

Top Tax Neutral jurisdictions meet the highest global transparency standards, in part, through the automatic exchange of tax data with international tax authorities by adopting US FATCA, OECD's Common Reporting Standards, and Country-by-Country Reporting.

No Base-Shifting Mechanisms in Tax Neutral Jurisdictions

Base-shifting to evade or avoid taxes requires a legal mechanism – usually in the form of terms of a double tax treaty. Tax Neutral jurisdictions have no Double Taxation Treaties that provide opportunities for abuse or misuse; therefore, they have no legal mechanism to allow base-shifting.

Additionally, Top Tax Neutral jurisdictions adopt the principles of the OECD's Base Erosion and Profit Shifting (BEPS) initiative and meet all economic substance requirements.

Tax Neutral regimes are a distinguishing feature among International Financial Centres (IFCs), as many others are tax treaty investment hubs with extensive double tax treaty networks.

Why Use Tax Neutral Jurisdictions If Not for Tax?

Global investors are increasingly engaged in a flight to quality -- relocating their resources based on sophisticated assessments of which financial centres offer the best combination of:

- ***Efficiency and neutrality***
- ***A global network and diverse industry***
- ***An experienced legal infrastructure and neutral tax environment***
- ***High regulatory standards and respect for appropriate privacy***
- ***World class professionals and credibility***
- ***Stability***

Very few international financial centres meet those qualifications – and **none** do it as **well** as Top Tax Neutral jurisdictions.

"Legitimate reasons for using an intermediate jurisdiction may include, but are not limited to... parties to a joint venture or partnership may be from different jurisdictions and want neutrality in selecting the jurisdiction for their venture (including equal legal and tax treatment) ..." [World Bank Group]

"Tax was paid in relation to prevailing Danish and international legislation. The reason it was placed in the [a Tax Neutral jurisdiction] at the time was that the fund was also intended for international investors, and the [Tax Neutral jurisdiction] had an investment set up that international investors can easily adapt to their business." [PFA Pension company, Denmark]

In Summary, Tax Neutrality is a globally responsible tax model that is simple and transparent and efficiently supports the global free flow of investment capital and financing without posing tax harm to other countries' tax bases. Tax Neutrality meets the criteria of an alternative tax policy model that is allowed under the OECD Model Tax Convention.

Comparative Benefits & Risks for Double Tax Treaties (DTTs) & Tax Neutrality

There are some circumstances where tax treaties are more suitable and other circumstances where Tax Neutrality is more suitable when addressing issues of double taxation and the following are important in considering the benefits, as well as the potential risks and costs:

TABLE 1

Do DTTs and Tax Neutrality provide the following BENEFITS?

Benefits	DTTs*	Tax Neutrality
Addresses double taxation	YES	YES[1]
Addresses tax conflicts	YES	YES[1]
Addresses tax evasion and aggressive tax avoidance through sharing of tax information	YES	YES[1,2]
Increased foreign investment as a result of removal or reduction of tax barriers	YES	YES[3]
Greater access to foreign technology and skills	YES	YES[3]
Flow-on benefits to the local economy from increased foreign investment	YES	YES[3]
Increased certainty for both taxpayers and tax administrations	YES	YES[4]
Improved consistency for tax treatment	YES	YES[4]
Protection for investment abroad	YES	YES[4]
Avoidance of fiscal evasion	YES	YES[1,2]

**Source: UN Model Double Taxation Convention between Developed and Developing Countries*

TABLE 2

Do DTTs and Tax Neutrality cause the following RISKS or COSTS?

Risks or Costs	DTTs*	Tax Neutrality
Immediate revenue costs	YES	NO[5]
Affect or limit on the operation of certain domestic tax laws	YES	NO[5]
Risk of treaty shopping and treaty abuse	YES	NO[5]
Risk of double non-taxation	YES	NO[6]
Need for changes and/or clarifications to domestic law to conform with tax treaties	YES	NO[5]
Challenges to tax administration capacity to negotiate and administer tax treaties	YES	NO[5]

**Source: UN Model Double Taxation Convention between Developed and Developing Countries*

[1]Two countries "that consider entering into a tax treaty should evaluate the extent to which the risk of double taxation actually exists in cross-border situations." The OECD Model Tax Convention goes on to indicate that where a country levies no or low income taxes and the other country is satisfied there are no risks of double taxation, a tax treaty would not be necessary. "In the absence of any actual risk of double taxation, these administrative provisions would not, by themselves, provide a sufficient tax policy basis for the existence of a tax treaty because such administrative assistance could be secured through more targeted alternative agreements, such as the conclusion of a tax information exchange agreement [TIEA] or the participation in the Multilateral Convention on Mutual Administrative Assistance in Tax Matters." *[OECD Model Tax Convention on Income and Capital, 2017]*

[2]By undertaking automatic exchange of tax information with relevant authorities in other countries under the OECD's Common Reporting Standard (CRS) and automatically shares tax information with over 100 other governments -including the UK and all EU Member Countries – which essentially assists them in the collection of their own taxes, regardless of what their unique tax laws are.

[3]There is no tax conflict and no risk of double taxation in cross-border economic transactions involving tax neutral jurisdictions. Therefore, as with DTTs, the elimination of double taxation barriers results in increased foreign investment into developed and developing countries, greater access to foreign technology and skills and flow-on benefits to these countries' local economies from the increased foreign investment.

[4]Tax neutrality is simple, transparent, and does not affect the domestic taxing rights of other countries. The result is increased certainty for both taxpayers and tax administrations in cross border transactions with Tax Neutral jurisdictions as well as consistency for tax treatment and certainty for foreign investment.

[5]Tax neutrality does not affect the domestic taxing rights of other countries, therefore other countries do not lose tax revenue as they do when allocating or giving up taxing rights to other countries under Double Taxation Treaties. As there are no treaties involved, there is: 1) no affect or limit on the operation of other countries' domestic tax law and no risk of treaty shopping or treaty abuse; 2) no need for changes and/or clarifications to other countries domestic laws; and 3) no demands or challenges to other countries tax administration capacity to negotiate or administer treaties.

[6]Tax Neutral jurisdictions cannot pose risk of double non-taxation because (i) they do not have tax treaties that provide opportunities for abuse or misuse and (ii) Their stated tax rate is exactly the same as their applied tax rate. Double non taxation is generally caused by the use of provisions in a tax treaty to shift the tax base from one country to a second country, and domestic tax policies in the second country (eg. Exemptions, exceptions, tax rulings, credits, etc.) that dramatically reduce the actual tax collected and retained to an amount substantially less than the stated tax rate the second country used to justify the shift of tax base under the treaty. *[OECD Harmful Tax Practices – Peer Review Results; Inclusive Framework on BEPS – Action 5, Jul 2019]*