International Taxation Evolves
The Mercantilist Paradigm

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"The oranges upon the trees in California are not acquired wealth until they are picked, and not even at that stage until they are packed, and not even at that stage until they are transported to the place where demand exists and until they are put where the consumer can use them. These stages, up to the point where wealth reaches fruition, may be shared in by different territorial authorities."

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The issue of realignment of taxation with economic activity and value creation is not merely a technical tax and transfer pricing issue. It reflects the controversy between non-OECD States and OECD States, between developing and developed economies, and between source and residence States in allocating taxing rights. It is this controversy that played an important role in the first study on the allocation of taxing rights of the Committee of Economic Experts in 1923. The reports published by the League of Nations in 1923 and onwards form the basis for the current OECD Model Tax Convention.

Colonialism and Fiscal Mercantilism

The mercantilist paradigm had played an important role in the attempts of the League of Nations to create a blueprint for an international framework of tax treaties in the Post-World War I period.

In Reports published after the first League of Nations Reports, evidence can be found of the mercantilist paradigm. Mitchell B. Carroll described the mercantilist paradigm in 1934 – fifteen years after the first attempts of the League of Nations and the International Chamber of Commerce (ICC) to create the international tax architecture

Colonialism and Fiscal Mercantilism

League of Nations' first attempt to solve double taxation was to assign most of the taxable income to residence countries:

Seligman (Committee of Econ. Experts 1923):

"(…) all intangible wealth, except real estate mortgages, should be assigned predominately or wholly, to domicile."

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Fiscal Mercantilism : supply chain transaction

ImperialCo (England) | **ColonyCo (India)**

Raw Materials: lowest price possible consistent with minimum required capital for ColonyCo to continue operations

Movable tangible property (machinery): leased out by ImperialCo to ColonyCo with leasehold payments

Capital: via loans from ImperialCo to ColonyCo with interest payments

Know-How: licenses with royalties paid by ColonyCo

Services: provided by ImperialCo via service fees to ColonyCo

Colonialism and Fiscal Mercantilism

1927 Report League of Nations: Source country has no right to tax business profits unless permanent establishment (very narrow PE concept)

1930: Report League of Nations: focus on PE //

1933: Departure of Adams and Dorn, replaced by Mitchell B. Carroll

1933: Introduction of precursor of article 9 Associated Enterprises by Carroll

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Colonialism and Fiscal Mercantilism

The consequence of removing subsidiaries from the definition of permanent establishments, determining business profits allocable to the subsidiary in terms of a stand-alone or one-sided (transfer pricing) method, essentially ignoring interim holding companies, and exempting royalties from source-based withholding taxation was to create significant tax planning opportunities:

A significant opportunity existed to base erode the colony country.

Colonialism and Fiscal Mercantilism

Mitchell B. Carroll (1934):

The framework of taxation that was introduced was based on the mercantilist belief that Imperial countries were the "source of capital and know-how while the colonies were passive suppliers of goods or services with little value added functionality".

Carroll systematically rejected a profit split.

The Mercantilist Paradigm

Modern mercantilist practices in the field of taxation arise from the same source as mercantilist policies of the sixteenth through eighteenth centuries.

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New Roles

Government

A rebalancing of the Power Equilibrium between National Governments and Multilateral Institutions, between Asia and the West.

Corporates / Tax Advisors

Sustainable solutions and balanced tax governance. A rebalancing of (governance) equilibrium between State and Corporates

New Roles

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