

# Recent Developments in International Tax Work at the OECD<sup>1</sup>

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# What is the Organisation for Economic Co-operation and Development?

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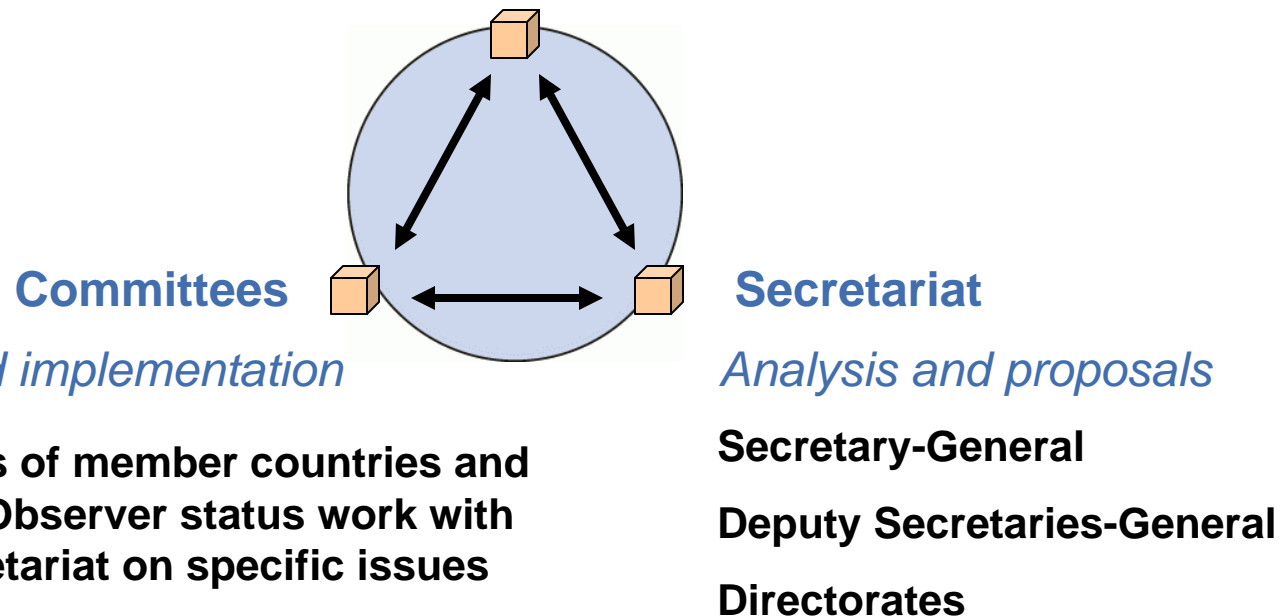
- An inter-governmental organisation composed of 30 member countries and observers
- Based around a Council, 20+ committees and a secretariat
- A setter of “soft” and occasionally “hard” rules
- A forum for discussion on reform initiatives
- A provider of comparative data and statistics

# OECD: How it works

## Council

*Oversight and strategic direction*

**Representatives of member countries; decisions taken by consensus**



*Discussion and implementation*

**Representatives of member countries and countries with Observer status work with the OECD Secretariat on specific issues**

*Analysis and proposals*

**Secretary-General  
Deputy Secretaries-General  
Directorates**

**Annual budget:  
Funded by member countries  
+ grants**

# Committee on Fiscal Affairs

What are we?

**A forum for senior policy makers and administrators representing Ministries of Finance and Tax Administrations**

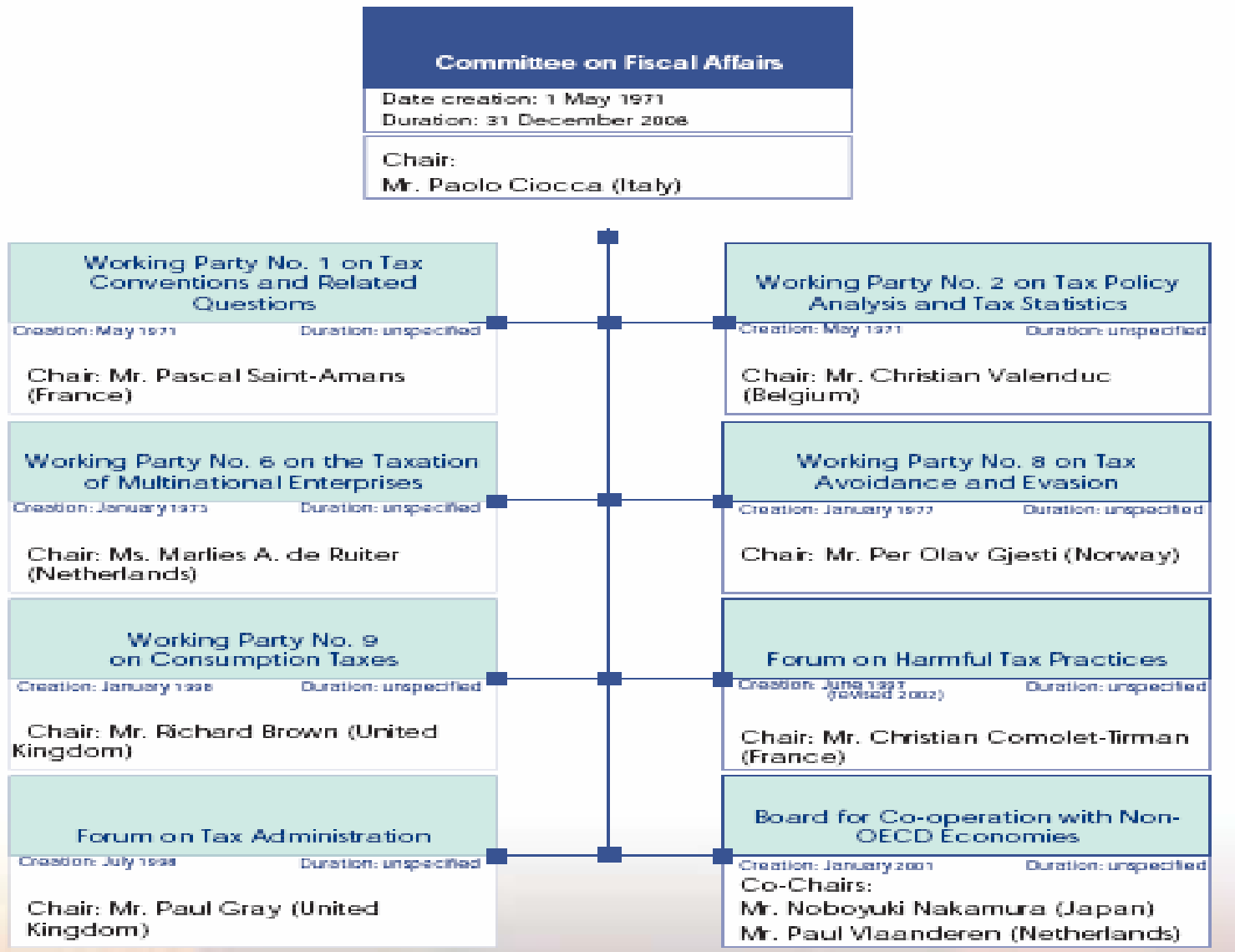
What do we cover?

**International tax focus but also related domestic tax policy and administration**

How are we organised?

- **Biannual meetings**
- **Eight working parties and various other sub bodies**
- **Secretariat in the Centre for Tax Policy and Administration**

# Committee on Fiscal Affairs – Main Sub bodies



## Committee on Fiscal Affairs

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### Aims:

- To eliminate tax measures distorting trade and investment flows
- To prevent double taxation
- To counteract tax evasion and avoidance
- To promote good practices in tax policy and administration, including dispute resolution

### Means:

- Encouraging dialogues between governments
- Promoting communication, co-operation and mutual assistance in tax matters
- Guidelines, information papers and models

# CFA's Co-operation with Non-OECD Economies

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## ■ Why?

- Tax is a borderless issue
- International tax problems require international solutions
- Help develop systems to enable governments to generate revenues for sustainable development and attract FDI

## ■ How?

- Use of policy dialogue
- Use of multilateral approach and partnerships
- Global, regional and country capacity building and dialogue programmes
- **Further details in presentation on Thursday**

## A Changing Global Environment

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- Globally integrated corporations dominate world trade
- The move to a service economy
- Rapidly changing business models
- Fully integrated financial markets
- Rise of offshore centres and innovative financial instruments

## The Threat to Tax Systems in this New Environment

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- Increased potential for tax induced distortions
- Tax competition intensifies
- Growing threats to national tax bases:
  - Outsourcing and Offshoring
  - New business models strip away tax base
  - Aggressive tax planning
  - VAT fraud increases
  - More difficult for governments to reconcile expenditures and revenue needs

## Transfer Pricing and Profit Shifting (extreme cases?)

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Examples of prices actually charged by US multinational companies to shift profits and avoid taxes (Source: Head of Tax, Reed Elsevier, European Tax Summit, February 2007) :

- plastic buckets from the Czech Republic at \$972.98 each,
- fence posts from Canada at \$1,853.50 each,
- a kilo of toilet paper from People's Republic of China (PRC) for \$4,121.81,
- a litre of apple juice from Israel for \$2,052,
- a ballpoint pen from Trinidad for \$8,500, and
- a pair of tweezers from Japan at \$4,896 each.

# Legislative Complexity

Table 2.1: Federal tax administration burden

Country	GDP ranking	GDP \$m	Number of pages of primary tax legislation (ranking)
United States	1	11,711,834	5,100 (5)
Japan	2	4,622,771	7,200 (4)
Germany	3	2,740,351	1,700 (10)
United Kingdom	4	2,124,355	8,300 (2)
France	5	2,046,646	1,300 (13)
China and Hong Kong	6	1,931,710	2,000 (9)
Italy	7	1,677,834	3,500 (7)
Spain	8	1,039,827	530 (17)
Canada	9	977,069	2,440 (8)
India	10	691,163	9,000 (1)
Korea	11	679,674	4,700 (6)
Mexico	12	676,497	1,600 (12)
Australia	13	637,327	7,750 (3)
Brazil	14	603,073	500 (16)
Russia	15	581,447	700 (=15)
Netherlands	16	578,079	1,040 (11)
Switzerland	17	357,542	300 (20)
Belgium	18	352,312	830 (14)
Sweden	19	346,412	700 (=15)
Turkey	20	302,769	350 (18)

Source: PwC study June – July 2006. GDP information is based on 2004 figures taken from World Bank data as at April 2006, for more information visit: <http://www.worldbank.org>

Note: The study does not measure state and local taxes. Countries levy taxes at different political levels, which will affect the relative ranking.

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## Major issues on the CTPA's Agenda

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- 1) Harmful Tax Practices project
- 2) Extending and monitoring the Transfer Pricing Guidelines  
(attribution of profits to PEs and comparability and profit methods)
- 3) Treaty non-discrimination
- 4) Resolving International Tax Disputes
- 5) Improving Exchange of Information
- 6) The New online Treaty manual
- 7) Tax Administration and the Seoul declaration
- 8) The new OECD
- 9) Challenges Ahead

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## Major issues on the CTPA's Agenda:

### 1) Eliminating Harmful Tax Practices

## Major issues on the CTPA's agenda: 1) Eliminating Harmful Tax Practices

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- Globalisation can have negative consequences:- may facilitate money laundering, bribery, corporate scandals, corruption, tax cheating
- These activities thrive in a climate of secrecy, lack of transparency, lack of cooperation
- Ministers in 1996 launched the OECD initiative to:
  - Eliminate harmful preferential tax regimes in OECD countries
  - Counter tax haven abuses
- In 2000 CFA identified 47 regimes in OECD countries as potentially harmful; today all of these regimes have been modified, to be considered no longer harmful, or abolished.
- In 2000 the OECD identified 35 tax havens; today all but 3 of them are committed to the principles of transparency and effective EOI
- Discussions continue with financial centres through Global Forum

## Eliminating Harmful Tax Practices: The future

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- May 2006 Global Forum Report shows many constructive developments but much remains to be done
- Where to?
  - Negotiation of TIEAs
  - ACP arrangement based on good governance and fiscal transparency as positive incentive
  - Movement towards globally accepted standards in transparency and exchange of information

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## Major Issues on the CFA's agenda:

### 2) Transfer Pricing

## Major issues on the CTPA's agenda: 2) Transfer pricing - Key projects

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- Attribution of profits to PE
- Review of comparability
- Review of profit methods
- Business restructurings

## a) Attribution of Profits to PEs

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### **Background:**

- Work launched in 1998 to seek common interpretation and consistent application of Article 7
- Spurred by development of global trading and e-commerce
- Discussion drafts released since 2001 in four Parts
- Presentation at the 2005 TTP Global Forum

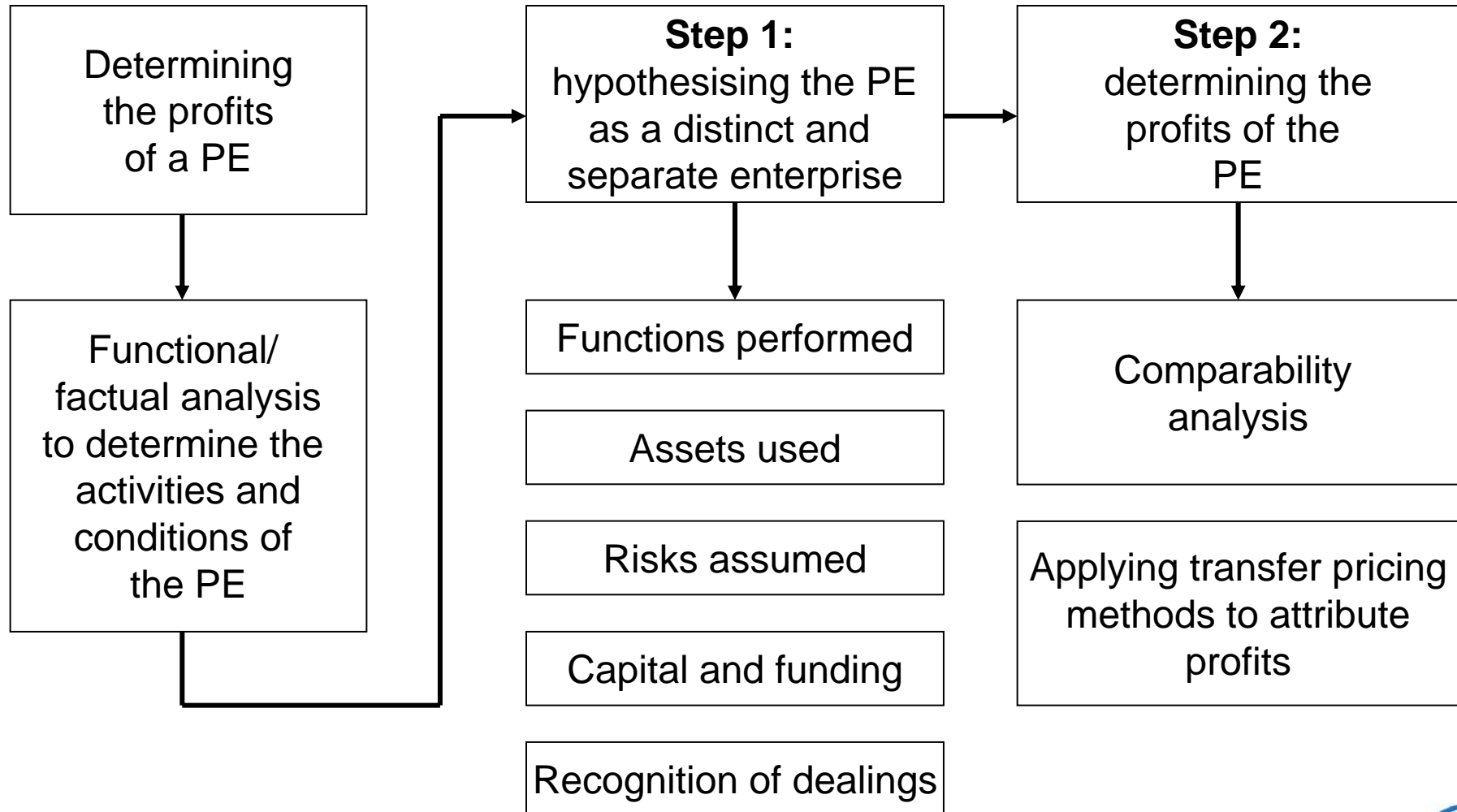
## Process

- Completed versions of Part I (General Considerations), Part II (Banking) and Part III (Global Trading) released on 21st December 2006.
- New version of Part IV (Insurance) released in August 2007: Comments by 31 October 2007; a consultation meeting with interested commentators will be held on 26 November 2007.
- These four parts replace the earlier discussion drafts that were previously issued.

## Authorised OECD Approach (AOA)

- The authorised OECD approach contains 2 steps:
  - Hypothesise the PE as a separate and distinct enterprise. Attribute to the PE functions, transactions / contracts with third parties, assets, risks, free capital.
  - Apply the arm's length principle and TP Guidelines by analogy to the “dealings” recognised between the PE and other parts of the enterprise it belongs to.

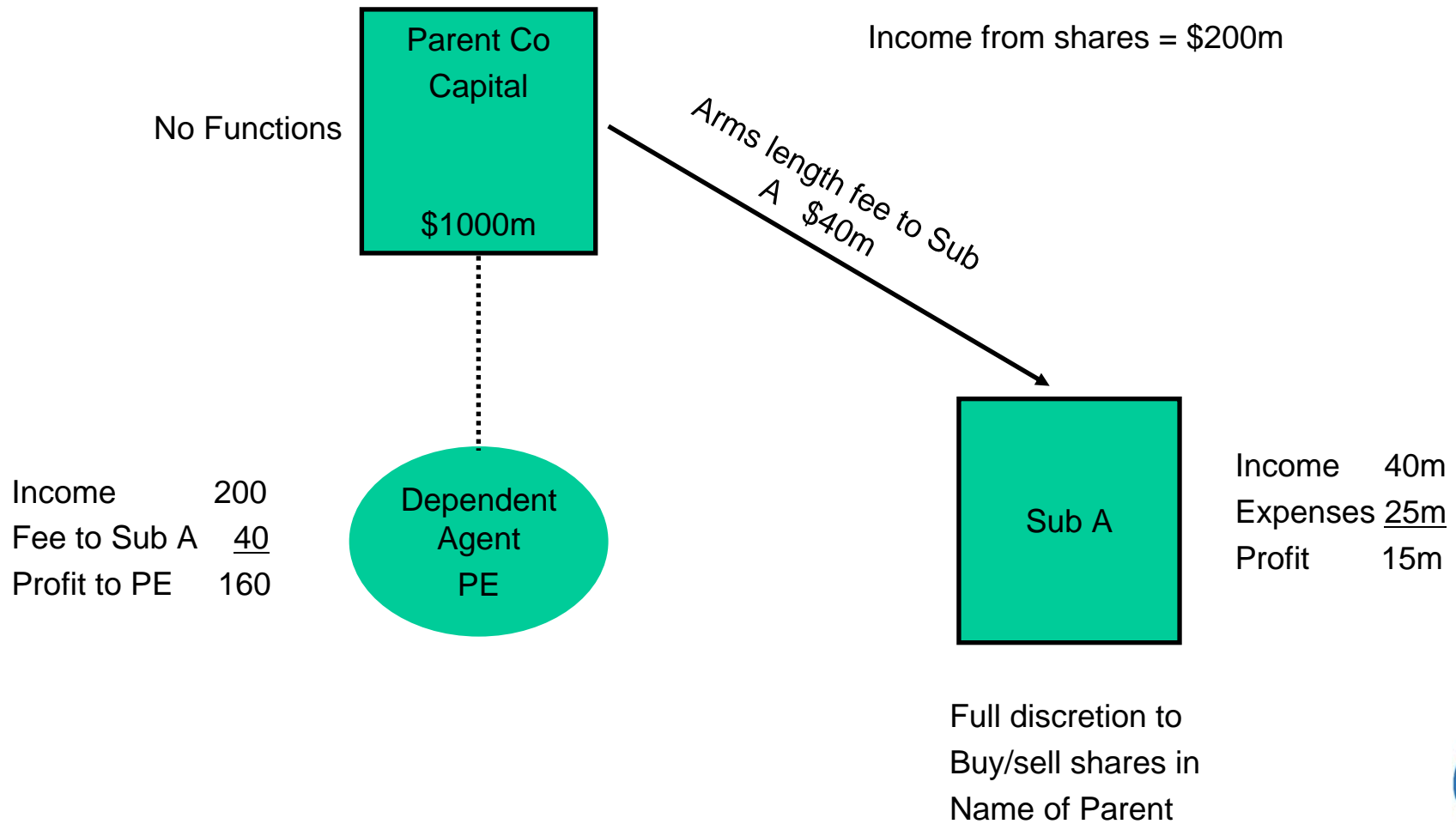
## AOA: An Outline



## Functional analysis

- Factual and functional analysis
- Attributing assets and risks: role of “significant people functions” and role of “key entrepreneurial risk taking functions”.
- Attributing free capital: more than one method allowed. Symmetry issue.

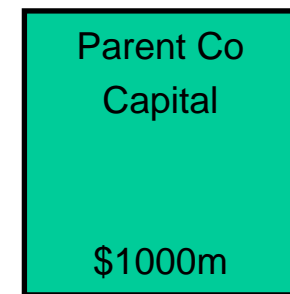
# Example 1



## Example 2

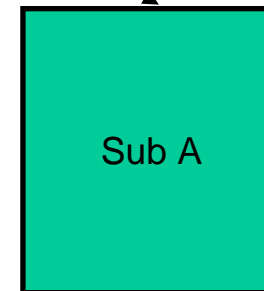
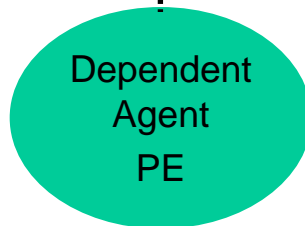
Traders make buy/sell decisions

Income	200
Fee to Sub A	<u>10</u>
Profit to HQ	190



Income from shares = \$200m

Arms length fee to Sub  
A \$10m



Income	10m
Expenses	<u>7m</u>
Profit	3m

Executes buy/sell  
Decisions of  
parent

## Comparison with Article 7 MTC

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- Areas where AOA conflicts with the existing Commentary:
  - Explicit recognition of internal dealings
  - General recognition of internal services at arm's length prices
  - Recognition of internal royalties
  - Recognition of internal interest dealings outside the financial sector

## Implementation: How do we get changes in place?

- Implementation package to reflect a two-track approach:
  - Implement full AOA through new text for Model Article 7, with new Commentary
  - Also prepare new Commentary for *existing* Model Article 7, importing as much as possible of AOA as does not conflict with existing Commentary
- Objective – to provide maximum legal certainty for interpretation of existing and new treaties

## b) Comparability and profit methods: Context and process

- Monitoring procedures of the OECD 1995 Transfer Pricing Guidelines
- The review of comparability and the review of profit methods are intrinsically linked
- Working methods and time line:
  - 2003: open questionnaire on comparability
  - February 2006: open questionnaire on profit methods
  - May 2006: discussion draft on comparability
  - [end of 2007 or 2008?] discussion draft on profit methods
- End product will be a revision of Chapters I and III of the OECD Guidelines

## Overview of issues addressed

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- Timing issues in comparability
- Internal comparables
- Determination of available sources of information and of their reliability
- Uncontrolled transactions
- Examining the five comparability factors
- Comparability adjustments
- Multiple year data
- Aggregation of transactions
- Definition of the arm's length range, extreme results, methods to enhance reliability, loss-making comparables
- Documenting a search for comparables

## c) Profit methods: overview

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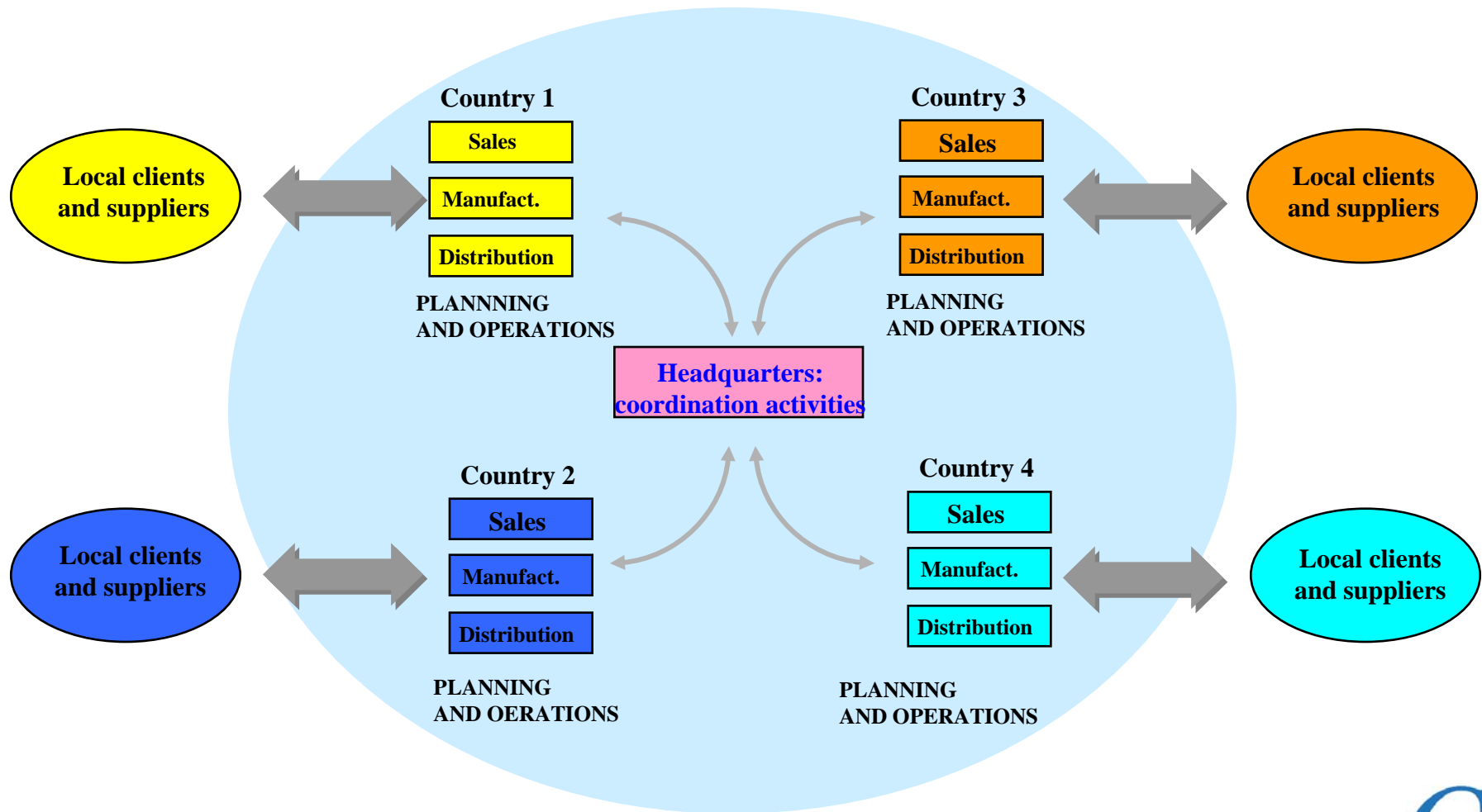
- Profit methods currently have a last resort status in the OECD Guidelines, but they are more widely used than would be expected from their last resort method status
- Re-discuss the status of the methods
  - Transactional Net Margin Method and Profit Split methods
- Develop further guidance on how to apply these methods in practice

## d) Business Restructuring: why look at this issue?

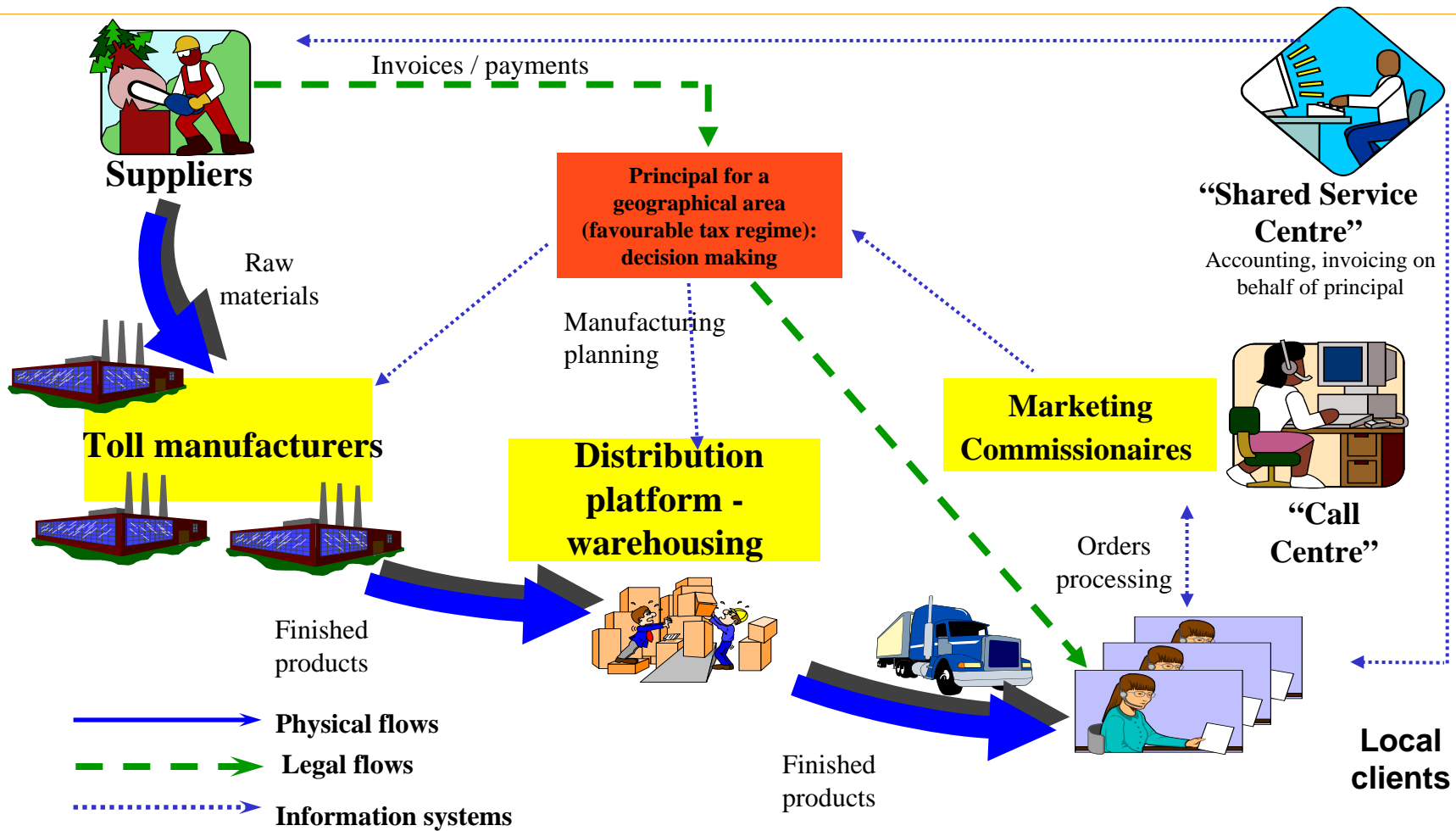
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- Cross-border redeployment by multinational enterprise of functions, assets and risks; cross-border reallocation of profits.
- Since the mid 90s: typically, conversion of “full fledged distributors” into “commissionnaires”; of “full fledged manufacturers” into “toll-manufacturers”; etc.
- Migration of intangible assets and of risks, together with associated profit potential, often to low tax jurisdictions.

# Illustration 1: traditional business model



# Illustration 2: global business model



## Business restructurings: commercial reasons

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- Typical commercial reasons: the implementation of global business models to maximise synergies and economies of scale, to streamline the management of business lines and to improve the efficiency of the supply chain, taking advantage of the development of internet based technologies that has facilitated the emergence of global organisations.
- Where restructurings have valid commercial reasons, OECD objective is not to create tax barriers to trade; but to apply sound international principles of taxation and to provide reasonable certainty.

## Tax effects of business restructurings

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- Mandate given by the CFA: call for balance
  - Governments want to tackle those restructurings which lack substance or are “abusive”
  - AND***
  - We need clearer guidance for restructurings that have sound commercial reasons, provide more certainty

## Process and working methods

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- CTPA Roundtable in January 2005
  - Treaty, transfer pricing, and indirect tax issues
  - Business and governments
  - OECD and Non-OECD Economies
- A Joint WP1 / WP6 Working Group set up  
=> transfer pricing and treaty aspects
- Small advisory group formed
- Objective to release a discussion draft for public comment by the end of 2008
- Still a work in progress; no conclusions yet

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## Major Issues on the CFA's Agenda:

### 3) Non Discrimination

## Major Issues on the CTPA's agenda:

### 3) Non Discrimination

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- Different treatment does not automatically result in a violation of nondiscrimination, comparability is required for proper analysis.
- No better treatment is required.
- Relationship with rest of Convention – something mandated by another part of the Convention shall not be viewed as discriminatory.

## Aspects: Nationality

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- Purpose: To prevent tax discrimination based on nationality, as long as non-nationals are “in the same circumstances, in particular with respect to residence”
- Clarify requirement of “similar circumstances” and application to companies. Provision intended to prevent unfavorable treatment that is based solely on nationality of the company
  - Example: in violation of paragraph 1: payroll tax imposed on all employers of local individuals, but higher rate for nonresident companies
  - Example: not in violation of paragraph 1: denial of consolidation benefits to companies not resident (and therefore not in the same circumstances)

## PEs

- Purpose: To prevent taxation “less favourably levied” on the PE of a foreign company than on domestic enterprises “carrying on the same activities”
- Focus should be only on the activities (and taxation) of the PE, not the enterprise as a whole
  - Consolidation / group regimes
  - Branch taxation

## Deductibility

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- Purpose: Prevent different rules concerning the deduction of payments to non-residents; those payments have to be “deductible under the same conditions” as payments to residents
- Does not prevent additional information requirements with respect to payments to non-residents as they are required to ensure similar level of compliance

## Resident and non resident corporates

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- Purpose: To prevent discrimination of foreign- owned or controlled enterprises of one State compared to “other similar enterprises” of that State
- Thin capitalization rules
- Seeks to ensure that all resident companies are treated equally; does not look at treatment of foreign shareholder
- Consolidation / group regimes

## Next Steps

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- Technical clarifications:
  - The Report and comments are being discussed at the September WP 1 meeting
  - Aim to include in the 2008 Update
- Broader policy issues - 2 meetings in 2008
- Desirability of alternative rules to take into account:
  - Non-discrimination provisions in trade and investment agreements
  - ECJ decisions
  - Dispute settlement mechanisms

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## Major issues on the CTPA's Agenda:

### 4) Resolving International Tax Disputes

## Major issues on the CTPA's Agenda: 4) Resolving International Tax Disputes

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- Major concern for business and government
- Disputes have increased in number and complexity...  
this trend will continue
- Need a more effective procedure to resolve disputes

# The Key Parameters for Successful Dispute Resolution

- A dispute resolution process requires:
  - Transparency
  - Guaranteed outcome
  - Timeliness
  - An outcome based upon clear principles
- These parameters are essential to maintain the confidence of taxpayers

## Current Article 25 of OECD Model

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- Article 25(1): taxpayer may bring case of taxation not in accordance with Convention to competent authority, notwithstanding domestic remedies
- Article 25(2): competent authorities “shall endeavour” to resolve case by mutual agreement
- Generally effective, but offers no final solution in cases where competent authorities cannot agree

## OECD's February 2007 Proposals

Supplementary Dispute Resolution – mandatory, binding arbitration of Article 25(1) cases unresolved after 2 years of MAP

Changes to the OECD's Model Tax Convention's Article 25 Commentary -- to incorporate proposals for improved MAP operation

Draft Manual on Effective Mutual Agreement Procedures (MEMAP) -- to explain MAP and describe best practices for tax authorities and taxpayers

## Key Concerns with Existing MAP Process

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- Certainty
- Barriers to MAP
- Timeliness, Efficiency
- Transparency

## Supplementary Dispute Resolution Proposal

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- Mandatory, binding arbitration of unresolved issues in Article 25(1) cases after 2-year MAP
- Flexible – mode of application left to mutual agreement of Contracting States
- Sample mutual agreement on procedures included in proposal
- Proposal recognizes not all countries are in a position to include this procedure
- Development since 2006 – no requirement to waive domestic remedies to access arbitration

## Proposed Commentary Changes

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- Clarify time limitations for invoking MAP
- Clarify triggers for MAP access
- Clarify (and limit) grounds for denying access
- Encourage suspension of collection during MAP
- Encourage appropriate treatment of interest and penalties
- Encourage use of MAP to make corresponding adjustments
- Clarify relationship with domestic law, to encourage full use of MAP
- Encourage use of Article 25(3)

# Manual on Effective Mutual Agreement Procedures (MEMAP)

- Online at [www.oecd.org/ctp/memap](http://www.oecd.org/ctp/memap)
- General guidance on MAP process
- For tax administrations and taxpayers, experienced and first time users
- 25 “Best Practices”
- Goal to enhance transparency, cooperation, timeliness, and overall effectiveness and efficiency of MAP

## Improving Dispute Resolution Mechanisms

### Current activity/next steps:

- Final Report's recommendations to be incorporated into 2008 Update to OECD Model Tax Convention
- WP1 and WP6 analyzing conforming changes to be made to Commentary and Transfer Pricing Guidelines
- OECD Member countries have agreed to publish MAP statistics annually on OECD website

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## Major Issues on the CTPA's agenda:

### 5) Exchange of Information

## Current Issues on CTPA's agenda: 5) Improving Exchange of Information

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1. Finalisation of the Manual on the Implementation of Assistance in Tax Collection Exchange of Information (available in English French and Spanish on [www.oecd.org/ctp/eoi](http://www.oecd.org/ctp/eoi))
2. Work on improving the efficiency of exchange
3. Improving Access to Bank Information for Tax purposes: the 2007 Progress Report

## Manual on assistance in tax collection

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### Why the need for such a manual?

- New Article 27 on assistance in tax collection in the OECD Model Tax Convention (optional article).
- Two thirds of OECD Member countries have a legal basis for assistance in tax collection (bilateral or multilateral).
- More countries are including an article on assistance in tax collection in their tax conventions
- NB: An article on assistance in tax collection based on Article 27 of the OECD Model will be added to the UN Model Tax Convention.

## Basis for the Manual

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- The new Article 27 of the OECD Model Tax Convention
- The joint Council of Europe /OECD Convention on Mutual Assistance in Tax Matters

## The manual follows a modular approach

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- Part I General and Legal Aspects of Assistance in Tax Collection
- Part II Measures of Conservancy
- Part III Practical Aspects
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# Contents

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- General and legal aspects of assistance in tax collection
- Measures of conservancy
- Practical aspects of assistance in tax collection

## Additional Modules to come

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- Model Memorandum of Understanding on Assistance in Tax collection based on Article 27
- Model Memorandum of Understanding on Assistance in Tax collection based on the joint Council of Europe /OECD Convention on Mutual Assistance in Tax Matters
- Standard electronic form to request assistance in tax collection

# Improving the efficiency of exchange of information



- Guidance note on training and awareness on exchange of information
- Guidance note on the use of exchange of information for risk assessment
- Guidance note on exchange of information feedback systems

## b) Improving the efficiency of exchange of information

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- Identify most common practical impediments to efficient exchange of information.
- Strategies on how to motivate tax officials to spontaneously provide information
- How to use current technology to increase the efficiency of information exchange
- How exchange of information teams are structured and placed within the tax administration: best practices.

## c) Improving access to bank information for tax purposes

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### **The 2000 OECD report: Improving Access to Bank Information for Tax Purposes**

#### **Sets an Ideal standard:**

That all member countries should permit access to bank information, directly or indirectly, for all tax purposes so that tax authorities can fully discharge their revenue raising responsibilities and engage in effective exchange of information with their treaty partners

## Improving access to bank information for tax purposes

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**To reach that ideal the 2000 OECD Bank report encouraged countries to :**

- Prohibit financial institutions from maintaining anonymous accounts
- Require financial institutions to identify their customers and beneficial owners of accounts
- Review any domestic tax interest requirement and remove it as a barrier to exchange of information

## Improving access to bank information for tax purposes

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**To reach that ideal the 2000 OECD Bank report encouraged countries to :**

- Re-examine and change policies that do not permit access to bank information for exchange purposes in criminal tax cases
- Achieve access to bank information for tax administration purposes
- Improve administrative feasibility & capability of information systems

## The 2007 OECD Progress Report outlines further progress

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- The process of incorporating the new OECD Model Article 26 in their tax treaties is now well underway in OECD countries and some non OECD economies.
- Further progress in access to bank information for civil tax purposes has occurred. Belgium, in particular will exchange bank information on request for both civil and criminal tax matters once its new tax treaty and protocol with the United States enter into force.
- Some countries have been successful in developing voluntary compliance strategies to encourage taxpayers having unreported funds concealed offshore to disclose them wilfully.

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## 6) New Tax Treaty website

## Contents of the Tax Treaty Website for Tax Officials

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- Basic description of the practical effect of the provisions of the OECD Model Tax Convention
- Summary for each Article of the Model
- Section on general issues, such as
  - Structure of tax treaties
  - Relationship between tax treaties and domestic law
  - Interpretation of tax treaties

## Administrative Issues

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- Describes the procedure typically used to apply tax treaty provisions on an Article-by-Article basis
- Prepared based on the information available on the websites of both member and non-member countries
- Hyperlinks to the relevant forms and guidance
- Main objective is to present the different country practices in administering treaty network

## Alternative Provisions

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### ***Currently under development***

- Source of reference on commonly found alternative provisions
- Analysis will be factual
- Focus on the technical drafting and implementation issues

## Other Parts of the Website

- **What's new?**  
Hyperlinks to the OECD CTPA public website
- **OECD Model and Commentary**  
Text of the Model and extracts of the Commentary
- **Directory of Government Tax Treaty Officials**  
Contact details of all the officials who have access to the website
- **Relevant Links**  
Hyperlinks to the websites of both member and non-member countries, international organizations and platforms
- **Discussion Group**  
Where tax officials can exchange views on tax treaties.

## Relationship with OECD MTC

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- The OECD Tax Treaty Website for Tax Officials has been prepared by the Secretariat as background information for the exclusive use of tax officials
- It does not necessarily represent the views of the OECD or of any of its member countries
- In case of any discrepancy between the website and the official interpretations included in the OECD Model Tax Convention, these official interpretations prevail

## How to Access the Website

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Contact:

**Raffaele RUSSO**  
***Tax Treaty Advisor***  
**OECD CTPA**  
***raffaele.russo@oecd.org***

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## Major Issues on the CTPA's agenda:

### 7) Tax Administration

## Major Issues on CTPA's Agenda: 7) Tax Administration

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- Effective international enforcement requires effective administration
- The Forum on Tax Administration has produced 21 guidance notes
- Risk management key issue
  - VAT abuse (a €60-80 billion p.a. problem in the EU)
  - Tax debts (a €400+ billion problem for OECD members)
- Ongoing comparative analysis of tax administration systems

# Role of the FTA

## Role and operations

- Created in late 2002 with a broad mandate:
  - *To develop effective responses to current administrative issues in a collaborative way, and engage in exploratory dialogue on key strategic issues that may emerge in the medium to long term*
- Commissioners etc meet around every 15-18 months.
- Supported by two Sub-groups- Taxpayer Services & Compliance- and the OECD Secretariat that deliver the work program.

## Objectives:

- Put tax administration work on a sounder footing
- Create ability to tap into and share expertise of member countries.

# Seoul Forum Meeting

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- One of the Seoul discussion themes focussed on.... “detecting, deterring and responding to international non-compliances”.
- Seoul Declaration follow-up items agreed by Commissioners:
  - Further development of the ATP schemes directory for revenue bodies.
  - Examining the role of tax intermediaries, particularly in relation to non-compliance and the promotion of unacceptable tax minimization arrangements with a view to completing study by end-2007.
  - Applying the OECD’s Corporate Government principles in the tax area and exploring the linkage between tax and good corporate governance.
  - Improvements to the training of revenue body officials.

## Tax Intermediaries Project

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- HMRC based project team created in late-September 2006 and working with OECD Secretariat.
- Study terms of reference were published in January 2007, after some preliminary consultations.
- Terms of reference reflect results of initial consultations and agreement that the focus should be on developing a relationship that benefits both revenue bodies, tax intermediaries and taxpayers
- There will be wide consultation and the aim is to complete a report with recommendations for consideration by Commissioners at next Forum meeting in January 2008.

# Outcomes

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- The expected report will broadly cover:
  - The arrangements revenue bodies have put in place to manage their relationships with tax intermediaries, to minimise the risks and to develop a climate of mutual trust and confidence;
  - The role of tax intermediaries in promoting compliance and reducing non-compliance by their clients, and the risks they sometimes pose in developing tax minimization arrangements;
  - The responsibilities of tax intermediaries and taxpayers with regard to those risks; and
  - The role of international co-operation between revenue bodies in managing those risks.

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## Major Issues on CTPA's Agenda

### 8)The New OECD

## Major Issues on CTPA's Agenda

### 8)The New OECD

- Ministerial Council decision in May 2007 to enlarge organisation. Dialogue has begun with Chile, Israel, Slovenia, Russia and Estonia who are initial candidates for membership. Other candidates for membership may also be included as the process develops
- Alongside the enlargement process, Council has also agreed to strengthen dialogue with Brazil, PRC, India, Indonesia, and South Africa.
- But continuing emphasis on partnership programmes broadening dialogue with all non-members is of critical importance.

## 9) The Challenges Ahead

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- How will enlargement affect the OECD debate?
- Will Non-OECD Economies continue to look to the OECD tax rules for guidance?
- Can we keep pace with rapidly changing business Models?
- Can the Arm's Length Principle survive?
- Can we help tax administrations to get the right balance between taxpayer service and enforcement?
- What is acceptable/unacceptable business restructuring from a tax perspective?

## Following and engaging in our work

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- OECD Internet site: [www.oecd.org/ctp](http://www.oecd.org/ctp)
- [richard.parry@oecd.org](mailto:richard.parry@oecd.org)