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double taxation treaties between austria and developing countries

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a legal and economic analysis

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vienna, april 2014

Study

A Legal and Economic Analysis of Double Taxation Treaties between Austria and Developing Countries

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Abbreviations

CEEC	Central and Eastern European Countries
CIS	Commonwealth of Independent States
DTT	Double Tax Treaty
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IFDI	Inward Foreign Direct Investment
MNE	Multinational Enterprise
ODA	Official Development Assistance
OECD	Organization of Economic Cooperation and Development
OFDI	Outward Foreign Direct Investment
PE	Permanent Establishment
SPE	Special Purpose Entity
TIEA	Tax Information Exchange Agreement
UN	United Nations
U.S.	United States

1. Introduction

In the last years, there is an increasing awareness that governments are losing substantial tax revenues due to “aggressive” tax avoidance schemes. The G20 and the OECD strongly promote the Base Erosion and Profit Shifting initiative (BEPS), the objective of which is to undermine aggressive tax planning structures used by multinational companies. From a developed country’s perspective, undermining aggressive tax planning can be achieved by improving current international tax rules.[1]

At the same time, there is a different discussion coming from the perspective of developing countries, calling for rethinking the international tax system. How do the international tax system in general and double tax agreements in particular impact developing countries? It is also being discussed whether developing countries at all benefit from the signature of Double Tax Treaties (DTTs) under the current internationally accepted standards.

Traditionally, DTTs are signed to avoid double taxation that results when two or more countries intend to tax the same income.[2] Moreover, it is often claimed that DTTs, which also provide mechanisms to exchange information between the tax authorities of the signatory countries, can help prevent tax avoidance and evasion. Additionally, countries may see DTTs as legally binding instruments that provide legal certainty for their resident companies, and may thus promote international business expansion. On the other hand, developing countries may sign DTTs in order to signal to the international community their openness to attract foreign direct investment (FDI) and their willingness to accept internationally accepted tax rules. However, objections are arising regarding the usefulness of DTTs for developing countries: their effectiveness in attracting new investment is questionable and there are fears of major tax revenue losses for developing countries.

This ongoing debate motivates the present study, which analyses the DTT network between Austria and developing countries.[3] Austria’s 36 DTTs signed with various developing countries are based on the internationally accepted standards, as embodied in the OECD Model Tax Convention on Income and on Capital. This study analyses in detail how these DTTs impact developing countries.

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[1] OECD (2013), p.11: While actions to address BEPS – base erosion and profit shifting - will restore both source and residence taxation in a number of cases where cross-border income would otherwise go untaxed or would be taxed at very low rates, these actions are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income.”

[2] Daurer (2013), p. 8.

[3] For the purpose of this study, we define developing countries as countries that received Official Development Assistance (ODA) in 2012/13. The list of ODA-recipients is taken from ÖFSE (2012), p. 123.

Our research builds on an interdisciplinary approach, combining both a legal and an economic perspective. The legal analysis explains (i) the various functions of the main international tax agreements, (ii) Austria's DTT policy, and (iii) the potential benefits and risks faced by developing countries under a DTT with Austria. In the economic section, by using empirical methods we analyze whether or not DTTs contribute to encourage Austrian foreign direct investment (FDI) in developing countries. DTTs cover taxes on income and capital and affect both individuals and corporations. Thus, our analysis deals with these types of taxes. While the legal analysis examines mainly the effects of DTTs on businesses, but also touches upon their effects on individuals, the economic analysis focuses on the effect of DTTs on multinational corporations.

In the following, Section 2 describes the main functions of the three major types of international tax agreements: Double Tax Treaties (DTTs), Tax Information Exchange Agreements (TIEAs), and the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (Mutual Assistance Convention). In order to understand these agreements, Section 2 discusses the application of these tax agreements and their main purposes from the perspectives of both developed and developing countries. Section 3 then analyses Austrian international tax policy with a main focus on its DTTs. In particular, the specific provisions regarding the allocation of taxing rights in the Austrian DTTs and their potential effect on developing countries are discussed. Section 4 continues with a brief description of the Austrian FDI activity in developing countries since 1990. Subsequently, we use economic data in order to analyze whether DTTs have an impact on Austrian FDI activity in developing countries. Section 5 summarizes the results of the legal and economic analyses and provides some recommendations.

2. The Functions of International Tax Agreements

This section gives an overview on the functions, purposes and applications of the three main types of international tax treaties: Double Tax Treaties, Tax Information Exchange Agreements, and the Convention on Mutual Administrative Assistance in Tax Matters. As the economic part of this paper (Section 4) focuses more specifically on the effect that DTTs may have on FDI, DTTs will be given more scope in this legal analysis.

2.1. Double Tax Treaties (DTTs)

Designing its own tax system is a pillar stone of every country's sovereignty.[4] Thus, two or more countries may tax the same income arising from a cross-border transaction. To prevent this situation, referred to as double taxation, countries enter into international agreements known as DTTs. DTTs prevent double taxation either by (i) allocating taxation rights exclusively to one signatory country or (ii) providing mechanisms where both signatory countries are granted taxation rights. In case where both signatory countries are granted taxation rights, DTTs provide the exemption and the credit method as a mechanism to avoid double taxation.

Under the exemption method, a "residence country" (i.e., a country where a company or an individual is considered to be a tax resident) is obliged to exclude income arising abroad (the "source country") from the taxable base to determine the tax due. This is referred to as Capital Import Neutrality (CIN), and ensures that a company or an individual investing abroad is subject to the same tax burden as a national competitor investing at home.[5] The credit method, on the other hand, requires that a residence country firstly computes the tax due on their residents' worldwide income, then the tax due is reduced by the taxes paid in a source country. The practical effect of the credit method is that a source country (the country where the income arises) is given the primary right to tax, whereas a residence country is allowed to tax the difference in tax rates between both countries. This occurs only when a residence country's tax rate is higher than a source country's tax rate, and is known as Capital Export Neutrality (CEN).[6]

Besides avoiding double taxation, DTTs also serve other purposes. These include (i) allocating taxation rights between signatory countries, (ii) providing legal certainty, (iii) preventing tax avoidance, (iv) combating tax evasion and, (v) attracting foreign direct investment. These points will be expounded in further detail through Section 2.1.3.

Since World War II, internationally accepted standards have emerged, which to some extent have standardized the provisions of most DTTs. These standards have been influenced by the domestic tax law of certain developed countries[7] and international organizations such as the OECD and the United Nations, which have developed their own models to serve as a basis for DTT negotiations.

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[4] See Lang (2013), p. 27.

[5] See Lang (2013), p. 131.

[6] See Maisto (2010), p. 324.

[7] Stewart (2002), pp. 8-10.

2.1.1 OECD Model and UN Model

The OECD's "Model Tax Convention on Income and on Capital" [8] was originally developed between 1956 and 1961,[9] publicly issued in 1963 and updated for the first time in 1977. Since then, both the OECD model and its commentaries, which serve as an official interpretation of its provisions, have been continuously revised.[10]

The OECD model is, needless to say, designed by its members, which are primarily high-income countries.[11] Although the positions of non-OECD countries are considered to be an integral part of the OECD model,[12] non-member countries usually do not participate in shaping and updating the model. Hence, the OECD model reflects the international tax policy interests of its members.

Since its origins, the OECD model has gradually gained in importance. The fact that this model has been used as a starting point for most DTT negotiations[13] makes it easier for OECD-countries to implement their policies into DTTs. Moreover, tax authorities and courts around the world frequently use the OECD model provisions and its commentaries to interpret DTT provisions.[14]

The OECD model was originally designed for countries with symmetric FDI positions. As this model favors the residence principle, which means that tax residents of a country are subject to tax on their worldwide income, generally speaking, it allocates a greater portion of taxation rights to a residence country.[15] This is either achieved by granting exclusive taxation rights to a residence country or by reducing taxation rights in a source country.

[8] OECD (2010), "Model Tax Convention on Income and on Capital 2010".

[9] Castelo Branco (2011), p. 46.

[10] In 1992, 1994, 1995, 1997, 2000, 2002, 2005, 2008 and 2010. An updated version is expected in 2014.

[11] Currently, there are 34 OECD member countries. This list includes Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

[12] Experts from non-OECD countries are invited to discuss issues related to negotiating, applying and interpreting DTTs, see section "Non-OECD Economies' Positions on the OECD Model Tax Convention". In: "Model Tax Convention on Income and on Capital 2010".

[13] See Pistone (2012), p.2.

[14] See Pistone (2012), pp. 5-6. Pistone shows that some countries give the OECD model and its commentaries an almost binding value, while other countries do so to a lower extent. Further, extensive research shows that there was a growing number of non-OECD countries where the OECD Model and its commentaries were used as arguments discussed in courts.

[15] Daurer (2013), p. 22.

The UN model,[16] which is similar to the OECD model and is also based on the residence principle, has been specifically designed for DTTs between dissimilar countries with asymmetric FDI positions. The UN model accounts for dissimilarities between countries and balances taxation rights more in favour of source countries. This is reflected in its provisions that aim at allocating more taxation rights to the country where the income arises (i.e. source country), albeit still at a reduced rate.

The UN model is, to a lesser extent, also used as a basis for DTTs.[17] The main reasons for this may be that the UN model is regarded as a response to updates to the OECD model and, further, the negotiation and bargaining powers of developed countries are usually strong enough to impose OECD model standards as the internationally accepted standards.[18]

2.1.2 Application of DTTs in Practice

As most DTTs around the globe are based on either the UN or the OECD model, the way in which they are structured and in which they are applied are very similar. The application of DTTs can be divided into four steps: (i) their eligibility (i.e. "personal scope"), (ii) the type of taxes to be covered (i.e. "substantive scope"), (iii) their allocation of taxation rights (i.e. "distributive scope") and (iv) their application of mechanisms to avoid double taxation.[19]

The first step concerns the question who is eligible to apply a DTT to taxable income (the so-called "personal scope"). These are "*persons* who are *residents* of one or both of the Contracting States".[20] Both terms "person" and "resident" are defined in DTTs. The term "person" includes "an individual, a company and any other body of persons".[21] Concurrently, the term "residence" includes "any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of similar nature".[22]

[16] UN (2011), "Model Double Taxation Convention between Developed and Developing Countries".

[17] See Pistone (2012) et al., p.2. "[T]he overall influence of the United Nations Model Double Tax Convention between Developed and Developing Countries (UN Model) has gradually declined, with its residual role confined only to a limited number of bilateral tax treaties or to some specific clauses". See also Pistone (2010) et al., p. 413.

[18] See Pistone (2010), p. 414.

[19] Lang (2013) et al., p 44.

[20] OECD Model (2010), Article 1.

[21] OECD Model (2010), Article 3 a).

[22] OECD Model (2010), Article 4(1).

The second step in applying a DTT concerns the type of taxes that will be covered by the treaty ("substantive scope"). A DTT built on either the OECD or the UN model covers both "taxes on income and on capital imposed on behalf of a contracting country or of its political subdivisions or local authorities".[23] This implies that DTTs cover income and capital tax levied not only at the federal level, but also at the state, municipal or regional level – depending on how the country is administratively divided. However, in practice, the understanding of which taxes should be covered by DTTs varies from country to country. For some countries like the United States, DTTs only cover income and capital taxes levied at the federal level, whereas in other countries like Austria, DTTs cover income and capital taxes levied at the federal, municipal and regional level.

DTTs usually include a list of taxes to be covered.[24] However, the application of a DTT is not limited to taxes explicitly listed, but it also extends its scope to any similar tax that is imposed after the date of the signature of the DTT, in addition to, or in place of, the taxes explicitly mentioned in the list.[25]

Once a DTT applies to the "person" and covers all taxes concerned, the third step is to apply the relevant clauses of a DTT to the taxable amount (i.e. "distributive rules"). Distributive rules in DTTs usually either share taxation rights between a residence and a source country or give a residence country exclusive taxation rights. Articles 6 to 21 (except Article 9) of an OECD-based DTT cover taxes imposed on different types of income (i.e. business profits, dividends, royalties, interest, etc.) and, in addition, Article 22 covers taxes on capital. The allocation of taxation rights between signatory countries is thus dependent on the type of income and/or capital gains involved.

The fourth step regards the application of mechanisms to avoid double taxation. This step comes into play if the applicable distributive rules grant taxation rights to both a residence and a source country. The residence country thus avoids double taxation either by the credit or the exemption method (see Section 2.1). In other words, in the case where taxation rights are exclusively allocated to the residence country, there is no further need to apply a mechanism to avoid double taxation. In contrast, in cases where taxation rights are shared, a source country is given the primary right to tax income arising within its territory and a residence country applies either the credit or the exemption method to the taxable amount to avoid double taxation.

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[23] OECD Model (2010), Article 2(1).

[24] OECD Model (2010), Article 2(3).

[25] OECD Model (2010), Article 2(4).

2.1.3 Purposes of DTTs

2.1.3.1 Prevention of Double Taxation

As mentioned, countries enter into DTTs to prevent double taxation. However, many countries have managed to prevent double taxation through comprehensive domestic legislation by including the credit or the exemption method in their legislation.[26] Thus, one may argue that the avoidance of double taxation should not be regarded as a main purpose to enter into a DTT, but the allocation of taxation rights between signatory countries.

However, the approach to eliminate double taxation by means of domestic legislation presents some differences in countries that use either the credit or the exemption method. For instance, broadly speaking, countries that use the credit method, like the US, usually avoid double taxation automatically without the need of a DTT. On the other hand, in countries that use the exemption method, like Austria, companies may need authorization from the Ministry of Finance that decides whether, and to what extent, double taxation is avoided unilaterally when a DTT is not in place.[27]

2.1.3.2 Allocation of Taxation Rights

DTTs allocate taxation rights to the residence and source country depending on the type of income (see Section 2.1.2). Generally, DTTs make distinctions between active income (business profits) and passive income (dividends, interest, royalties) to allocate taxation rights.

With regards to active income, the internationally accepted standards embodied in the OECD and UN models provide for the exclusive allocation of taxation rights to a residence country, unless the income is generated through a permanent establishment (PE)[28] located in

[26] Daurer (2013), pp. 10-11. See also OECD (2014a), Public Discussion Draft – BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, p. 5. This draft recommends countries to take into account tax policy considerations before entering into a DTT by *"... evaluating the extent to which the risk of double taxation actually exists in cross-border situations involving their residents. A large number of cases of residence-source juridical double taxation can be eliminated through domestic provisions for the relief of double taxation (ordinarily in the form of either the exemption or credit method) which operate without the need for tax treaties."*

[27] See Schindler, Bauman, Twardosz (2011), p. 175.

[28] According to the IBFD Glossary, "The term permanent establishment is generally used to refer to a non-resident's business presence in a particular country that is of a sufficient level to justify that country's taxation of the attributable profits. When used in the context of tax treaties, a permanent establishment is generally constituted by a fixed place of business in the source country through which the business of an enterprise is wholly or partly carried on, but may also be constituted in certain circumstances by virtue of the activities carried on in the source country by a dependent agent, sometimes referred to as an agency permanent establishment. Examples of the former kind of permanent establishment frequently given in tax treaties include a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of

the other signatory country (i.e. source country). In such a case, the source country is generally entitled to tax only part of the profits attributed to the PE.[29]

There are two aspects that play a central role in allocating taxation rights. The first aspect concerns the definition of PE, and the second is the computing of profits attributable to the PE.

First, each DTT stipulates certain requirements that define whether business activities carried out in another country are to be considered as a PE. Such requirements include, for example, the number of months that a construction site project lasts, or that the business activities are to be carried out through a fixed place of business such as an office or a factory. These requirements are stricter in the OECD model than in the UN model. For instance, according to the OECD model, if a resident of a signatory country obtains income in connection with a construction site project in the other signatory country lasting for more than 12 months, such resident would be regarded to have a PE in that other signatory country, whereas in the UN model the requirement is only more than 6 months for a PE. That means that under the UN model, an activity is more easily defined as a PE than under the OECD model. In this way, the UN model allocates more taxation rights to a source country.

Second, the computing of profits attributable to a PE taxable in a source country is also dealt with differently by the OECD and UN models. Under the OECD model, profits attributable to the PE are computed as if the PE were an independent company. This means that one has to identify all transaction that could take place between both a PE and the foreign company that creates such a PE (referred to as internal dealings), as if they were independent and unrelated companies. Those transactions should be priced to give rise to a profit element for the PE.[30] The method used to price these transactions is the "arm's length principle", determining the price by considering the functions performed, the assets used and the business risks assumed by both the PE and the foreign company that created the PE.

Unlike the OECD model, the UN model applies a broader approach to allocate profits to a PE. Rather than allocating only profits attributable to a PE resulting from the application of the arm's length principle, the UN model stipulates that a source country can tax not only the profits attributable to the PE, but also profits arising from any similar transaction made by the foreign company operating in the country where the PE is located (this is known as the

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extraction of natural resources, or a building site or construction or installation project that exists for more than a certain period (typically 6 to 12 months)." IBFD Tax Research Platform, Glossary, Permanent Establishment.

[29] OECD Model (2010), Article 7(1).

[30] See Lang (2013), p. 97.

"force of attraction principle"). This usually results in more taxation rights for a source country.

As regards passive income, a source country is usually granted the primary, albeit reduced taxation right (except for royalties under Article 12 OECD DTT model), and a residence country taxes the remaining amount. Typically, a DTT stipulates a lower tax rate on passive income than a countries' domestic law would usually establish. For instance, domestic tax law usually stipulates source taxation for this type of income at a flat tax rate of 20-30%,[31] whereas DTTs reduce such tax rate to 15% or less.[32]

Between two countries with an asymmetric investment pattern, it is mostly the capital importing country (i.e. typically a developing country) that foregoes tax revenue. In the absence of a DTT, a source country would usually impose higher taxes on passive income and a residence country may credit the tax paid in the source country in order to unilaterally avoid double taxation.

2.1.3.3 Providing Legal Certainty

DTTs set common rules applicable in both a residence and a source country, and thus provide legal certainty for investors and tax administrations.[33] From the perspective of a residence country, legal certainty is crucial to protect their residents investing abroad from international tax conflicts, giving rise to unsolved double taxation. From a source country's perspective, legal certainty would serve as an indicator that a foreign investor would be subject to comprehensive taxation rules.

However, in an asymmetric DTT, providing legal certainty also means, to some extent, to influence the taxation rules of a source country (typically a developing country) by imposing the rules of developed countries, as DTTs are based on internationally agreed standards such as the ones dictated by the OECD.[34]

While developing countries are free to negotiate DTTs as they see best, in practice this is not always the case. Developing countries are at a disadvantage, for three main reasons: (i)

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[31] See Vann (1998), p. 46.

[32] Under the OECD Model, a source country is entitled to the following withholding tax rate on passive income: for dividends 5% and 15% (depending on the stake in the company), for interest 10% and for royalties 0%. In contrast, the UN Model does not provide specific withholding tax rates, but recommends the signatory states to negotiate them.

[33] Bilateral Investment Treaties (BIT) are another way to achieve legal certainty, however discussion on such treaties is beyond the scope of this paper. The interested reader can for instance refer to Neumayer and Spess (2005) or Sauvant (2009).

[34] Pistone (2010), p. 414.

they often lack strong negotiation and bargaining powers, such as enough expertise to negotiate DTTs, (ii) they have a prevailing and urgent need to attract FDI, and (iii) there is pressure to meet internationally accepted standards.

It should also be noted that a DTT is not carved in stone. Though signatory countries commit themselves to respect the application of DTTs as matter of principle under international law, it is not rare to find cases where a country enacts new domestic tax law provisions that override the application of DTTs ("treaty override"). For instance, this may be the case when a country discovers that a DTT opens up possibilities for taxpayers to avoid taxes in both the residence and the source country, thus taking independent steps to eliminate such tax loopholes.

2.1.3.4 Prevention of Tax Avoidance

Academic literature confirms that the prevention of tax avoidance is one of the purposes behind DTTs.[35] Although tax avoidance is not, per se, an illegal way to reduce taxes due, this term usually refers to "unacceptable" taxpayer behaviour: although complying with the letter of the law (i.e. literal interpretation), an individual or a company deliberately acts against the sprit or the intention of the law with the aim to reduce tax liability.[36]

There are various situations where the application of DTTs results in double non-taxation, i.e. income is neither taxed in a residence nor in a source country. Figure 1 illustrates a scenario where a DTT grants full taxation rights to a source country, thus preventing a residence country from taxing the income. However, by virtue of its domestic law, the source country does not exercise its taxation right. Evidently, this leads to double non-taxation of the relevant income of A Co.

Some DTTs include anti-avoidance provisions that aim at tackling unduly and abusive applications of DTT provisions, that solely have the goal to achieve an overall lower, or sometimes even a zero tax burden in both a residence and a source country (such as the situation in Figure 1). DTT provisions to combat tax avoidance include, among others, (i) subject-to-tax clauses, (ii) switch-over clauses, and the (iii) "beneficial owner" concept.[37]

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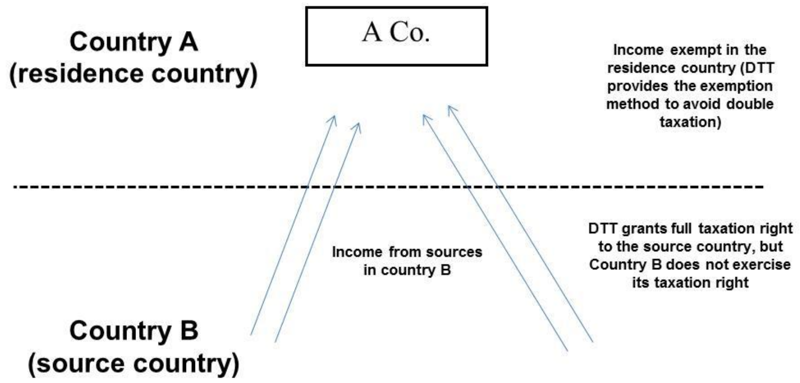
[35] Loukota, Seitz, Toifl (2004), p.365.

[36] IBFD Tax Research Platform, Glossary, tax avoidance.

[37] See OECD (2014a), pp. 27-28. The OECD report recommends clarifying that DTTs are not intended to be used to generate double non-taxation. This would be done by including in the title that the prevention of tax avoidance and evasion are purposes of DTTs, as well as including in the preamble that DTTs are intended to eliminate double taxation without creating opportunities for non-taxation.

Figure 1: Double Non-Taxation Arising Through the Application of a DTT



Source: own illustration

Subject-to-tax clauses are not explicitly found in the OECD model itself, but the OECD commentaries suggest including them in DTTs in some situations.[38] A subject-to-tax clause applies if a source country is allocated taxation rights but it does not exercise its taxation right (e.g. because the income is tax-exempt under domestic law), allowing a residence country to override the DTT and tax the income under its own domestic law. In a situation as the one depicted in Figure 1, a subject-to-tax clause would render the DTT inapplicable and thus double non-taxation is avoided.

Switch-over clauses in DTTs also prevent double non-taxation. These provisions apply when a source country does not exercise its taxation rights, which it is entitled to under a DTT. In this case, the switch-over clause allows a residence country to switch from the exemption to the credit method. This means the income is taxed in the residence state.

A third anti-avoidance provision in DTTs is the concept of "beneficial ownership". This is a term found in DTT provisions based on the OECD and UN models and deals with passive income. Its main objective is to combat a phenomenon known as "treaty shopping".[39] Treaty shopping is defined as "the diversion of FDI to achieve reduction of withholding taxes."[40] Figure 2 shows an example of treaty shopping.

A company, Corporation A, resident in Country A, wishes to invest in Country C. Instead of directly investing in Country C, it chooses to set up Corporation B in Country B,

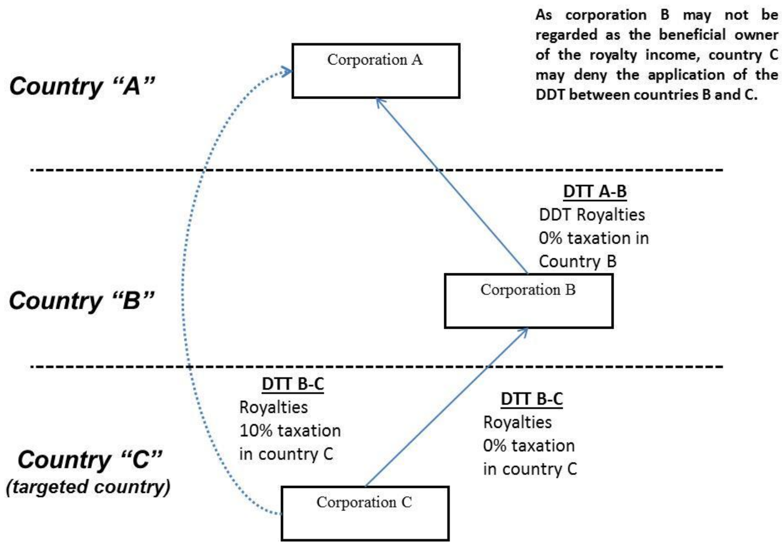
[38] For instance, see OECD Model (2010), Commentary, Article 1, Paragraph 15.

[39] See OECD (2014a), p. 5. This draft, issued on March 14, provides additional recommendations to tackle treaty shopping scenarios, such as the "Limitation on Benefits provision" (LoB) which the US includes in its DTTs. Such provisions prevent treaty shopping by limiting the application of a DTT to companies that have a certain minimum level of local ownership ("look through approach"), to companies that benefit from a privileged tax regime ("exclusion approach"), and to companies that are not subject to tax in respect of the income in question ("subject-to-tax approach"). See IBFD Tax Research Platform, Glossary, Limitation on Benefits provision.

[40] Weyzig (2013), p. 50.

which has a more favourable DTT with Country C (i.e. the DTT between Country C and B provides for lower taxation in Country C than in the DTT between Country A and C). Corporation A then finances its investment in Country C by funnelling the funds through Corporation B - for the sole purpose of reducing source country taxation. This is the case, for instance, where Corporation C pays royalties to the interposed Corporation B who in turn would pay the same royalties to Corporation A. This is done to reduce Country's C source taxation. If Corporation C pays royalties directly to Corporation A, source taxation would be 10 percent. However, zero percent taxation would be achieved, if Corporation C pays royalties, firstly, to Corporation B, which in turn pays the same royalties to Corporation A. The "beneficial owner" clause in a DTT would allow Country C, where the actual investment is to be made and from where the royalties are paid, to ignore the DTT between Country C and Country B, and tax the income arising within its territory either according to its domestic law or by applying the DTT between Country C and A (10% source taxation).

Figure 2: Illustration of a Treaty Shopping Situation



Source: own illustration

These anti-avoidance provisions can only target tax avoidance scenarios resulting from the application of DTTs. In fact, both in practice and in the academic literature,[41] it is recognized that DTTs may open up possibilities for tax avoidance schemes (such as the "treaty shopping" depicted in Figure 2). If there were no DTTs, these specific possibilities of tax avoidance would not exist.

[41] Russo (2007), p.69.

2.1.3.5 Tackling Tax Evasion

In contrast to tax avoidance, tax evasion is an illegal way of avoiding paying taxes. Countering tax evasion is often mentioned as another purpose of DTTs. Both the OECD and the UN model contain similar provisions that allow for information exchange (Article 26 of both models) and administrative cooperation between tax authorities (Article 27 of both models), enabling government agencies to enforce tax compliance.

Generally speaking, as most tax systems around the world are based on the residence principle, i.e. taxation of their residents' worldwide income, the exchange of financial information (e.g. bank accounts in a given country held by tax residents of other countries) is imperative for a country to effectively enforce taxation of income from foreign sources.[42] Without such a network of exchanging information, it is harder for tax authorities, especially those from developing countries, to detect cases where its tax residents do not report all income derived from foreign sources. Therefore, a mechanism for the exchange of information, which may also be an effective instrument to frighten potential tax evaders,[43] would be crucial for both developed and developing countries to ensure they collect their tax revenues.

There are two existing types of exchange of information clauses in both DTTs and TIEAs: a major clause and a minor clause (for more information about TIEAs see Section 2.2). The major clause, in line with OECD standards, obliges signatory countries to exchange relevant information for the application of both DTT provisions and enforcement of domestic laws regarding taxes of every kind (income tax, valued added taxes, etc.).[44] A minor clause only allows exchanging information relevant for the application of DTT provisions (i.e. it does not cover exchange of information for enforcement of domestic laws).

Moreover, tax authorities can exchange information in different forms. The OECD model puts forward three types of information exchange: (i) exchange upon request (a request for information is made having in mind a specific case of potential avoidance/evasion), (ii) automatic exchange (a country systematically exchanges all information it has regarding business transactions of residents of another country gaining income within its territory) and

[42] See McGauran (2013), p. 15.

[43] See Alliance Sud (2005), p. 14.

[44] See Lang (2013), p. 157.

(iii) spontaneous exchange of information (a country exchanges information without any request but it assumes the information may be of interest to the other country).[45]

Although the OECD favours the automatic exchange of information for which it is currently developing a framework,[46] it is often the case that an automatic exchange of information is only available where DTTs between OECD countries are signed, but not in asymmetric DTTs agreed on between developed and developing countries.

Furthermore, a provision dealing with administrative assistance for collecting taxes is included in the OECD and the UN model (since 2002 and 2011 respectively). This provision allows signatory countries to assist each other in executing tax revenue claims. It could be argued that another specific tax agreement such as the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, (see Section 2.3 for more detail), could solve this dilemma,[47] without having to exclusively negotiate DTTs. Therefore, the argument that DTTs are necessary to tackle tax evasion (as well as tax avoidance) is not entirely convincing, as an effective exchange of information and administrative cooperation to recover tax claims could also be achieved by signing other types of tax agreements that exclusively deal with these issues.[48]

With regards to administrative assistance in the recovery of tax claims, there is a global tendency to shift from bilateral to multilateral agreements. The OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, with the strong political support of the G20,[49] have pushed many countries to comply with their standards, otherwise they may be exposed as non-compliant countries before the international community.[50] Such a transition to multilateral agreements could be beneficial for developing countries, if an important goal is to obtain legal means for exchanging information to counteract tax evasion and/or avoidance. This could be the case, for example, where third countries are involved in a

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[45] OECD Model (2010), Commentary on Article 26, Paragraph 9 and 9.1.

[46] On February 13, 2014 the OECD issued a Global model allowing for the automatic exchange of financial account information, available at http://www.oecd.org/ctp/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Common-Reporting-Standard.pdf

[47] Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which will be discussed in Section 2.3.

[48] Daurer (2013), p. 301.

[49] Since 2009 the G20 has encouraged countries to sign the Multilateral Convention on Mutual Administrative Assistance in Tax Matters including most recently at the meeting of the G20 Leaders Summit in September 2013 where the Communiqué stated "We call on all countries to join the Multilateral Convention on Mutual Administrative Assistance in tax Matters without further delay." See www.oecd.org/tax/exchange-of-tax information/conventiononmutualadministrativeassistanceintaxmatters.htm.

[50] See Pistone (2014). The US is also pushing for a multilateral and automatic exchange of information through the implementation of the US FATCA regime, see Lang and Owens (2013), p.3.

"beneficial owner" scenario (see Section 2.1.3.3). Multilateral agreements theoretically allow a country to obtain information in connection with investments that are not made directly, but are routed either through a country which a DTT with the source country or alternatively through other low tax jurisdictions.

2.1.3.6 Attracting Foreign Direct Investment

For developing countries, another important reason for entering into DTT negotiations, besides exchanging information, may be to attract FDI.[51] Although developing countries (typically in the position of a capital-importer and thus of a source country) forego tax revenues when using the OECD and UN DTT models, the rationale behind this is to attract enough direct investment to offset immediate tax revenue losses. Evidently, taxation is only one of many factors determining the location choice of international firms (for a discussion of factors see Section 4.5). Yet, it is undoubtedly an important tool policy makers have at their disposal.[52]

A priori, it is not clear whether and how DTTs impact FDI flows. On the one hand, they may have a positive effect. Developing countries entering into these agreements signal to the international community a spirit of openness and willingness to adopt internationally accepted tax standards. In addition, also the reduction of withholding tax rates and the relief from double taxation may encourage FDI. On the other hand, DTTs may hamper FDI, as they also allow the exchange of information between the tax authorities (also see Section 3.1). Hence, it is an empirical question as of whether or not DTTs help to attract FDI. So far, the empirical evidence on this issue is inconclusive (see Section 4.6 for an overview on the existing literature).

Furthermore, studies show that a comprehensive domestic legislation that provides an overall transparent, non-discriminatory and predictable tax environment may be more important for foreign investors than a DTT alone.[53] In fact, a clear relationship between domestic law and DTTs is important for an easier application of DTT provisions. This is the case, for example, with terms that are not explicitly defined in DTTs, with procedures to

[51] According to the OECD (n.d.), FDI is defined as "a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship" (p. 7).

[52] See e.g. Egger and Merlo (2011).

[53] See Pickering (2013), p. 19.

apply the DTT provisions (i.e. withholding taxes on passive income, methods to avoid double taxation), and with procedures to exchange tax information, among others.[54]

2.2 Tax Information Exchange Agreements (TIEAs)

Another form of an international tax agreement is a Tax Information Exchange Agreement, or TIEA, which is a bilateral tax agreement facilitating the exchange of information concerning tax affairs of individuals and companies alike. The origin of TIEAs dates back to 2002, when the OECD issued its "Model Agreement on Exchange of Information" [55] that served as a starting point for bilateral negotiations of this nature. Since then it has been adopted as an internationally accepted standard. TIEAs are concluded with a view to address tax avoidance and evasion. Unlike DTTs, TIEAs do not include provisions concerning the allocation of taxation rights and avoidance of double taxation.

However, the practical effect of many TIEAs is questionable, because many of these agreements only provide for an exchange of information "on request" rather than on an automatic basis. Exchange of information on request means that in order to obtain information from the tax authorities of the other signatory country it is necessary for a requesting country to provide relevant information about the identification of the person under examination. For instance, a requesting country must already know which of their tax residents holds bank accounts in other countries. This makes it difficult for countries, especially for developing countries, often having weaker administrative capacities, to detect cases of tax avoidance and/or evasion.

Some TIEAs do not even clearly state which information is considered to be necessary for making a valid request. In this case, the tax authorities concerned decide on a case-by-case basis whether or not to provide information. This makes the application of a TIEA even more uncertain, as countries may have room to interpret and decide whether they are willing to exchange information requested or not.

The OECD, with the strong political support of the G20, has recently published a report in 2014 suggesting the setting of standards for the exchange of financial account information on an automatic basis.[56] In order to ensure the automatic exchange of information, compatibility between domestic laws and DTTs is required (also see Section 2.1.3.5). This applies to laws providing for the protection of financial information held by banks and other

[54] Nakayama (2011), p. 4.

[55] OECD (2002), "Model Agreement on Exchange of Information and Tax Matters".

[56] See FN 43.

financial institutions. In principle, the OECD standards do not allow requested countries to decline the providing of information due to domestic bank secrecy regulations.[57] Thus, countries are strongly encouraged to adopt their domestic laws to give tax authorities access to information held by banks and other financial institutions, if they do not want to be exposed as non-compliant jurisdictions. However, the path to achieve an automatic exchange of information may be a long way, as the current attitude of some OECD countries is to apply the automatic exchange of information standard either exclusively with other OECD countries or by being only formally but not substantively compliant.[58]

2.3 Multilateral Convention on Mutual Administrative Assistance in Tax Matters

The final international tax agreement to be discussed in this paper deals with the Convention on Mutual Administrative Assistance in Tax Matters (Mutual Assistance Convention). It is a multilateral agreement designed by the OECD and the Council of Europe to promote international cooperation and to facilitate the executing of revenue claims. Thus, the Mutual Assistance Convention serves as a legal instrument to address tax avoidance and evasion without a need to sign a bilateral tax agreement like a DTTs or a TIEA. As of December 2013 there were over 64 signatories[59] of the Convention, including all G-20 countries, all BRIC countries, almost all OECD and EU countries and an increasing number of developing countries.

The Mutual Assistance Convention was issued by the OECD in 1988 and came into force in 1995. In 2010, an amending protocol was opened for non-OECD signatory countries and was entered into force in June 2011. This multilateral agreement is broader than a TIEA, as it provides additional tools to facilitate cooperation between tax administrations. This includes the exchange of information on request, on a spontaneous and an automatic basis, joint tax audits between tax authorities of signatory countries, assistance in recovery of taxes and the servicing of documents.

The multilateral approach achieves a "level playing field" for developing and developed countries; moreover, this also may be useful for countries trying to address

[57] See OECD Model (2010) Article 26 (5); also OECD (2002) Model Agreement on Exchange of Information and Tax Matters Article 5(4).

[58] See Pistone (2014).

[59] The list of signatory countries can be found at http://www.oecd.org/tax/exchange-of-tax-information/status-of-convention.pdf

complex tax planning structures like the "treaty shopping" scenario as listed in Section 2.1.3.3.

2.4 Summary: General Issues Regarding Tax Agreements

As presented above, the three major international tax agreements, consisting of DTTs, TIEAs and the Mutual Assistance Convention, all have their role and function in dealing with international tax matters.

While DTTs comprise of a number of issues, such as avoidance of double taxation, the allocation of taxation rights, the exchange of information and administrative cooperation, TIEAs and the Mutual Assistance Convention address tax evasion and avoidance by means of exchanging information and administrative cooperation between tax authorities. Generally, the three types are not mutually exclusive, but may be used concurrently.

The importance of the OECD DTT model should not be underestimated: it is the foremost model for DTTs and used as a basis for DTT negotiations, to a much greater extent than the UN model. Most DTTs worldwide are based on these models and are thus very similar in their structure and content to each other. One should also be aware that as the internationally accepted standards for DTTs stem principally from the OECD model, they carry with them the vested interests of OECD member countries. On another note, this by-and-large uniformity of DTTs also makes it possible for us to make such general statements about DTTs as discussed in this paper.

Regarding DTTs in general, there are many different purposes for becoming a signatory to such an agreement. The most traditional one is to avoid double taxation. However, it is questionable whether this is still relevant, as many countries provide for the same or at least very similar mechanisms to avoid double taxation under their domestic tax laws.

The other purposes of DTTs, as explained earlier, are to (i) allocate taxation rights, (ii) provide legal certainty, (iii) prevent tax avoidance, (iv) tackle tax evasion and (v) attract FDI. Both developed and developing countries may pursue these purposes with very different goals in mind. In the case of developed countries, the main purpose of DTTs may be to achieve a favourable allocation of taxation rights and, to provide legal certainty to its residents investing abroad; whereas for a developing country the main purpose may be to obtain a legal instrument to exchange information and, most importantly, to attract FDI.

With regards to the allocation of taxation rights, DTTs more than often favour the residence-based principle and, generally, a greater portion of taxation rights is granted to a residence country. In the case of an asymmetrical FDI relationship between the two signatory countries, the source country (typically a developing country) risks an un-proportional tax revenue sacrifice. Thus, we see it reasonable for developing countries to consider whether there may be more favourable ways for them to achieve the goals other than signing a DTT.

Legal certainty may also be achieved by means of domestic tax law. By entering into a DTT between countries with asymmetric investment patterns, legal certainty implies that a residence country (typically a developed country) imposes its tax rules on a source country (typically a developing country). This holds true whenever a DTT is based on the OECD model. However, DTTs alone cannot achieve legal certainty, as the most important basis for legal certainty is to enact comprehensive domestic tax rules that prove compatible with signed DTTs.

Once there is a comprehensive tax environment (i.e. domestic tax laws) in place, it would theoretically be desirable for a developing country to be clear on their reasons for entering into DTT negotiations (e.g. for the exchange of information, for attracting FDI, for political reasons such as responding to pressure either from other countries or international organizations, etc.).[60] This is crucial for determining the type of provisions to that should be negotiated (e.g. the exchange of information in line with OECD standards, allocation of taxation rights in line with the UN Model, etc.). In the case that attracting FDI is the main goal for developing countries to enter into DTT settlements, caution should be exercised with whom and under which terms DTTs are negotiated. This is, for instance, to avoid "treaty shopping" scenarios, where foreign investors may prefer to use conduit companies established in countries with more favourable DTT networks (i.e. lower taxation for the source country) rather than investing directly in a given country.[61]

It is also clearly evident that some corporations and individuals significantly reduce their tax liability using the various international tax avoidance scenarios (e.g. "treaty shopping"). It is often claimed that DTTs can prevent tax avoidance. However, anti-avoidance provisions, which are included in DTTs, can only prevent tax avoidance schemes that arise from the application of a DTT itself.

[60] Pickering (2013), p. 5.

[61] For a discussion on treaty shopping and how the Netherlands is used to route FDI to developing countries see Weyzig (2012).

As a DTT allows for the exchange of information and cooperation between tax administrations, signing a DTT does nevertheless help to fight tax evasion. However, there is the problem with information provided on request, as it is often difficult and cumbersome to access the required data. In addition, TIEAs also deal with the exchange of information in tax matters. If countries wish to further benefit from assistance in tax matters, there is also the Mutual Assistance Convention. The Mutual Assistance Convention has the advantage of multilateralism, where predetermined rules set a consistent legal framework for all signatory countries to be implemented. In this respect, a country should thus be aware that it has several tools to achieve exchange of information and assistance in tax matters, and should weigh out which one suits its needs best.

It may be argued that attracting FDI stands out as the most important reason for a developing country to enter into DTT negotiations. The evidence from other studies in this field is inconclusive, i.e. it is not clear whether or not DTTs actually trigger increased FDI inflows into developing countries; thus it is an area worth further examination. Thus, in order to investigate this thesis, we will turn to a case study of Austria and its DTT network with developing countries. Section 3 will discuss in detail Austria's DTT network from a legal perspective. In Section 4, we will then analyze econometrically the effect of DTTs on Austrian FDI in developing countries and draw conclusions from our results.

3. Austrian DTT Network with Developing Countries

3.1. General Remarks on Austrian International Tax Policy

Austria is a small Central European economy that depends on its international economic relations to prosper. Austria tailors its tax policy to achieve two main goals, to: (i) support the international expansion of its domestic firms and, (ii) make itself attractive as a business location for the headquarters of multinational enterprises (MNEs).

In 2005, Austria introduced a very generous group taxation regime in its domestic law.[62] Under this law, losses made by non-resident companies can be deducted and added to the tax liability of a group of related companies in Austria.[63] Moreover, Austria has also implemented laws regarding the outbound payments of dividends and interest taxation,

[62] See §9 KStG (Körperschaftssteuergesetz) for a definition of a group („Unternehmensgruppe").

[63] The Tax Law Amendment Act 2014 revises the scope of the group taxation law. From 1 March 2014, only non-Austrian resident companies, which are either resident in another EU country or in a non EU-country provided that Austria concluded a comprehensive mutual assistance agreement with such non EU country, are eligible for the group tax regime. IBFD News, report on 17 January 2014.

aiming to attract regional headquarters to Austria. With regards to dividends, Austria has introduced a participation exemption scheme (i.e. *Schachtelprivileg*), in which a shareholder participation of 10% in an Austria company is enough to be exempt from withholding taxes on dividends distributed to non-residents. Further, interest payments to non-residents are, under certain circumstances, not subject to withholding tax.[64]

Austria seems to be quite successful in attracting foreign investment. According to the Austrian Business Agency, about 300 foreign firms have established regional headquarters to serve the Central and Eastern European (CEE) markets and over 1000 MNEs coordinate their CEE activities from a base in Austria.[65] Evidently, there are good economic reasons to invest in Austria, or to use Austria as a location for regional headquarters. Yet, Austria's favourable tax system may arguably also play a role in a company's decision to invest in Austria.

Austria also positions itself as an attractive location for Special Purpose Entities, or SPEs. These are entities with little economic activity in Austria, but are used to manage the flow of funds within a multinational group.[66] In 2011, SPEs made up about a third of Austria's outbound and inbound FDI stocks.[67] Even though SPEs are considered legal entities, some might arguably be used for tax avoidance purposes "to channel investments and intra-group financing from one country to another through conduit structures".[68] These types of structures seem to be successful in investing indirectly in other countries. For example, using microdata on Dutch SPEs, Weyzig (2012) provides empirical evidence that such SPEs are used for treaty shopping via the Netherlands.[69]

Apart from the favourable features of the domestic tax system for MNEs, another essential factor of Austria's attractiveness as a business location is its large DTT network.[70] Austria, which has one of the longest traditions in settling DTTs,[71] has a large DTT network, which to date consists of 86 DTTs and seven TIEAs; of these DTTs, 38 are with developing countries, 3 are signed but not in force, and one TIEA is signed with St. Vincent and the

[64] The Tax Law Amendment Act 2014, effective as of 1 March 2014, also revises the taxation of interest. Non-resident tax exempt interest payments now include any interest payment as defined in the Savings Directive.

[65] ABA (n.d.)

[66] OECD (2013), p.18. The OECD defines SPEs as "entities with no or few employees, little or no physical presence in the host economy, whose assets and liabilities represent investments in or from other countries, and whose core business consists of group financing or holding activities". Besides Austria, the Netherlands, Luxembourg and Hungary are other OECD countries that attract a large amount of SPEs.

[67] OeNB (2012), p. 10.

[68] OECD (2013), et al. p.18.

[69] See Weyzig (2012).

[70] Loukota (1998).

[71] Freiherr von Roenne (2011), pp. 24-26.

Grenadines.[72] Austria's DTT network reflects its policy focus of (re)negotiating treaties with countries with which it has close economic ties. Accordingly, Austria's DTT network with developing countries in Asia is quite narrow, and it has very few DTTs with African and Latin American countries.[73] Only five DTTs with countries in Latin America and one DTT with a sub-Saharan country (South Africa) are in place.[74]

While formerly, Austrian DTT negotiators primarily aimed to boost tax revenues for Austria, increasing the attractiveness of Austria as a business location is now seen as the main function of its DTTs.[75] The Austrian Ministry of Finance strives to guarantee a "level playing field" for Austrian investors in the host countries where they operate. This means that Austrian MNEs – that includes both Austrian and foreign MNEs with established headquarters in Austria – should face a legal environment not less favourable than other MNEs.[76]

In order to ensure a uniform international tax policy in its DTT network, Austria has established a DTT model that is very close to the OECD model. With its DTTs, Austria pursues four goals, namely to: (i) prevent international double taxation, (ii) foster bilateral economic relations, (iii) increase legal certainty, and (iv) prevent international tax avoidance and/or tax evasion.[77]

From Austria's perspective, the main purpose of DTTs is to avoid double taxation.[78] Austria is a classical "exemption country", i.e. it prefers to apply the exemption method as a mechanism to avoid double taxation.[79] Double taxation relief provided under Austria's domestic tax law is fairly similar to the relief provided under its DTTs. The exemption method under Austria's domestic law applies to active income, such as income derived from

[72] For a list of developing countries with which Austria has signed DTTs, see Table 3 in the Annex.

[73] See Roller (2012), p. 220, "less than four per cent of all Austrian exports and less than two per cent of all Austrian imports are with African and Latin American countries these countries"; see also see Section 4.2.

[74] Roller (2012), p. 220.

[75] Lang (2012), p. 116. This can also be observed in the Austrian Federal Economic Chamber, which is responsible for promoting good business, being closely involved in advising the government in the DTT negotiation process (Lang, 2012, p 125).

[76] Jirousek (2013a), p. 17.

[77] Loukota, Seitz, Toifl (2004), p. 364.

[78] Jirousek (2013a), p. 19.

[79] See IBFD Tax Research Platform, Country Analysis, International Aspects "The provisions on unilateral double taxation relief were issued on 17 December 2002 as a Decree of the Minister of Finance (Verordnung des Bundesministers für Finanzen betreffend die Vermeidung von Doppelbesteuerungen, BGBl II 2002/474) on the basis of the authority given in section 48 of the Federal Fiscal Code (BAO). These provisions are effective for tax years ending in the calendar year 2002 and later tax years. Previously, double taxation relief could be obtained as a concession of the Minister of Finance (section 48 of the BAO); see also §48 BAO.

businesses carried on through a PE situated abroad, subject to tax of at least 15%.[80] The credit method, as is standard with most exemption countries, applies to passive income (i.e. dividends, interest and royalties). However, with no obvious differences between the exemption method provided under Austria's DTTs and its domestic tax law, signing a DTT seems not to be necessary for Austrian tax residents to avoid international double taxation.[81]

For Austria, a second spinoff of DTTs is fostering economic relations. It is crucial from the Austrian perspective to negotiate a DTT that reduces source taxation on passive income like dividends, interest and royalties as much as possible, even below the standards embodied in the OECD Model (see Sections 3.2.3).

The third purpose of Austrian DTTs is to provide legal certainty. Austria tries to ensure that DTT provisions are interpreted in the same way in both the residence and the source country. Austria insists on including a provision in the DTT protocol stating that DTT provisions should be interpreted according to the OECD Commentaries, which are revised periodically.[82] Thus, Austria ensures that the latest version of the OECD Model and its Commentaries are legally binding and applicable for taxpayers, tax authorities and, even in the law courts of signatory countries.[83]

Fourth, preventing international tax avoidance and evasion is a major concern for Austria and, for that matter, an increasingly important goal for many governments in recent years. To prevent international tax avoidance, Austria prefers to apply anti-avoidance provisions in its domestic law, and not in its DTTs. Austria´s argument is that specific anti-avoidance provisions in DTTs may stimulate creative tax planners to find ways to curb them and, therefore, it would be difficult for tax authorities to argue that there are possible abusive applications of DTTs.[84]

Concerning tax evasion, the exchange of information provisions in DTTs have proven to be useful tools. All Austrian DTTs (except for the one with Luxembourg) provide for the exchange of information concerning tax matters. For a long time, Austria has had major

[80] Not all DTTs, however, follow the exemption method. Austrian DTTs that follow the credit method are mostly with countries that used to be seen as tax havens, such as Bahrain, Barbados, or Belize (Lang, 2012, p. 22).

[81] Loukota, Seitz, Toifl (2004), p.364.

[82] See Jirousek (2013b), p. 478, ff. "This principle of dynamic interpretation is explicitly stated in many of the Austrian protocols, although it could also be applied in the absence of specific treaty provisions on the basis of interpretation rules of Art. 31 of the Vienna Convention on the Law of Treaties and in the context of para. 35 of the Model Commentary in the Introduction of the OECD MC". Lang criticises this dynamic interpretation, because later versions of the OECD commentary which were not available at the time when a given DTT was negotiated should not be legally binding to DTT provisions, see also Lang and Brugger (2008), pp. 107-108.

[83] See Pistone (2012), p.6.

[84] See Loukota, Seitz, Toifl, (2004), p.368.

information exchange clauses only with OECD countries. Other countries, especially developing countries, were only offered minor exchange clauses.

The official reason given was that there is no certainty as to whether non-OECD countries would be able to secure privacy of exchanged data.[85] However, according to Lang (2012), another reason might be that offering "too much" administrative assistance, i.e., too much information, to other tax authorities, may constitute a "competitive disadvantage" for Austria.[86]

Austria is known internationally for its strict bank secrecy rules, which undoubtedly impede on the exchange of information in connection with bank accounts of foreign residents held with Austrian banks. Although in 2005 the OECD introduced a new standard of information exchange in its DTT model,[87] still wanting to preserve its bank secrecy laws, Austria made a reservation and refused to implement this standard. Yet, due to international pressure of the G20, the OECD and the EU, in March 2009, Austria had to withdraw its objection to Article 26 of the OECD Model and started a way to endorse the OECD standards regarding transparency and administrative assistance in tax matters.[88] Since then, Austria has been, to some extent, adapting its DTT network. In the more recently negotiated DTTs and the renegotiations of existing DTTs, Austria is slowly implementing, to some extent, information exchange following OECD standards.[89]

Although such adjustments in Austria have been made, such as applying its strict bank secrecy rules only to domestic situations, the exchange of information with non-OECD countries occurs via the "on request" basis. This forces the requesting country to provide enough information to clearly identify the person under examination, limiting the power of this provision to only limited and specific cases (also see Section 2.2.).[90]

In the field of administrative cooperation for the recovery of tax claims, Austria has been slower to adapt international standards. Article 27 of the OECD Model, which deals with this issue, is included in Austrian DTTs only when requested by a signee country[91] and when

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85 See Loukota, Seitz, Toifl, (2004), p.369.

86 For the fear that illegal earnings might be reported, there is anecdotal evidence of major orders that were shifted from countries with a major information clause to other countries that do not have such a major information clause (see Lang, 2012, p. 109).

87 OECD Model (2010) Article 26 (4) and (5).

88 At the same time, also Belgium, Switzerland, and Luxembourg accepted to change their policies in this regard and to endorse the OECD standards (Jirousek, 2014, p. 27).

89 To date, more than 20 DTTs have already been revised (Jirousek, 2014, p. 29).

90 Jirousek (2013 b), p. 467.

91 For instance, the DTTs with Mexico and Turkey contain such provisions (Lang, 2012, p. 128).

Austria assumes that the partner country respects laws concerning confidentiality and the use of such information exclusively for tax matters.[92] Therefore, similar to the exchange of information issue, Austria prefers to include this provision in DTTs exclusively with OECD-countries and not with developing countries.

As shown in Section 2.3, there is also a global trend for information exchange and administrative cooperation to shift from a bilateral to a multilateral approach. Through the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, global standards are being established.

3.2 The Allocation of Taxation Rights in Austria's DTTs and the Effects on Developing Countries

In each of its DTTs signed, Austria tries to deviate as little as possible from the OECD Model. This extends from the way Austria interprets to how it applies its DTT provisions. As mentioned in Section 3.1, the regularly updated OECD Commentaries are legally binding in some Austrian DTTs.[93] Austria's view is that a DTT in line with the OECD model becomes a valuable and attractive instrument for promoting business and bilateral relations.[94]

However, for a developing country (typically a source country), such an agreement would mean shifting some of its taxation rights (acquired by means of its domestic tax legislation) to Austria, as DTTs favour residence-based taxation. To forgo this shift in taxation rights, a developing country recons with the benefits and advantages of attracting investment from Austria.

With regards to the DTT business profits provision, which is one of the most relevant rules allocating taxation rights in DTTs (Article 7 of both the OECD and the UN models), Austria tries to implement the OECD Model in its entirety. This provision stipulates that when a company resident in Austria generates business profits in another DTT partner country, the profits are only taxable in Austria. However, in the case where there is a PE (i.e. a substantial business presence through a fix place of business or a dependent agent) in the other DTT country, the other country has the right to tax the profits attributable to that PE. As will be explained in more detail in Section 3.2.1, Austria seeks to impose the OECD Model with

[92] See Lang (2012).

[93] See, for example, DTT Austria-Cuba, point 7 of the Protocol; see also DTT Austria-Mexico, point 1 of the Protocol.

[94] Loukota, Seitz, Toifl (2004), p. 368.

regards to both the definition of a PE and the method to compute how much profit is attributable to a PE.[95]

With regards to other tax allocation rules, Austria's DTT policy includes two main deviations from the OECD Model. These deviations concern taxes on dividends and interest. Here, Austria aims to reduce source taxation even beyond internationally accepted standards (see Sections 3.2.3). Such deviations are in line with Austria's domestic tax law and its goal to promote itself as an attractive business location.

3.2.1 Business Profits

The definition of a PE and the method of computing business profits attributable to the PE are crucial. Unlike the OECD model, domestic laws, especially those of developing countries, provide for a wider definition of what a PE is and the different ways in which profits are attributable to a PE. Thus, Austria's position to fully adopt the principles of the OECD model in its DTTs can lead to a situation where certain activities, which may be regarded as a PE under the domestic law of the source country, are not regarded as a PE according to the definition in the DTT. As a result, the source country, where the PE is located, is granted less taxation rights.

Further, a delicate issue of DTTs with developing countries is the so-called "Service PE" provision, which Austria tends not to include in its DTTs, as it is not part of the OECD model. Such clause provides that a company is deemed to own a PE in a source country if a foreign company renders services through employees and/or other personnel in the source country. This may include, for instance, management fees paid by a subsidiary located in another country to headquarters located in Austria, and may apply to SPEs located in Austria that manage subsidiaries belonging to the same business group. In the absence of this Service PE provision in Austrian DTTs, services rendered by Austrian SPEs would technically not constitute a PE in other countries. This may open the possibility of shifting taxable profits like management fees from a company located in a developing country to Austria; as management services would not create a PE, they would be treated as business profits to be exclusively taxed in the residence country (i.e. Austria).

[95] The definitions and the method to compute the profits attributable to the PE differ in the UN and the OECD Model.

3.2.2 Transfer Pricing Rules

Transfer pricing rules, i.e., the rules stipulating how prices for the sale of goods or the render of services between related companies should be set, are not per se an allocation of taxation rights rule. However, these prices are extremely important in international taxation because they determine the allocation of profits between countries. The international standard for setting these prices is the arm's length principle, which states that prices for such transactions between related parties should be comparable to prices that unrelated companies would charge. Also Article 9 of the OECD Model stipulates the arm's length principle for computing transfer prices on transactions within companies of the same business group, and such is the position of Austria. Most Austrian DTTs have an Article 9 that follows OECD standards.[96]

The effectiveness of transfer pricing rules as an important component of the international tax system has been recently questioned. Not only in public opinion, as reported in the media and proliferated by NGO's, but also governments and international organizations, namely the OECD and UN, have questioned whether these rules may need to be updated. In recent tax cases involving MNEs like, for example, the cases from 2013 in the UK with Amazon, Google and Starbucks,[97] transfer pricing rules have been used to shift profits between jurisdictions, especially to low-tax countries and/or tax havens.

Transfer pricing rules are not only a problem for developed countries, but also, and probably even more so, for developing countries. Apart from the famous cases above involving Amazon, Google and Co., which received substantial attention in the media, some cases involving developing countries have also recently caught the public eye. For example, Action Aid recently published a case where SAB Miller, one of the world's largest breweries, shifted profits out of a number of African countries by means of mispriced management and licensing fees.[98]

Given that transfer pricing rules are complex and difficult to interpret, the experience, expertise and negotiation skills of tax administrations are particularly important for enforcing their correct application and thus ensuring correct tax payments.[99] Furthermore, it should also be taken into account that, in practice, it is sometimes difficult for both taxpayers and tax

[96] Roller (2012), p. 220.

[97] For a brief summary on tax avoidance schemes used by UK multinational companies, see UK HM Revenue and Customs (2012).

[98] For information on the SAB Miller Case see e.g. Roller (2012, p. 221). Roller (2012) also cites other cases of companies shifting profits out of developing countries by illegitimate use of transfer pricing (p. 223).

[99] It is often stressed that „transfer pricing is not an exact science" (OECD, 2010b, p. 2).

authorities, especially from developing countries, to find adequate data on comparable transactions in order to set a price in accordance with the arm's length principle.[100] Essentially, developed countries have a considerable advantage in having more trained and experienced personnel than developing countries.[101]

3.2.3 Passive Income

3.2.3.1 Royalties

Austria follows the OECD model and insists in DTT negotiations to exempt royalties from taxation at the source country.[102] As mentioned in section 2.1.3.2, withholding tax rates on passive income - including royalties - are usually higher under domestic law than under DTTs. Table 4 in the Annex shows for a selected number of developing countries withholding tax rates on royalty in domestic law and withholding tax rates on royalty income in their DTTs with Austria.

In cases where Austria negotiates a DTT and grants taxation rights to a source country, Austria strives to keep the definition of royalties as close as possible to the definition provided in the OECD Model. The practical implication of this policy is that if there is a 0% withholding tax rate for royalties, only the residence country (presumably in most cases Austria) can tax the income. If a DTT allows for the taxation of royalties in a source country, the narrow definition of the term "royalties" implies that some payments do not qualify as royalties but rather as business profits. In this case, the DTT provision regarding business profits stipulates exclusive taxation rights for the residence country (i.e. Austria).

3.2.3.2 Dividends

Austria's domestic tax law includes the so-called "international participation exemption law", according to which foreign source dividends received by Austrian companies are exempt from taxation.[103] This legislation is derived from the EU Parent Subsidiary Directive, which standardizes tax exemption for internal company dividends within the EU.

[100] In a meeting on 26-28 March 2014, a paper issued by the OECD Secretariat in conjunction with the Task Force on Tax and Development regarding possible approaches to address the concerns over the lack of data on comparables that have been expressed by developing countries was discussed. For information in this regard see http://www.oecd.org/ctp/transfer-pricing/transfer-pricing-comparability-data-developing-countries.htm; also see OECD (2014b).

[101] Roller (2012), p. 221f.

[102] Loukota, Seitz, Toifl (2004), p. 368; see also table 3, for the withholding tax rates on royalties with developing countries in Austrian DTTs.

[103] See IBFD Research Platform, Country Analyses, Austria, Corporate Taxation, International Aspects, p.57.

However, even beyond the intended scope of the EU Directive, Austrian DTTs extends the participation exemption regime to include non-EU countries.

Austria's DTT policy favours the removing of taxation on the cross-border distribution of dividends. The reason to exempt intercompany dividends is to avoid economic double taxation. This means that, in practice, taxation is imposed only once in a money trail. Taxation occurs only when a company generates profits, and not a second time on shareholders, where dividends are distributed. To achieve this, Austria keeps source taxation on dividends as low as possible; in some cases taxation reaches 0% (see Table 5 in the Annex for a comparison between withholding tax rates on dividends in Austria's DTTs with developing countries and withholding tax rates in domestic laws of these developing countries). The scope of the EU participation exemption requirement is also extended to a minimum shareholder participation of 10% as stipulated in Austrian DTTs.[104]

In contrast to Austria's DTT policy, the OECD Model advocates a 5% withholding tax rate at the source for direct investments where a shareholder holds at least 25% of the capital of the company paying dividends,[105] and a 15% withholding tax rate for portfolio investment where a shareholder holds less than 25% of the capital of the company paying dividends.[106] From Austria's perspective, this deviation from the OECD Model is seen as a strategy to create an attractive legal environment in order to promote international business. This is especially targeted at foreign companies that are willing to use Austria as a routing investment vehicle for investment in third countries.

3.2.3.3.Interest

Interest payments to non-residents are, generally speaking, not subject to taxation under Austrian tax law.[107] Similar to dividend taxation, Austria negotiates in its DTTs to reduce source taxation on interest to as low as possible (in some cases taxation can reach 0%).[108] Austria's argument for zero source taxation of interest payments is that as Austria does not tax interest payments made to non-residents, source taxation provided under DTTs would only benefit the other signatory country. Thus, there would be a unilateral revenue loss for

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[104] Loukota, Seitz, Toifl (2004), p.367.

[105] OECD Model (2010) Article 10 (2) a).

[106] OECD Model (2010) Article 10 (2) b).

[107] See IBFD Research Platform, Country Analyses, Austria, Corporate Taxation, International Aspects, p.65; IBFD Research Platform, News, Austria, Ministry of Finance issues draft version of the Tax Law Amendment Act 2014 on January 17, 2014.

[108] Loukota, Seitz, Toifl (2004), p. 367. Also c.f. Annex, Table 3.

Austria.[109] Table 6 in Annex shows that, in many developing countries, withholding tax rates in their DTTs with Austria are lower than the ones in their domestic laws.

However, if 0% taxation is not achieved, Austria accepts source taxation only when it is ensured that its DTT country partner does not grant third countries – especially neighbouring countries – lower withholding tax rates.[110] This is usually negotiated in a "most favoured nation clause" provision, stating that if a DTT country partner agrees on a lower withholding rate for passive income, or on exemption, in a DTT with any other country, this lower tax rate, or exemption, will automatically apply to the DTT with Austria.[111]

If a source country potentially grants lower interest taxation in a DTT with another country, for Austria there would be a potential risk of treaty shopping for Austrian and other foreign companies working under their jurisdiction. These firms may be able to use the DTTs with other countries to reroute FDI to developing countries, thus harming Austria's intent to establish itself as a business location for routing investment in developing countries. However, most "favoured nation clauses" increase the complexity of a DTT, especially for developing countries and their increasing DTT networks, creating a significant advantage for Austria as a competitive location for routing investment to third countries.

3.3 Summary: Austria's DTTs with Developing Countries

Austria's international tax strategy has four main goals at its core, to: (i) prevent double taxation, (i) foster bilateral economic relations, (ii) increase legal certainty, and (iii) prevent international tax avoidance and/or tax evasion. As regards to double taxation, this is already dealt with in a similar way under Austria's domestic law.

In Austria's view, the signing of DTTs fosters bilateral economic relations and increases legal certainty. Austria uses the OECD Model as a starting point for its DTT negotiations and includes provisions binding the latest version of the OECD commentaries as a legal means for interpreting DTT provisions. The practical effect of these outcomes is to ensure reduced source taxation.

[109] Loukota, Seitz, Toifl (2004), p.367

[110] Jirousek (2013a); most favoured nation clauses have the effect of requiring one of the contracting states to grant similar tax benefits to residents of the other contracting state to the extent it grants such benefits (e.g. by way of a bilateral tax treaty) to residents of other countries and those benefits are more favourable (lower taxation at source) than those in the tax treaty between the two contracting states, see IBFD Tax Research Platform, Glossary, most favoured nation clause; see also Hofbauer (2005), pp. 445-453.

[111] DTT Austria-Chile, point 7 of the Protocol.

With regard to preventing tax avoidance and tax evasion, Austria prefers not to include specific anti-avoidance provision in its DTTs, but addresses this issue by applying anti-avoidance measures under its domestic tax laws. Therefore, it is arguable whether the signing of DTTs actually help in preventing tax avoidance.

According to the OECD, the effective tools to fight international tax evasion are the exchange of information and administrative cooperation between tax jurisdictions. In this respect, Austria's policy deviates from the OECD standards. While Austria has major exchange information clauses in DTTs with OECD countries, non-OECD countries are offered minor exchange information clauses.

To sum up, it could be conjectured that in its DTTs, Austria: (i) disproportionally allocates taxation rights to the residence country (which typically, in relation with developing countries, is Austria) thus inducing a loss in revenue for developing countries, and (ii) limits a developing country's access to satisfactory equal exchanges of information according to OECD standards. Therefore, developing countries that sign a DTT with Austria can only hope that revenue sacrificed is offset with the attraction of new FDI that a DTT may bring. In the analysis to follow, we investigate from an economic perspective whether Austrian DTTs with developing countries actually trigger an increase in FDI in developing countries.

4. Economic Analysis of the Effects of DTTs on Austrian OFDI in Developing Countries

4.1 Austria's FDI Position

The Austrian economy is a "latecomer in FDI".[112] Until the mid-1990s, both outward and inward FDI stocks per GDP were below average when compared with European countries.[113] During this time, Austrian firms largely confined their international activity to trade, and rarely ventured into international investment projects. In 1994, outward FDI stocks amounted to 7,671 million Euros, which corresponded to 5% of Austrian GDP.[114] Since 1995, the year of Austria's accession to the EU, Austrian OFDI (outward foreign direct investment) has soared (see Figure 3). The opening up of the Eastern European markets has accelerated the growth of Austrian OFDI to such a degree that Austria was among the 20 largest foreign

[112] Bellak (2001), p. 108.

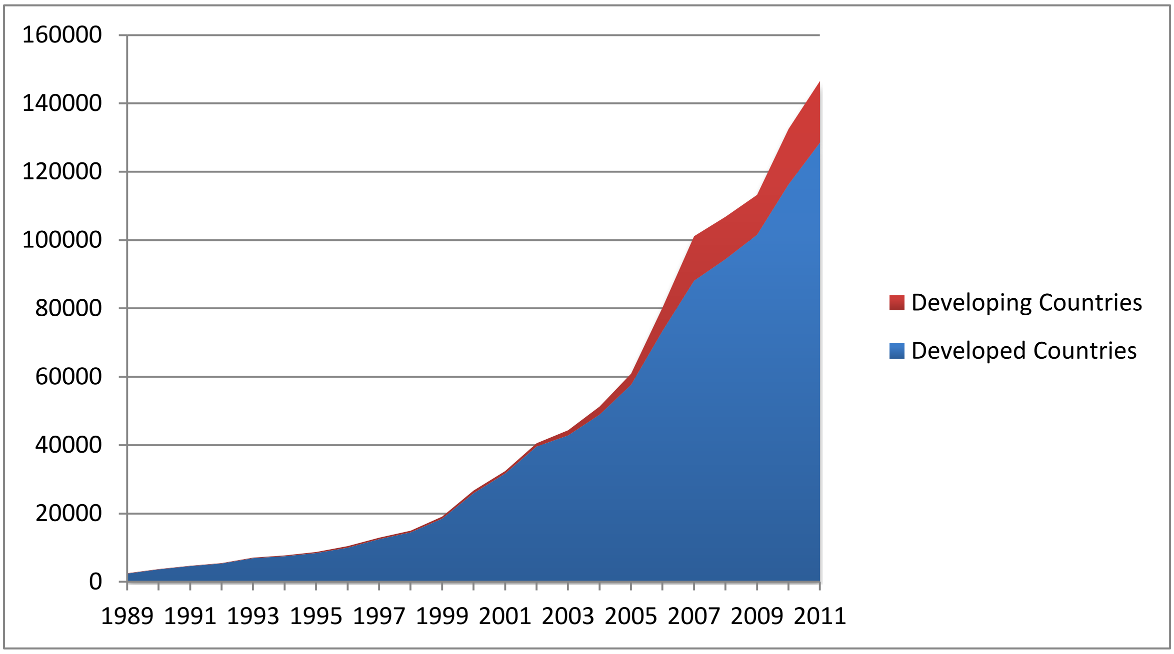
[113] For a detailed analysis of the patterns of Austrian FDI see Bellak (2001).

[114] BMWFJ, 2012a.

investors globally in 2008.[115] Albeit outgoing investments flows decreased considerably in the course of the current economic crisis[116], OFDI stocks reached 146,550 million Euros and accounted for about 51% of the Austrian GDP in 2011 (the latest year for which data is currently available).[117]

Until 2009, Austria's inward foreign direct investment (IFDI) had always exceeded its OFDI stocks.[118] Also in 1994, inward FDI stocks, which accounted for 7% of Austrian GDP, slightly surpassed its outward stocks.[119] Like OFDI, also Austrian IFDI increased considerably in the 1990s, but not as quickly as OFDI. In 2002, Austria's investment position started to reverse, and the country became a net capital-exporter.[120] Since 2010, Austria's OFDI stocks have also been exceeding its IFDI stocks. In 2011, IFDI stocks amounted to 39.3% of Austrian GDP.[121]

Figure 3: Total amount of Austrian OFDI stocks in million Euros, 1989-2011



Data source: OeNB Statistische Sonderauswertung. Own illustration.

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[115] Bellak and Mayer (2010).

[116] BMWFJ, 2012b.

[117] BMWFJ, 2012a; FDI data source: OeNB Statistische Sonderauswertung.

[118] Bellak (2001), p. 108

[119] BMWFJ, Österreichs Außenwirtschaft 2012a, p. 10.

[120] BMWFJ, 2012b, p. 2.

[121] BMWFJ, 2012b, p. 3.

4.2 Geographical distribution of Austrian OFDI

Globally, FDI flows to developing countries have increased significantly in the last decade. In 2012, for the first time ever, developing countries attracted more FDI inflows than developed countries (52%).[122] Following this trend, Austrian FDI to developing countries has gained in importance since the year 2000 and, in 2011, 15.6% of all Austrian OFDI projects were located in developing countries.[123]

Austrian OFDI in developing countries is primarily focused in Europe and Asia. In 2011, about 45% of all Austrian OFDI that flowed to developing countries was allocated in Europe (see Table 1). 37% of the Austrian OFDI projects were located in Asia (esp. China and India), 12.4% in Latin America (esp. Brazil and Mexico), and 4.4% in Africa (mainly South Africa).

On the country level, in 2011, Austrian firms were active in 50 of the 143 countries that receive official development assistance (ODA-recipient countries). Nevertheless, Austrian FDI activity in developing countries is quite concentrated. Ninety percent of all Austrian OFDI was invested in only 17 ODA-recipient countries. In 2011, the most important investment locations for Austrian firms among developing countries were Serbia, China, the Ukraine, and Turkey (see Table 1).

4.3 Sector Distribution of Austrian OFDI

Concerning the sector distribution of Austrian OFDI in 2011, of a total of 795 OFDI projects in developing countries, approximately a third were in manufacturing industries, a quarter in trading, and the remaining 40% in services and related activities. Of the latter, the finance and insurance sector constituted a major share, accounting for 17% of all Austrian OFDI projects in developing countries.[124]

[122] UNCTAD, (2013), p. xii.

[123] Data source: OeNB Statistische Sonderauswertung.

[124] Data source: OeNB Statistische Sonderauswertung.

Table 1: Geographical Distribution of Austrian FDI Projects in 2011

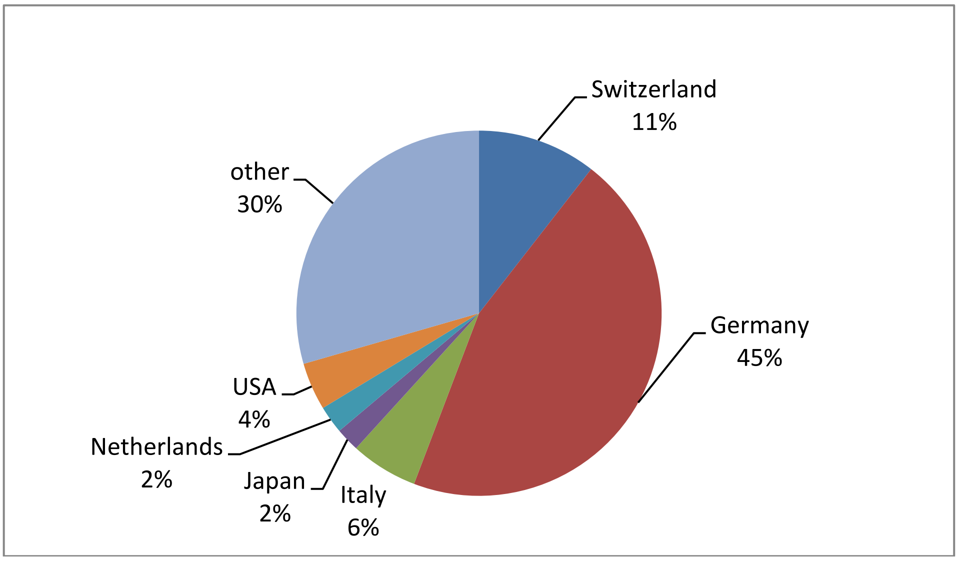
Region/Country	Number of projects	in percentages	Country Rank
Developing countries total	795	100%	
Europe	**364**	**45.79%**	
Serbia	126	15.85%	1
Ukraine	95	11.95%	3
Bosnia and Herzegovina	60	7.55%	5
Macedonia	28	3.52%	8
Albania	20	2.52%	9
Montenegro	19	2.39%	10
Belarus	11	1.38%	15
Asia	**295**	**37.11%**	
China	115	14.47%	2
Turkey	69	8.68%	4
India	39	4.91%	7
Thailand	15	1.89%	13
Malaysia	14	1.76%	14
Kazakhstan	9	1.13%	16
Africa	**35**	**4.40%**	
South Africa	18	2.23%	11
Tunisia	5	0.63%	17
Algeria	5	0.63%	17
Latin America	**101**	**12.70%**	
Brazil	47	5.91%	6
Mexico	16	2.01%	12
Chile	9	1.13%	16
Colombia	9	1.13%	16
Argentina	9	1.13%	16
Grenada	5	0.63%	17

Data source: OeNB, Statistische Sonderauswertung, own calculations.

4.4 Seat of the Parent Companies of the Austrian OFDI

Austria has also positioned itself as an attractive hub for businesses (see also Section 3.1). A number of foreign companies have established affiliates in Austria, used to invest in third countries, especially in Central Eastern European Countries (CEEC). Of the Austrian OFDI in developing countries, about one third, both in terms of FDI projects and in terms of total capital invested, is attributed to foreign companies that invest in the respective developing countries via an Austrian subsidiary. Figure 4 shows in which countries the seats of these companies are located.[125]

Figure 3: Location of the Seats of the Parent Companies of Austrian OFDI in Developing Countries (Percentage of All Austrian OFDI Projects with "Foreign" Parents) in 2011



Data source: OeNB Statistische Sonderauswertung. Own illustration.

4.5 Links between DTTs and FDI

As discussed in Section 2.1.3, attracting FDI inflows is a main (though not the only) motivation for developing countries to sign DTTs. Many of the other expected benefits, such as increased certainty for foreign investors or the prevention of tax avoidance and evasion are hard to quantify with concrete evidence. We thus focus in this section on one question, namely, whether or not DTTs trigger increases in FDI in developing countries.

The influx of FDI is often viewed as highly attractive to many countries, as FDI inflows can spur economic growth.[126] FDI may boost capital accumulation, create job opportunities, increase the integration into the international economy, and contribute to the formalization of the host economy by extending value chains. As a result, also tax revenues may rise.[127] Moreover, affiliates of MNEs can enhance human capital in a host country and generate technological spillovers to local businesses, such as knowhow regarding new

[125] Data source: ibid.

[126] OECD (2002), 16ff; UNCTAD (2012).

[127] OECD (2002), 116ff.

production techniques. This may increase productivity of local firms.[128] FDI can thus be an integral part of a country's strategy to foster economic development.[129] The theoretical basis for such positive effects is mainly provided by the "capital fundamentalism" approach, as well as the neoclassical and the endogenous growth theories.[130]

On the other hand, FDI inflows can also trigger considerable downsides. FDI may create economic enclaves that are not connected with the local economy, crowd out domestic investment, and/or curtail economic instability. Investments of foreign companies could contribute to environmental pollution and deterioration. Multinational corporations may also be able to circumvent national regulations like those regarding labour laws.[131] The dependence theory moreover emphasizes that FDI influx may contribute to perpetuating the economic and political dependence of developing countries ("the periphery") on developed countries ("the centre"). As long as foreign affiliates located in the periphery are constrained to supplying developed countries with natural resources and inexpensive labour, while decision making functions remain in the headquarters in developed countries, the presence of MNEs in the periphery contributes to sustaining political and economic dependence. Additionally, by opening up markets in the periphery, MNEs from the centre are able to preserve and strengthen their dominating role in the international stage.[132]

To what degree potential benefits of FDI materialize largely depends on local political or institutional factors, as well as on the absorptive capacities of a host economy.[133] When a host country has a certain level of technological knowhow, of human capital stock, and when the infrastructure, including financial markets, are developed to a certain degree[134], it is more likely to reap the benefits from FDI inflows.[135] Generally, middle-income countries are thus found to benefit more from FDI than low-income countries.[136]

Clearly, a range of political and economic factors determines a country's attractiveness for FDI. Amongst others, geographical location, political stability, infrastructure, the size of

[128] Goodspeed et al. (2011).

[129] Ibid.

[130] see Rostow (1961), Solow (1956), Romer (1990). For an overview see e.g. Todaro and Smith (2006), pp. 102ff.

[131] For an in-depth discussion see e.g. Navaretti and Venables (2004).

[132] Todaro and Smith (2006), p. 115ff.

[133] Crespo and Fontoura (2007); OECD, 2002.

[134] Hermes and Lensink (2003).

[135] Borensztein et al. (1998); Crespo and Fontoura (2007), p. 420.

[136] Blomström et al., (1994); Narula and Zanfei (2005).

the host market, labour cost, quality of the host country's institutions, and red tape of potential host countries all play a role in a MNE's decision where to set up a foreign affiliate.[137] Business surveys and econometric analyses also show that in addition to these determinants, tax factors – including the presence of double tax treaties – impact the location choice of MNEs.[138] From a policy perspective, DTTs are very appealing as an instrument to attract investment, as they can be implemented rather quickly in comparison to changing other factors such as the skill level of workers, which, for example, take a long time to show positive results.

4.6 Previous Economic Literature on the Effects of DTTs on FDI Activity

The economic literature investigating in how far DTTs have an impact on FDI has produced mixed results. Some authors find that DTTs promote higher FDI activity.[139] Other studies find no or negative effects of DTTs on FDI.[140] While some authors like Baker (2012) argue that DTTs simply do not impact FDI decisions, others like Coupé et al. (2009) or Blonigen et al. (2014) attribute inconclusive findings to the conflicting single provisions in the DTTs (also see Section 2.1.3.5).

Blonigen, Oldensky and Sly (2014) try to disentangle the opposing effects of DTTs. Using data on foreign subsidiaries of U.S. MNEs, the authors estimate the impact of DTTs on two different types of industries: industries that mainly use inputs traded on an organized exchange, and industries for which this is not the case. Blonigen et al. argue that the exchange of information, which DTTs provide for, more strongly affects firms that use inputs traded on an organized exchange. The ability of such firms to manipulate transfer prices is more strongly impaired by the exchange of information, as comparable prices for these inputs are easily observable by tax authorities. DTTs are found not to influence the investment patterns of these firms. According to Blonigen et al., the reason for this is that the negative effect of the exchange of information offsets the positive effect of lower withholding tax rates. For other firms, that rely more on inputs for which comparable prices are not readily observable and, thus, the exchange of information is not regarded as relevant, DTTs are found to

137 see e.g. World Economic Forum (2013); OECD (2002), 38ff.

138 For a recent comprehensive survey see Feld and Heckemeyer (2011).

139 e.g. Barthel, et al. (2010); Davies et al. (2010); Neumayer (2007).

140 e.g. Baker (2012); Egger et al. (2006); Davies et al. (2010); Louie and Rousslang (2007); Millimet and Kumas (2007).

encourage their international activity. Blonigen and his co-authors claim that for these firms, the effect of DTTs to provide relief from double taxation may prevail.

Regarding the extant literature, we would like to emphasize two issues. The first relates to the type of investment decision that is analysed, and the second to the sample of host countries that such analyses cover.

First, a firm's international location choice consists of two separate decisions. One, a firm decides as to whether or not to invest in a specific country, the so-called "extensive margin". Once this decision is made, a firm chooses how much capital to invest in a foreign affiliate, i.e. the firm decides on the "intensive margin of investment". Davies et al. (2010) and Egger and Merlo (2011) are, to our knowledge, the only studies explicitly analysing this decision at the so-called "extensive margin". Using Swedish and German firm-level data respectively, both studies find that when a DTT is in place between two countries, there is a positive effect on the likelihood of a firm to establish an affiliate in a given host country. Both studies argue that this positive effect may be explained by the tax certainty that DTTs signal.

Second, the samples of most existing studies include both developed and developing countries as potential host countries. Yet Blonigen and Wang (2005) claim that investment location decisions in developed and developing countries are likely to be determined by very different factors. Thus, the grouping of both types of countries in empirical analysis is considered to be problematic. In our analysis we only include developing countries as potential host countries.

Existing studies focusing on non-OECD countries as host countries do not produce clear-cut findings. On the one hand, Coupé et al. (2009) fail to find a consistent impact stemming from DTTs on FDI in transition economies, and Baker (2012) concludes that DTTs do not impact FDI location decisions in developing countries. On the other hand, Neumayer (2007) finds positive effects of DTTs on FDI in middle-income countries (but not in low income countries), and Barthel et al. (2010) find that DTTs encourage FDI in middle-income countries and in developing countries more generally.

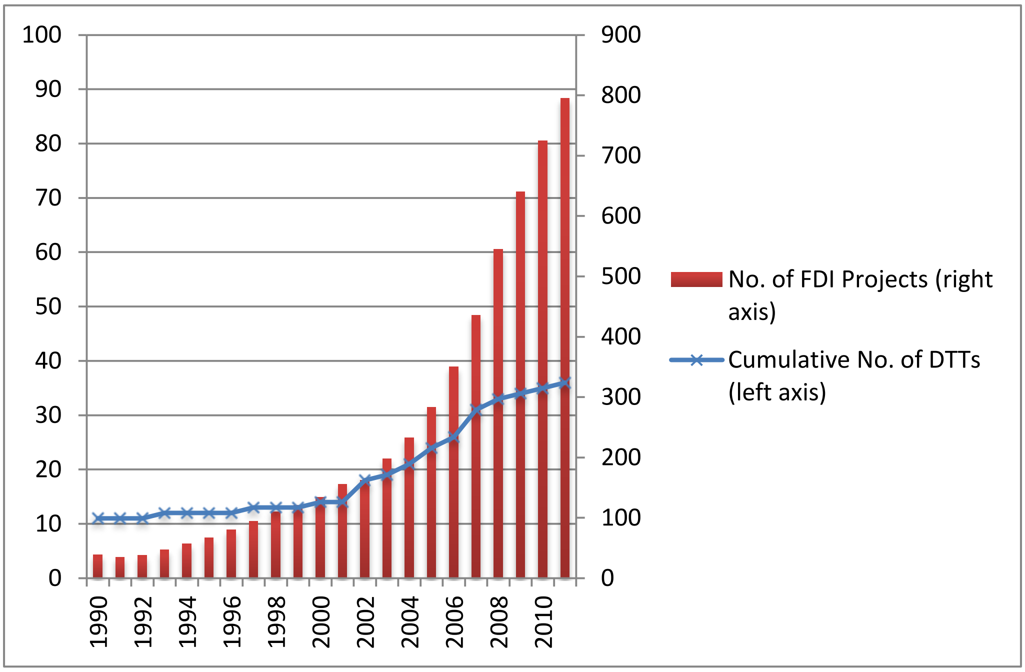
4.7 Research Design

4.7.1 Sample

Austrian FDI activity in developing countries has increased significantly since 1990 and also the number of DTTs that Austria has signed with developing countries has risen (see

Figure 5).[141] As of December 2013, 36 Austrian DTTs with developing countries are in place.[142]

Figure 4: Austrian FDI and DTTs with Developing Countries, 1989-2011



Data sources: OeNB Statistische Sonderauswertung, Bundesministerium für Finanzen (2014). Own illustration.

For the following analysis of Austrian FDI projects in developing countries, the Austrian National Bank has kindly provided the FDI data on special request. We have constructed a panel data set that covers 104 potential host countries over the period from 1990 to 2011.[143]

4.7.2 Dependent Variable

As DTTs may impact international investment at both the extensive and the intensive margin, we study both effects. First, it is examined whether the existence of a DTT makes it more likely that an Austrian firm invests in a given host country. This effect of DTTs at the extensive margin of investments is analysed in a logistic regression model. As dependent variable, we use a dummy variable that takes the values one or zero, indicating whether or not Austrian FDI exists in a specific host country.

[141] The data on FDI projects should include both subsidiaries and PEs. However, for practical difficulties of collecting the data on PEs, not all Austrian PEs abroad are recorded in the data.

[142] For a list see Table 4 in the Annex.

[143] Out of the 104 countries, there are some countries that do not have data available for all years.

Second, we analyse whether having a DTT with Austria leads to an increase in the number of Austrian FDI projects in a developing country. This can be interpreted as the intensive margin.[144] The number of FDI projects in a given country in a given year is the dependent variable, and count data models are used.[145]

4.7.3 Explanatory Variables

The explanatory variable of main interest is a dummy variable indicating whether or not Austria has a DTT in place with a specific partner country. The economic literature gives several methods in which to measure this: some studies use the date when a DTT is signed; others use the date when a treaty becomes effective. We use the latter, as this is the date that is most relevant for international investors.[146] As a robustness test, we also run regressions with the date of signature, which leads to the same result.

Depending on how the value chain of a company is split geographically, the literature distinguishes between two types of FDI: horizontal and vertical FDI.[147] When a company transfers activities abroad, which are in the "same (horizontal) stage of the production process"[148], this is known as horizontal FDI. Vertical FDI, on the other hand, refers to the international division of activities *along* the value chain.[149]

Horizontal FDI is assumed to be more likely in more alike countries. This idea is incorporated in our empirical framework through the similarity index, which indicates how similar a potential host country is to Austria in terms of GDP per capita (*similarity*). Alternatively, the GDP per capita (*gdppc*) is also used.[150] Trade costs, captured by variables

[144] This analysis is a bit of a hybrid, as it can arguably also be interpreted as an extensive-margin decision (see Egger and Merlo, 2011, p. 149).

[145] Due to confidentiality reasons, the amount in EUR of the individual investments is not available for research. Thus, regressions using the actual size of the investment in Euros are not possible.

[146] Also see Barthel et al., 2010, p. 372.

[147] See e.g. Navaretti and Venables (2004), p. 24ff.

[148] Ibid at p. 25.

[149] Ibid at p. 27.

[150] We also ran regressions that focus on dissimilarities between countries which drive vertical FDI. We used the percentage of persons that are enrolled in secondary schooling in a potential host country and compared this ratio to the Austrian enrolment ratio in secondary schooling (data from the World Development Indicators of the World Bank). We tested whether a higher difference in secondary enrolment ratios encourages or discourages Austrian FDI in a potential host country. The dissimilarity variable has a negative effect on FDI in the logit regressions, indicating that countries that are more similar to Austria in terms of secondary schooling are more likely to receive Austrian FDI. The count data regressions, on the other hand, suggest that countries that are more dissimilar to Austria receive a larger number of Austrian FDI projects. Also in these regressions, the DTT variable has a positive and significant effect on Austrian FDI activity.

such as distance or the trade barriers between two countries, are also seen as a major determinants of FDI. As our regressions include country fixed effects that account for factors that do not vary over time, the geographical distance between Austria and respective host countries is not included. Rather, we use the general openness of a country to trade, defined as total exports plus imports divided by GDP, as a control variable to represent the general openness of a country (*openness*). It is expected that a country that is generally more open to international economic activity also attracts more FDI.

As we are interested in the effects of international tax policy, a measure of the corporate income tax rate is included in our analysis. Ideally, corporate tax rates of a host country (statutory or effective) as well as withholding tax rates on dividends, interest, and royalties that are distributed to Austria would be included in our analysis. All these tax rates potentially play a role in a firm's location decision; however, withholding tax rates for developing countries are not readily available and are very difficult to compile. With this being considered, withholding tax rates have not been included in our empirical analysis. As corporate tax rates for many developing countries are also not available, we follow the lead of Egger et al. (2006) and Baker (2012), using general government final consumption expenditure as a percentage of GDP as a proxy for the corporate tax rate.[151] A higher tax rate is expected to make a country less attractive for foreign investors.[152]

As a further control variable, we incorporate the corruption index, made available by the Heritage Foundation (*corruption*). Empirical studies bring about mixed evidence as to whether corruption deters or encourages FDI.[153] Thus, it is not clear which sign to expect for the corruption variable in our regressions. Descriptive statistics for the variables are provided in Table 9 in the Annex, and Table 10 in the Annex gives an overview of the sources of each variable used in our analysis.

[151] The regressions were also run using the statutory corporate tax rate of the host countries. For many specifications, the results remain unchanged, however the DTT-variable is not persistently significant. This is probably due to the smaller sample of countries, which excludes notably the CIS-countries, which still are important FDI locations for Austria firms, and most African countries. In this smaller sample of countries, the proxy used and the statutory corporate income tax rate exhibit very similar results. Results are not presented here but are available on request; tax data from Mintz and Weichenrieder (2010) and Braun and Weichenrieder (forthcoming).

[152] For a recent overview of the empirical evidence of the effect of taxation on FDI see Feld and Heckemeyer (2011).

[153] Egger and Winner (2005), for instance, find a positive relation between corruption in the host country and FDI. Wei (2000) and Egger and Winner (2006), on the other hand, find that higher levels of corruption deter FDI.

Additionally, the quality of the infrastructure of potential host countries is used as a control variable (*infrastructure*). Countries with a better infrastructure are expected to also be more attractive for Austrian investors.

4.7.4 Estimation Technique

As mentioned above, logistic and count data regression models based on maximum likelihood estimators are the methods used for our analysis. The logistic model is a binary response model with the dependent variable being a dummy variable. A prime candidate for count data models is the Poisson specification. However, this model requires equidispersion in the data, i.e. the mean of the dependent variable should be equal to its variance. As our data shows overdispersion, we do not use a Poisson specification, but rather a negative binomial model.[154]

For both the logistic and the count data specifications, a fixed effects estimation including time and country dummy variables was implemented. Thereby, time trends and time-invariant country-specific effects such as geographical distance or cultural and historical ties are accounted for, which are not captured by our control variables.[155]

A problem with such regressions, which is hard to alleviate, is reverse causality or endogeneity, that is, we cannot be sure to measure the effect of DTTs on FDI. It could as well be that the regressions actually capture the effect of FDI on DTTs, i.e., we actually measure that Austria is more likely to sign a tax treaty with a country where there is already a lot of Austrian FDI. In order to mitigate this problem, we lag all explanatory variables. In addition, the fixed effects estimation method is used in order to deal with potential endogeneity caused by omitted variables. Thereby, only within-variation in the data is taken into account and variation from across country-pairs is ignored.[156]

In addition, by using fixed effects estimation, countries with which treaties are in place already before the sample period starts (i.e. before 1989) do not impact our estimation results, as there is no within-variation in the treaty variable. As countries are likely to sign DTTs with countries with which they have had close economic ties at an earlier stage and continue to do so, "older treaties are more likely to be correlated with unobserved variables and therefore

[154] In some count data regressions the alpha-likelihood test indicates equidispersion in the data. In these cases, also the Poisson model was estimated. As the results do not change, we decided for the sake of uniformity to use the negative binomial model in all count data regressions shown here. Due to the large number or zeros in our dependent variable, also a zero-inflated negative binomial model was estimated. The results brought about by the zero-inflated negative binomial model do not differ from the results of the negative binomial model.

[155] also see Barthel et al. (2010).

[156] Blonigen and Davies (2002).

[are more likely to be] endogenous".[157] Thus, excluding old treaties helps to alleviate the problem of endogeneity.[158] Due to these problems, an upward bias for the DTT dummy in our regressions is expected.

4.8 Estimation Results

First, we investigate whether having a DTT with Austria makes it more likely that a host country receives Austrian FDI. The first two columns in Table 2 show the results of these binary choice models. All regressions include time and country fixed effects and a constant. The sample in Column (1) includes 38 host countries and covers the years 1990-2011. The regression in Column (2), which additionally includes the corruption index of a host country as a control variable, covers fewer countries (30) and a smaller time-span (1996-2011) due to the availability of the corruption data.[159]

Our main variable of interest, the dummy variable, stating whether there is a treaty in effect between Austria and a host country (*DTT_e*), is significant and positive in these logit regressions. This suggests that potential host countries, which have a DTT with Austria in place, are more likely to attract Austrian investment than those that do not.[160]

The control variables, which are all lagged by one year, show the expected signs. Higher taxes in a host country decrease the likelihood that a developing country receives FDI from Austria.[161] The positive and statistically significant coefficient of the similarity variable indicates that: the more similar a potential host country is to Austria in terms of GDP per capita, the more likely it is that Austrian firms invest in that country. The quality of the infrastructure in the host country has the expected positive sign, but is only statistically significant in the regression covering the longer time period. Openness to trade of a country also has the expected positive sign, but is statistically not significant in the logit regressions. The corruption index, spanning from 0 to 100, where greater values indicate a lower level of corruption, is positive and statistically significant. This indicates that a lower level of

[157] Barthel et al. (2010), p. 373.

[158] See e.g. Blonigen and Davies, 2004.

[159] The number of countries is so low because there are many countries with no variation in the FDI variable. See Table 7 in the Annex for the list of host countries included in the binary choice models.

[160] It would also be desirable to quantify this effect. However, in logit regressions, only the sign, but not the magnitude of the covariates should be interpreted. For many types of logit regressions, marginal effects can be calculated, in order to measure the size of the effects. However, for the fixed-effects model, estimated with the maximum likelihood method that we implement, this is not possible (Wooldridge, 2010, p. 625).

[161] We also tested whether the effect of a DTT depends on the level of corporate taxation in the host country, but did not find any evidence for this.

corruption increases the likelihood that Austrian firms invest in a specific host country. The logistic estimation models thus suggest that having a DTT with Austria makes it more likely that a developing country receives Austrian FDI.

Second, we investigate whether or not DTTs also impact the number of Austrian FDI projects in developing countries. Columns (3) and (4) of Table 2 present the regression results for the negative binomial model. The sample in Column (3) covers the years 1990 to 2011 and includes 104 countries. In Column (4), the sample also includes the corruption index and spans the period 1996-2011, covering 101 countries.[162] The regressions again include time and country fixed effects as well as a constant.

As in the logit regressions, the main variable of interest is whether or not there is a DTT in place. The count data regressions suggest that developing countries that have a DTT in place with Austria are expected to have a 33.7% or 25.2% increase in the number of Austrian FDI projects, depending on the model used (see Columns (3) and (4) respectively). Evaluated at the mean number of FDI projects, this implies that these developing countries are expected to have 0.8 additional FDI projects. This is a sizable effect.[163]

[162] See Annex, Table 8, for the list of countries included in these regressions. In this sample, the number of countries is higher than in the logit regressions as the FDI variable in the count data models evidently exhibits more within-variation.

[163] Studies that analyse the impact of DTTs on FDI stocks in developing countries, measured in amounts of dollars, find similar results. For instance, Barthel et al. (2010) find that "DTTs increase the bilateral FDI stock between 27% and 31%" (p. 367). However, these results cannot be compared directly, because in our study, the dependent variable is the number of FDI projects, which are evidently of different sizes.

Table 2: Baseline Regression Results

	logit		count data	
	(1)	(2)	(3)	(4)
DTT_e	2.877***	2.280***	0.337***	0.252***
	(3.45)	(2.60)	(4.95)	(3.69)
ln_ct	-1.259**	-1.815**	-0.599***	-0.430**
	(-2.06)	(-2.09)	(-3.98)	(-2.02)
similarity	19.85***	32.51**	5.859***	4.612***
	(3.02)	(2.50)	(7.10)	(5.39)
infrastructure	0.0941**	0.0102	0.0133***	0.00718
	(2.28)	(0.15)	(2.61)	(1.32)
openness	0.790	0.397	0.821***	0.637***
	(1.13)	(0.27)	(4.27)	(2.72)
corruption		0.0545***		0.0117***
		(2.92)		(4.01)
constant	13.18	14.26	3.060***	2.833***
	(0.03)	(0.02)	(6.19)	(4.20)
year FE	yes	yes	yes	yes
country FE	yes	yes	yes	yes
period	1990-2011	1996-2011	1990-2011	1996-2011
observations	816	459	2133	1383
no. of countries	38	30	104	101
pseudo-R^2	0.46	0.45	0.53	0.54
log-likelihood	-302.04	-173.92	-1370.48	-985.41

Notes: in Columns (1) and (2) the dependent variable is binary variable indicating whether or not there is Austrian FDI in a given country; in Columns (3) and (4) the dependent variable is a count variable indicating the number of Austrian FDI projects in a host country. Columns denote coefficients rather than odd ratios. All control variables are lagged by one period and the natural logarithm of the corporate tax rate is taken. T-statistics in parentheses. Stars denote p-values: *** p<0.01; ** p<0.05; * p<0.1.

The control variables in the count data models are similar to the ones in the logit regressions. A higher tax rate discourages Austrian investment. The similarity index and the openness of a country have a positive and statistically significant effect on the number of Austrian FDI projects in a country. The coefficient of the quality of the infrastructure variable is again positive and statistically significant in the larger sample (Column 3). The coefficient of the corruption variable indicates that lower levels of corruption cause a country to be more attractive for Austrian investors. The count data models thus suggest that developing countries with DTT attract more Austrian FDI projects than those without a DTT.

4.9 Robustness Tests

In order to check the robustness of our results, a number of alternative specifications were run. The date of signature of a DTT (*DTT_s*) was trialled instead of the date of effectiveness of a DTT (see Annex, Table 11). In place of the similarity index, data on the GDP per capita of the host countries (*ln_gdppc*) was included (see Annex, Table 12). Moreover, the population (*ln_pop*) of host countries was used as a proxy for the host country's potential market size (see Annex, Table 13). Against our expectations, we do not find a positive and significant effect on FDI. The size of the host country population does not increase the number of Austrian FDI projects in a statistically significant way. A reason for this may be that relatively small countries like Serbia or Bosnia Herzegovina are among the countries that attract the most Austrian FDI.

For further testing the robustness, our sample was restricted in three different ways (see Annex, Tables 14 and 15). First, CEE countries[164] that historically attract a large part of Austrian OFDI and thus may bias our regressions results were excluded from the regression (Columns (1) to (4), Annex, Table 14). Second, B(R)IC countries[165], which due to their market size and growth rates in the last decades have attracted a lot of FDI regardless of a DTT, were also left out (Column (5), Annex, Table 14). Third, our sample of host countries includes ten jurisdictions, which are or have been listed as tax havens by the OECD and/or the Bank for International Settlements: Antigua and Barbuda, Belize, Costa Rica, Dominica, Grenada, Lebanon, Liberia, Mauritius, Panama and Uruguay.[166] In the robustness tests, these countries are excluded from the sample of potential host countries, as investing in these countries may arguably be motivated by other factors when compared to investing in "normal" developing countries (Annex, Table 15). All these alternative specifications confirm the results of our baseline regressions, that there is a positive relationship between DTTs and Austrian investment projects in developing countries.

[164] The CEE countries in our sample are Albania, Bosnia and Herzegovina, Macedonia, Montenegro, and Serbia.

[165] Brazil, China, and India: Russia is not included in our sample of host countries.

[166] Costa Rica and Uruguay were in the OECD "List of Jurisdictions That Have Not Committed to the Internationally Agreed Tax Standards". Antigua and Barbuda, Belize, Dominica, Grenada, Liberia, and Panama were included in the OECD "List of Jurisdictions That Have Committed to the Internationally Agreed Tax Standard, But Have Not Yet Substantially Implemented It". Lebanon and Mauritius are in the list of offshore centres published by the Bank of International Settlements (see Hebous, 2014). Additionally, also Malaysia and the Philippines were in the OECD "List of Jurisdictions That Have Not Committed to the Internationally Agreed Tax Standards", but these two countries are large countries, which may attract investment also for economic reasons; thus we decided to leave them in the sample.

4.10 Discussion

The econometric analysis presented here suggests that DTTs significantly encourage Austrian FDI activity in developing countries. As Austria mainly has DTTs with middle-income countries[167] (except for Tajikistan and Nepal), our results are in line with Neumayer (2007), who also finds that the presence of DTTs triggers increased FDI in middle-income countries. Our results suggest that the number of Austrian investment projects in middle income countries increases by 25.2% to 33.7% when a DTT is in place.

However, these figures should be taken with some caution. First, even though we tried to mitigate the concerns of endogeneity in the analysis, they are arguably not entirely solved. Thus, it is not totally clear, whether DTTs trigger more FDI or whether rather Austria signs DTTs with countries where Austrian firms are active. As we expect an upward bias due to these endogeneity problems, the actual effect may be smaller than the regression results suggest.

Second, the method used captures short term-effects only. In the long run, the impact of DTTs on FDI may be different. According to a recent study of the Netherlands Bureau for Economic Policy Analysis (CBP) DTTs only have a temporary positive effect. The CBP study suggests that "[t]he average effect of a new treaty reaches a peak at almost 35% higher bilateral FDI stocks after six years, but becomes insignificant after eleven years."[168]

It should also be considered that about a third of Austrian FDI projects in developing countries actually originate from third countries. As seen in Section 4.4, international firms use their Austrian subsidiaries for investing in other countries, including developing countries. In the econometric analysis above, it is impossible to prove or discredit whether firms invest in a respective developing country via Austria are doing so simply because of a DTT between Austria and a respective developing country. That is, our results may capture some treaty shopping, which could also lead to an overestimation of the effect of DTTs on Austrian FDI activity (also see Section 2.1.3.3).[169] As Weyzig (2013) suggests:

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[167] As of July 2013, according to the World Bank (2013), middle-income countries are defined as having a Gross National Income per capita of between 1,036 USD and 12,615 USD.

[168] Weyzig (2013), p. 62.

[169] There are studies that find empirical evidence that treaty shopping takes place (e.g. Mintz and Weichenrieder, 2008; Dreßler, 2012; Weyzig, 2012). We are, however, not aware of any evidence that the Austrian DTT network is used for treaty shopping purposes. Lang (2012) sees a risk that the inclusion of provisions regarding the waiving of the withholding taxation of residents in Austria's tax treaties with countries that used to be considered as tax havens may provide incentives to shift profits out of Austria into third countries via these partner countries, that tax income at a very low rate or not at all (p. 115). Steiner (2013) provides anecdotal evidence that Austria is being used as a conduit country for routing profits generated in a multinational's European affiliates overseas. According to Steiner, this routing via Austria takes place not because of the

> Due to treaty shopping, the effect of tax treaties on total inward FDI in developing countries may be smaller than most existing studies suggest. FDI diversion via a treaty country leads to overestimation of the effect of the treaty on bilateral FDI originating from the country itself (p. 63).

Thus, the reader is advised to take all these matters into consideration when examining the results of this economic analysis.

5. Conclusions and Recommendations

This study investigates the effects developing countries may expect when signing a DTT with Austria. Our economic analysis suggests that the signature of a DTT with Austria encourages Austrian FDI activity in middle-income countries. This is achieved in a number of ways, as listed below.

Signing a DTT helps to avoid double taxation. However, as Austria's domestic tax law contains provisions which allow to prevent double taxation unilaterally, this seems not to be the only (or main) impetus for increasing FDI activity.

DTTs also signal legal certainty for potential investors. Legal certainty is, however, not achieved solely by signing a DTT, but through the interplay of a DTT with a comprehensive, transparent, and stable domestic tax system. Also, developing countries should be aware that the legal certainty embodied in a DTT implies that the residence country (most likely to be Austria), would, to some extent, impose its tax rules on the source country (most likely to be the developing country).

In addition, reduced withholding tax rates as compared with the domestic tax rates may contribute to attract FDI. Austria's policy goal is to reduce withholding tax rates as much as possible (even below the rates proposed by the OECD) and also to include, in some cases, a "most favoured nation clause", which may lead to further tax rate reductions in the future. However, such reduced withholding tax rates may also imply downsides for a source country. As withholding tax rates can help to mitigate profit shifting by MNEs,[170] having no or very low source taxation creates opportunities for tax avoidance. Additionally, capital-importing

Austrian DTT network but because overall the Austrian tax system is so attractive for multinationals (also see Section 3.1).

[170] "In particular, withholding taxes on interest, royalties, and management fees form a barrier against profit shifting to low-tax affiliates by multinational firms" (Weyzig, 2013, p. 42).

countries risk losing tax revenues, if the increased FDI inflows are not large enough to make up for revenue that is lost.

Curbing tax avoidance is also a frequently mentioned effect of a DTT. Considering the evidence presented in this paper, we do not share this view. Anti-abuse clauses in DTTs can only curb tax-planning possibilities to a certain point; in any case, such possibilities are created by the application of the DTTs themselves. Thus, we do not recommend the use of specific anti-abuse clauses in DTTs, as we believe that such clauses only encourage tax planning and avoidance schemes.

Furthermore, DTTs help to mitigate tax evasion, as they provide for the exchange of information and administrative cooperation between tax administrations. However, by signing TIEAs and the Multilateral Convention, countries can often achieve the same purposes. For developing countries, these tax agreements may even be more beneficial alternatives, as they do not unproportionally shift taxation rights to the residence country (which is likely to be Austria). Moreover, the multilateral approach of the Mutual Assistance Convention is an advantage in the fight against tax avoidance and evasion, as it also provides, at least in theory, a "level playing field". Similar rules apply to all signatory countries and, further, information can be exchanged with third countries. However, Austria has not yet to date ratified the Multilateral Convention. This makes Austria's DTT network all the more important.

On another note, the exchange of information on request (as established in DTTs) does not always alleviate the problem of tax evasion. For example, wealthy individuals can hide their money in bank accounts abroad, which is a problem for both developed and developing countries; however developing countries that have weaker tax administrations may arguably suffer more from this form of tax evasion.[171] Information being exchanged only on request requires countries to provide information to identify the taxpayer under examination. Acknowledging that this is a complicated task, we would argue that through the automatic exchange of information, could one curb the problem of tax evasion to a greater degree.[172]

From the arguments provided above, it becomes clear that signing a DTT with Austria entails both potential benefits and risks for developing countries. It would be advisable for developing countries to conduct DTT impact analyses in order to be able to estimate their

[171] Anecdotal evidence suggests that such money is also in bank accounts in Austria, that has a very stable political environment and (used to) offer bank secrecy (see e.g. Skjönsberg (2012); Huter (2014); Höller (2014)).

[172] Also see McGauran (2012): "The inclusion of information exchange agreements does not ensure detection of evasion and avoidance. On-request information exchange (…) typically fails to detect tax avoidance and evasion because strong indications need to exist to be able request information from another tax authority" (p. 19).

potential effects. Such analyses could also shed light on which provisions to be included or adapted to achieve desired goals.

Also for Austria, the results of this study are relevant. The growing internationalization of the Austrian economy implies that its international tax policy impacts other states. Like all member states of the European Union, Austria has subscribed to "policy coherence": Austria commits to consider the goals and principles of its developmental policy in *all* policy areas that affect developing countries.[173] In the light of this "policy coherence" principle, Austria might, for example, need to re-examine how its DTT policy with regard to withholding tax rates affects resource mobilization in developing countries.

Finally, there is ample room for further research. Most economic studies, including the present one, assume all tax treaties to be identical. However, even though they may be very similar in structure, each DTT is different. It is surprising that still little is known about how these different types of DTTs impact on FDI. In addition, as already indicated above, further empirical evidence on how DTTs affect tax revenues of signatory states is needed. Corporate taxes, as well as withholding taxes, can be a significant source of revenue for developing countries.[174] Also, case studies analysing the benefits and disadvantages of individual DTTs could be very insightful. However, not least because of the scarcity of available data, conducting such studies may be very challenging.

[173] Austria has embraced the principle of policy coherence in its national law: §1 Zi 5 EZA-G "Der Bund berücksichtigt die Ziele und Prinzipien der Entwicklungspolitik bei den von ihm verfolgten Politikbereichen, welche die Entwicklungsländer berühren können."

[174] For instance, in 1997, withholding tax revenues made up 3% of GDP in Brazil, while corporate tax revenues excluding withholding taxes accounted for 3.7% (Weyzig, 2013, p. 40). McGauran (2013) undertook an effort to estimate the tax revenue losses due to DTTs signed between developing countries and the Netherlands.

6. Annex

Table 3: List of Austrian DTTs with Developing Countries

Albania (2009)	Malaysia (1988)
Algeria (2007)	Mexico (2006)
Argentina (1978-2008)	Moldova, Republic of (2006)
Armenia (2005)	Mongolia (2005)
Azerbaijan (2002)	Morocco (2007)
Belarus (2003)	Nepal (2003)
Belize (2004)	Pakistan (1968)
Bosnia and Herzegovina (2012)	Philippines (1983)
Brazil (1977)	Serbia, Republic of (2011)
Chile (signed 2012, not yet ratified)	South Africa (1998)
China (1993)	Syrian Arab Rep. (signed 2009, not ratified yet)
Cuba (2007)	Tajikistan* (1979)
Egypt (1961)	Thailand (1987)
Georgia (2007)	Tunisia (1979)
India (2002)	Turkey (1974)
Indonesia (1989)	Turkmenistan* (1979)
Iran, Islamic Republic of (2005)	Ukraine (2000)
Kazakhstan (2007)	Uzbekistan (2002)
Kyrgyzstan (2004)	Venezuela (2008)
Libya (signed 2010, not ratified yet)	Vietnam (2011)
Macedonia (2008)	

Note: Years in parentheses depict years when DTT becomes applicable; *old DTT with USSR applicable until new DTT signed (Tajikistan: new DTT signed in 2011, applicable as of 2013)

Source: Austrian Ministry of Finance

Table 4: Comparison of tax rates on royalties in domestic tax law and withholding tax rates stipulated in the DTT with Austria for selected developing countries

Country	**Domestic Tax Law Rates (in %)**	**DTT Rates (in %)**
Albania	10	5
Algeria	4.8/24	10
Belarus	0/12/15	5
Bosnia and Herzegovina	10	5
Brazil	15/25	10/15/25
China (People's Rep.)	10/20	10
India	25/27.037	10
Kazakhstan	15	10
Macedonia (FYR)	10	0
Malaysia	10	10/15
Mexico	5/25/30/40	10
Serbia	20/25	5/10
South Africa	12	0
Thailand	3/15	15
Tunisia	0/15	10/15
Turkey	20	10
Ukraine	15/17	0/5

Note: Some countries' domestic tax law stipulates different withholding tax rates depending on the type of royalties. For example, Mexico stipulates 5% for railroad wagons; 30% for patents, trademarks and advertising; 40% if paid to entities subject to preferential tax regime (tax havens); and 25% for other royalties.

Source: IBFD database

Table 5: Comparison of tax rates on dividends in domestic tax law and withholding tax rate stipulated in the DTT with Austria for selected developing countries

Country	Domestic Tax Law Rates (in %)		DTT Rates (in %)	
	Individuals, companies (portfolio investment)	**Qualifying companies (direct investment)**	**Individuals, companies (portfolio investment)**	**Qualifying companies (direct investment)**
Albania	10	0/10	15	5
Algeria	15/15	15/0	15	5
Belarus	12/0	0/12	15	5
Bosnia and Herzegovina	0/5/10	0/5	10	5
Brazil	0	0	15	15
China (People's Rep.)	0/5/10/20	0/10	10	7
India	0/15	0/15	10	10
Kazakhstan	15	0/15	15	5
Macedonia (FYR)	10	0/10	15	0
Malaysia	0	0	10	5
Mexico	0	0	10	5
Serbia	20/25	0/20	15	5
South Africa	15	0	15	5
Thailand	10	0/10	–	10
Tunisia	0	0	20	10
Turkey	15	0/15	15	5
Ukraine	15	0/15	10	5

Note: Many countries do not tax dividends distributed to non-residents. This is to avoid economic double taxation, which means that taxation is imposed only on the profit making company, and not when the dividends are distributed.
Some countries' domestic tax law stipulates different withholding tax rates depending to whom dividends are paid (e.g. individuals, companies). For example, Serbia stipulates 25% if recipient of dividends is resident in a jurisdiction with a preferential tax regime and 20% in all remaining cases.

Source: IBFD database

Table 6: Comparison of tax rates on interest in domestic tax law and withholding tax rates stipulated in the DTT with Austria for selected developing countries

Countries	Domestic Tax Law Rates (in %)	DTT Rates (in %)
Albania	10	5
Algeria	10/40/50	0/10
Belarus	0/10/12	5
Bosnia and Herzegovina	0/10	5
Brazil	0/15/25	–/15
China (People's Rep.)	0/10/20	10
India	10/20/21.63	10
Kazakhstan	15	10
Macedonia (FYR)	10	0
Malaysia	15	15
Mexico	4.9/10/15/21/30/40	0/10
Serbia	0/15/20/25	10
South Africa	0	0
Thailand	1/15	10/25
Tunisia	5/20	10
Turkey	0/1/3/5/7/10/12/13/15/18	10/15
Ukraine	0/5/15	2/5

Note: Some countries' domestic tax law stipulates different withholding tax rates depending to whom the interest is paid. For example, Mexico stipulates 4.9% if paid to non-resident banks, or to publicly traded securities if a tax treaty applies, 10% if paid to financial institutions, or to publicly traded securities, 15% if paid to reinsurance companies, 21% if paid to non-resident suppliers of machinery and equipment or paid by financial institutions but not subject to 10% or 4.9% rates, 40% if paid to entities subject to preferential tax regime (tax haven), and 35% other interest.

Source: IBFD database

Table 7: Countries Included in Binary Choice Models

Albania[a]	Grenada[a]	Mozambique
Algeria	Guatemala	Namibia[a]
Antigua and Barbuda[a]	Honduras	Nicaragua
Armenia	Iran	Nigeria
Azerbaijan	Jordan	Pakistan[a]
Belarus	Kazakhstan	Panama
Chile	Libya	Paraguay
Costa Rica	Macedonia[a]	Peru[a]
Cuba	Malaysia[a]	Tunisia
Ecuador	Mauritius	Turkey
Egypt	Mexico	Uzbekistan
Georgia	Moldova	Vietnam
Ghana	Morocco	

Note: Countries marked with an [a] are not included in the corruption index

Table 8: Countries Included in Count Data Models

Afghanistan[a]	Congo, Rep. of	Jamaica	Pakistan
Albania	Costa Rica	Jordan	Panama
Algeria	Cuba	Kazakhstan	Papua New Guinea
Angola	Djibouti	Kenya	Paraguay
Antigua and Barbuda[a]	Dominica[a]	Kyrgyz Republic	Peru
Argentina	Dominican Republic	Lebanon	Philippines
Armenia	Ecuador	Lesotho	Rwanda
Azerbaijan	Egypt	Liberia	Senegal
Bangladesh	El Salvador	Libya	Serbia
Belarus	Equatorial Guinea	Macedonia	Sierra Leone
Belize	Eritrea	Malawi	South Africa
Benin	Ethiopia	Malaysia	Sudan
Bhutan	Gabon	Mali	Suriname
Bolivia	Gambia	Mauritania	Syrian Arab Republic
Bosnia and Herzegovina	Georgia	Mauritius	Tajikistan
Botswana	Ghana	Mexico	Thailand
Brazil	Grenada[a]	Moldova	Tunisia
Burkina Faso	Guatemala	Mongolia	Turkey
Burundi	Guinea	Montenegro	Turkmenistan
Cambodia	Guinea-Bissau	Morocco	Uganda
Cameroon	Guyana	Mozambique	Ukraine
Central African Republic	Haiti	Namibia	Uzbekistan
Chad	Honduras	Nepal	Venezuela
Chile	India	Nicaragua	Vietnam
China	Indonesia	Niger	Zambia
Colombia	Iran	Nigeria	Zimbabwe

Note: Countries marked with an [a] are not included in the models including the corruption index

Table 9: Summary Statistics

Variable	Obser-vations	Mean	Standard Deviation	Minumum	Maximum
logit 1990-2011					
FDI_d	816	0.44	0.50	0	1
DTT_e	816	0.24	0.43	0	1
ln_ct	816	2.60	0.39	1.58	3.77
similarity	816	0.09	0.07	0.004	0.42
infrastructure	816	11.60	9.69	0.12	49.32
openness	816	0.82	0.38	0.24	2.12
logit 1996-2011					
FDI_d	459	0.47	0.50	0	1
DTT_e	459	0.27	0.45	0	1
ln_ct	459	2.56	0.37	1.61	3.69
similarity	459	0.08	0.06	0.007	0.31
infrastructure	459	12.24	8.82	0.32	43.13
openness	459	0.83	0.32	0.25	1.78
corruption	459	31.42	15.19	7	79
count data 1990-2011					
FDI	2133	2.42	9.82	0	126
DTT_e	2133	0.20	0.40	0	1
ln_ct	2133	2.60	0.45	0.72	4.24
similarity	2133	0.06	0.07	0.004	0.48
infrastructure	2133	7.84	8.84	0.017	49.32
openness	2133	0.76	0.39	0.04	2.89
count data 1996-2011					
FDI	1383	3.18	11.19	0	126
DTT_e	1383	0.26	0.44	0	1
ln_ct	1383	2.55	0.42	0.72	3.75
similarity	1383	0.06	0.06	0.004	0.48
infrastructure	1383	8.52	8.37	0.06	43.13
openness	1383	0.77	0.37	0.08	2.12
corruption	1383	28.98	13.87	4	79

Table 10: Data Sources of the Variables Used in the Regression Analysis

Variable	**Explanation**	**Source**
FDI	Number of Austrian investments in a given country in a given year	Austrian National Bank (OeNB Statistische Sonderauswertung)
FDI_d	Dummy of whether or not there is an Austrian investment in a given country in a given year	Austrian National Bank (OeNB Statistische Sonderauswertung)
DTT_s	Dummy equal to 1 in the year a DTT is signed btw Austria and the respective partner country; also 1 in all subsequent years	IBFD and Austrian Ministry of Finance
DTT_e	Dummy equal to 1 in the year a DTT btw Austria and the respective partner country becomes effective; also 1 in all subsequent years	IBFD and Austrian Ministry of Finance
similarity	"Similarity is an index, defined as one minus the ratio of the absolute value of GDP per capita minus GDP per capita in [Austria], relative to the higher of both GDPs per capita" (Overesch and Wamser, 2009: 1670).	own calculation; based on UN GDP data
infrastructure	Telephone lines (per 100 people)	World Bank, World Development Indicators, available at http://data.worldbank.org/data-catalog/world-development-indicators
corruption	Index ranging from 0 to 100, where 0 means very corrupt and 100 very little corrupt	Heritage Foundation, avail. at: http://www.heritage.org/index/explore?view=by-region-country-year
gdppc	GDP per capita	United Nations
openness	(Exports +imports)/gdp	Penn World Table 8.0 (Feenstra et al., 2013)
corporate tax rate	Host country corporate tax rate; proxied by general government final consumption expenditure as a percentage of GDP	World Bank, World Development Indicators, available at http://data.worldbank.org/data-catalog/world-development-indicators

Table 11: Robustness Test 1. Date of signature of DTT

	logit		count data	
	(1)	(2)	(3)	(4)
DTT_s	3.293***	4.106***	0.320***	0.256***
	(4.10)	(4.07)	(4.59)	(3.27)
ln_ct	-1.368**	-2.215**	-0.652***	-0.520**
	(-2.19)	(-2.44)	(-4.36)	(-2.32)
similarity	20.50***	21.69*	6.069***	4.702***
	(3.10)	(1.75)	(7.18)	(5.20)
infrastructure	0.0801*	-0.0633	0.0134**	0.00640
	(1.91)	(-0.89)	(2.53)	(1.16)
openness	0.438	-1.073	0.891***	0.769***
	(0.61)	(-0.69)	(4.60)	(3.27)
corruption		0.0541***		0.00995***
		(2.79)		(3.27)
constant	14.54	18.21	3.138***	3.074***
	(0.02)	(0.02)	(6.29)	(4.51)
year FE	yes	yes	yes	yes
country FE	yes	yes	yes	yes
period	1990-2011	1996-2011	1990-2011	1996-2011
observations	816	459	2133	1383
no. of countries	30	38	104	101
pseudo-R^2	0.47	0.48	0.53	0.55
log-likelihood	-296.49	-165.62	-1371.58	-986.64

Notes: dependent variable in columns (1) and (2) is a binary variable dependent variable indicating whether or not there is Austrian FDI in a host country; dependent variable in columns (3) and (4) is a count variable indicating the number of Austrian FDI projects in a host country; columns denote coefficients; all control variables are lagged by one period and the natural logarithm of the corporate tax rate is taken; t statistics in parentheses; stars denote p-values: *** p<0.01; ** p<0.05; * p<0.1;

Table 12: Robustness Test 2. GDP per Capita

	logit		count data	
	(1)	(2)	(3)	(4)
DTT_e	2.958***	2.313***	0.314***	0.240***
	(3.49)	(2.65)	(4.63)	(3.40)
ln_ct	-1.245**	-1.884**	-0.530***	-0.379
	(-1.99)	(-2.13)	(-3.38)	(-1.61)
ln_gdppc	1.272**	1.874**	0.609***	0.472***
	(2.38)	(2.26)	(6.47)	(4.30)
infrastructure	0.103**	0.0223	0.00394	-0.00112
	(2.51)	(0.34)	(0.72)	(-0.18)
openness	0.730	0.209	0.852***	0.681***
	(1.04)	(0.14)	(4.41)	(2.76)
corruption		0.0606***		0.0109***
		(3.22)		(3.71)
constant	4.020	2.339	-1.294	-0.483
	(0.01)	(0.00)	(-1.28)	(-0.39)
year FE	yes	yes	yes	yes
country FE	yes	yes	yes	yes
period	1990-2011	1996-2011	1990-2011	1996-2011
observations	816	459	2133	1383
no. of countries	30	38	104	101
pseudo-R^2	0.46	0.45	0.53	0.55
log-likelihood	-303.94	-174.89	-1374.41	-989.58

Notes: dependent variable in columns (1) and (2) is a binary variable indicating whether or not there is Austrian FDI in a host country; dependent variable in columns (3) and (4) is a count variable indicating the number of Austrian FDI projects in a host country; columns denote coefficients; all control variables are lagged by one period and the natural logarithm of the corporate tax rate is taken; t statistics in parentheses; stars denote p-values: *** p<0.01; ** p<0.05; * p<0.1;

Table 13: Robustness Test 3. Inclusion of Population as Control Variable

	logit		count data	
	(1)	(2)	(3)	(4)
DTT_e	2.896***	1.962**	0.222***	0.185***
	(3.39)	(2.12)	(3.29)	(2.63)
ln_ct	-1.261**	-1.754**	-0.560***	-0.276
	(-2.06)	(-2.00)	(-3.69)	(-1.25)
similarity	19.86***	30.36**	5.611***	4.567***
	(3.02)	(2.33)	(7.07)	(5.34)
ln_pop	0.219	-4.287	-2.121***	-2.202***
	(0.11)	(-1.00)	(-4.76)	(-3.86)
infrastructure	0.0947**	-0.00274	0.00209	-0.00333
	(2.27)	(-0.04)	(0.40)	(-0.55)
openness	0.791	0.221	0.853***	0.845***
	(1.13)	(0.15)	(4.49)	(3.50)
corruption		0.0512***		0.0115***
		(2.72)		(3.94)
constant	9.676	93.13	41.76***	42.50***
	(0.01)	(0.13)	(5.13)	(4.13)
year FE	yes	yes	yes	yes
country FE	yes	yes	yes	yes
period	1990-2011	1996-2011	1990-2011	1996-2011
observations	816	459	2111	1377
no. of countries	30	38	103	100
pseudo-R^2	0.46	0.45	0.53	0.55
log-likelihood	-302.03	-173.41	-1359.31	-977.76

Notes: dependent variable in columns (1) and (2) is a binary variable indicating whether or not there is Austrian FDI in a host country; dependent variable in columns (3) and (4) is a count variable indicating the number of Austrian FDI projects in a host country; columns denote coefficients; all control variables are lagged by one period and the natural logarithm of the corporate tax rate is taken; t statistics in parentheses; stars denote p-values: *** p<0.01; ** p<0.05; * p<0.1;

Table 14: Robustness Test 4. Exclusion of CEECs and the B(R)IC

	no CEECs				no B(R)IC
	logit		count data		count data
	(1)	(2)	(3)	(4)	(5)
DTT_e	2.909***	2.280***	0.373***	0.256***	0.242***
	(3.49)	(2.60)	(4.58)	(2.87)	(3.67)
ln_ct	-1.462**	-1.815**	-0.555***	-0.489**	-0.548***
	(-2.29)	(-2.09)	(-3.39)	(-1.99)	(-3.69)
similarity	19.85***	32.51**	5.731***	4.497***	8.915***
	(3.03)	(2.50)	(6.50)	(4.76)	(10.04)
infrastructure	0.0861**	0.0102	0.0201***	0.00814	
	(2.12)	(0.15)	(3.55)	(1.39)	
openness	0.594	0.397	0.729***	0.475*	1.249***
	(0.83)	(0.27)	(3.42)	(1.83)	(7.21)
corruption		0.0545***		0.0128***	
		(2.92)		(3.84)	
constant	14.46	14.26	2.785***	3.011***	2.678***
	(0.02)	(0.02)	(5.18)	(4.00)	(5.64)
year FE	yes	yes	yes	yes	yes
country FE	yes	yes	yes	yes	yes
period	1990-2011	1996-2011	1990-2011	1996-2011	1990-2011
observations	773	459	2068	1345	2093
no. of countries	36	30	99	96	101
pseudo-R^2	0.45	0.45	0.53	0.55	0.53
log-likelihood	-289.88	-173.92	-1222.81	-896.91	-1203.02

Notes: dependent variable in columns (1) and (2) is a binary variable indicating whether or not there is Austrian FDI in a host country; dependent variable in columns (3)to (5) is a count variable indicating the number of Austrian FDI projects in a host country; columns denote coefficients; all control variables are lagged by one period and the natural logarithm of the corporate tax rate is taken; t statistics in parentheses, stars denote p-values: *** p<0.01; ** p<0.05; * p<0.1;

Table 15: Robustness Test 6. Exclusion of Tax Haven Countries

	logit		count data	
	(1)	(2)	(3)	(4)
DTT_e	3.351***	2.146**	0.345***	0.251***
	(3.87)	(2.39)	(4.99)	(3.69)
ln_ct	-1.058*	-1.856**	-0.541***	-0.437**
	(-1.67)	(-2.04)	(-3.52)	(-2.04)
similarity	26.72***	59.84***	6.113***	4.679***
	(3.20)	(3.46)	(7.11)	(5.45)
infrastructure	0.0893	0.0231	0.0145***	0.00724
	(1.56)	(0.30)	(2.77)	(1.32)
openness	3.473***	2.048	1.166***	0.641***
	(3.44)	(1.18)	(5.53)	(2.70)
corruption		0.0633***		0.0116***
		(3.13)		(3.95)
constant	10.71	10.46	2.644***	2.836***
	(0.01)	(0.01)	(5.14)	(4.18)
year FE	yes	yes	yes	yes
country FE	yes	yes	yes	yes
period	1990-2011	1996-2011	1990-2011	1996-2011
observations	706	415	1950	1304
no. of countries	33	27	95	94
pseudo-R^2	0.49	0.49	0.54	0.55
log-likelihood	-248.32	-146.86	-1263.21	-947.37

Notes: dependent variable in columns (1) and (2) is a binary variable indicating whether or not there is Austrian FDI in a host country; dependent variable in columns (3) and (4) is a count variable indicating the number of Austrian FDI projects in a host country; columns denote coefficients; all control variables are lagged by one period and the natural logarithm of the corporate tax rate is taken; t statistics in parentheses; stars denote p-values: *** p<0.01; ** p<0.05; * p<0.1;

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