1. How does base erosion and profit shifting affect your country?

They are a threat to proper business and fair competition resulting in an increased tax burden on all other taxpayers. Profits should be taxed where the economic activity takes place rather than where the goods or services are sold.

2. If you are affected by base erosion and profit shifting, what are the most common practices or structures used in your country or region, and the responses to them?

Tonga has a relatively new Income Tax system in which the issue of base erosion and transfer pricing are addressed to some extent. It is addressed through a non resident withholding tax regime such that a non resident conducting business is subject to Tongan non resident withholding tax irrespective of where the services are performed if paid by a Tongan residents. The gaps that are a threat are non residents operating through branches, non Tongans operating businesses that are solely for Tongans, transfer pricing through double/fictitious invoices and transfer of goods from one country to another without paying for them.

Tourist businesses sell packages offshore and through the internet but the service is performed in Tonga and no profits assessed in Tonga as the income derived is not repatriated to Tonga.

Tonga does not have any Double Taxation Agreements but has prepared Exchange of information agreements with 2 countries which are in the process of completion.

Recently new laws regarding the extractive industries and thin capitalisation have been introduced.

3. When you consider an MNE's activity in your country, how do you judge whether the MNE has reported an appropriate amount of profit in your jurisdiction?

MNE's activity in Tonga has the same treatment as that of Tongan taxpayer. The Tongan tax administration has risk analysis tools to identify taxpayers who do not comply with the tax obligation. Once identified, the taxpayers are subjected totax audit proceduresfor the tax assessment and collection. Additionally, the Tongan tax administration appliesthe transfer prices rules in transactions between related companies.

4. What main obstacles have you encountered in assessing whether the appropriate amount of profit is reported in your jurisdiction and in ensuring that tax is paid on such profit?

The main obstacle is the lack of effective exchange of tax information and of specific rules relating to branches and significant unregulated cash economy economy.

Not having robust transfer pricing guidelines that require taxpayer adhere to arm's length principle for related party transactions.

5. Do you agree that actions 4, 6, 8, 9, 10, 11, 12 and 13 are particularlyimportant priorities for developing countries?

Yes

6. **Which of these OECD's Action Points do you see as being most important for your country, and do you see that priority changing over time?**

   The most important actions are – 4, 8, 9, 10, 12 and 13

7. **Are there other Action Points currently inthe Action Plan but not listed above that you would include as being most important for developing countries?**

   # 5 counter harmful tax practices more effectively taking into account transparency and substance; # 7 – prevent the artificial avoidance of PE status

8. Having considered the issues outlined in the Action Plan and the proposed approaches to addressing them (including domestic legislation, bilateral treaties and a possible multilateral treaty) do you believe there are other approaches to addressing that practices that might be more effective at the policy or practical levels instead of, or alongside such actions, for your country?

No

9. Having considered the issues outlined in the Action Plan, are there are other base erosion and profit shifting issues in the broad sense that you consider may deserve consideration by international organisations such as the UN and OECD?

Treatment of branches profits and cash economy

10. Do you want to be kept informed by email on the Subcommittee's work on base erosion and profit shifting issues for developing countries and related work of the UN Committee of Experts on International Cooperation in Tax Matters?

Yes please direct to the following:
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Do you have any other comments you wish to share with the Subcommittee about base erosion and profit shifting, including your experience of obstacles to assessing and then addressing the issues, as well as lessons learned that may be of wider benefit?

Not for now