Taxation rights slipping through the cracks: How developing countries can get a better deal on their tax treaties

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This report has been written and researched by ActionAid UK. ActionAid is a global movement of people working together to further human rights for all and defeat poverty.

1. Executive summary

Tax treaties prescribe how countries can tax cross-border activities between the treaty partners. In the overwhelming majority of cases, they are outdated and unfair. In the form that they commonly take (following the OECD model) tax treaties are bad for developing countries because they:

- give multinational corporations a legal means to avoid or dramatically reduce tax through **treaty shopping**;
- are **inequitable** – they carve up taxing rights and generally impose more limitations on the taxing rights of developing countries than on the taxing rights of developed countries. This results in reduced developing country revenue[1]; and
- **limit the ability of developing countries to collect tax** by setting maximum tax rates, narrowing the scope of taxable earnings and limiting the sovereign discretion to increase taxes.

Tax treaties are squeezing the taxing rights of developing countries and impairing their ability to collect revenue urgently needed to fund essential services, infrastructure, development goals and the promotion of women's rights.

It is often said that tax treaties will stimulate increased foreign investment and will therefore be a net positive to a nation's economy. The available evidence suggests however that any benefits which tax treaties *might* bring cannot be assumed. Tax treaties always have costs and as a result should be approached with extreme caution, particularly by developing countries.

Developing country governments have the power to close the tax loopholes created by tax treaties and stop the inequity. Some countries are re-evaluating the strength of their negotiating hand; for example Uganda, Nigeria, Rwanda, South Africa and Mongolia have either cancelled or renegotiated treaties or suspended negotiation of new treaties until a clear negotiating position is developed.

This briefing calls upon states to adopt a sceptical and evidence based approach to tax treaties which considers their development impacts and their distributional (equity) impacts. Both developed and developing countries have a responsibility to make tax treaties fairer.

2.Introduction to tax treaties

A tax treaty is a legally binding agreement between states which governs the taxation of cross-border activities; namely investments by a resident of one state in the other state, and vice versa.

Tax treaties do not create new taxing rights, but instead limit the taxing rights of each treaty partner in respect of investments involving the other treaty partner. In most countries, treaty law overrules domestic law. This means that treaties tie the hands of domestic governments, which cannot act inconsistently with a tax treaty while it is in force.

There are approximately 3000 active tax treaties globally; a number which is steadily growing. Developing countries play a major role. Since the mid-1990s most new treaties have involved at least one non-OECD country.

Three main arguments are advanced in support of tax treaties. It is said that they:

- create a legal basis for cooperation, information exchange and oversight of international investment amongst tax authorities;
- prevent double taxation – paying tax in two jurisdictions on the same income;[2] and
- signal to potential investors that the country is "open for business" having created an investor friendly (stable or low taxing) environment.

The first of these objectives can be achieved without signing a tax treaty. Intergovernmental collaboration and information exchange can be agreed through separate mutual assistance and information exchange agreements. These do not limit the taxing sovereignty of Governments.

The second – prevention of double taxation – can be addressed through domestic law. Most developed countries now choose not to tax income of their residents earned overseas. Where this is not the case, it is common for states to offer tax credits to their residents to cover tax paid in another country. To the extent that there is a risk of double taxation, domestic law can prevent it. A treaty is not needed.

Regarding the treaty as a friendly statement towards investors, it cannot not be assumed that treaties will cause foreign investment to increase. The available evidence on this is inconclusive. Treaties, particularly those based on the OECD model convention discussed below, are a very costly way to send signals to foreign investors given that they limit a country's taxing potential. Instead of signing tax treaties (effectively spending by way of foregone revenue), countries would often do better to spend on infrastructure, improvements to administrative efficiency or anti-corruption measures. Unlike tax treaties, these expenditures will reduce the costs faced by foreign investors, while at the same time benefiting citizens.

3. The problem with tax treaties

Recommendation 1 – All Governments should cancel tax treaties with tax havens and refuse to sign new treaties with tax havens.

Recommendation 2 – Developing country Governments should not sign tax treaties based on the OECD model.

This section considers the major problems with current tax treaties for developing countries.

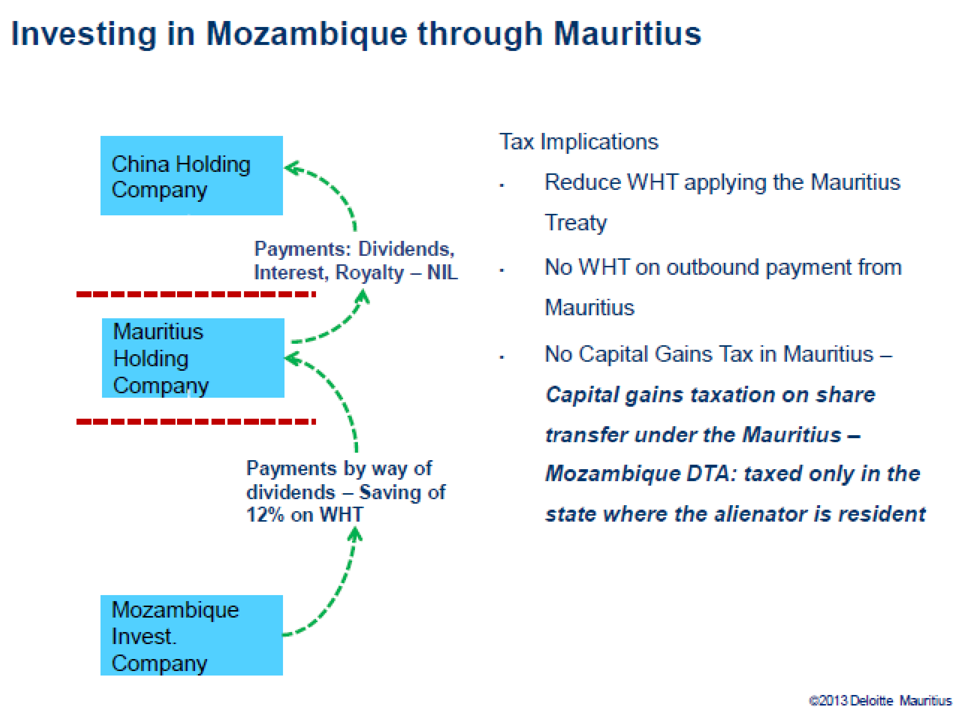
Problem 1: Tax treaties allow treaty shopping

Payments may be routed through countries with favourable tax treaties, resulting in reduction or avoidance of certain taxes on cross-border investments. This is known as 'treaty shopping'.

The diagram below is from a presentation given by Deloitte in 2013 entitled *Investing in Africa through Mauritius*[3]. It depicts a hypothetical company structure. Note that there need not be any real economic activity in the country through which money is routed, here Mauritius, in order to obtain treaty benefits.

There is no tax treaty between China and Mozambique. If a Chinese company invests directly in Mozambique, dividends paid are subject to a 20% withholding tax by the Mozambique Government if they are sent back to China.

If the Chinese company routes the investment through a Mauritius holding company, it can take advantage of the tax treaty between Mozambique and Mauritius – providing for an 8% withholding tax on outbound dividend payments – and then of the favourable Mauritian tax regime – Mauritius does not impose withholding taxes on outbound dividend payments. In this scenario the company reduces withholding tax from 20% to 8% on remitted dividends to China.



The existence of tax treaties with Mauritius and the Netherlands can slash corporate tax. Entering into a treaty with these countries may expose your country to treaty shopping.

The IMF has commented that developing countries "would be well advised to sign treaties only with considerable caution" in light of estimates that "treaties with the Netherlands led to foregone revenue for developing countries of at least EUR 770 million in 2011; [and] similar rough calculations suggest that US tax treaties cost their non-OECD country counterparts perhaps $1.6 billion in 2010."[4]

Problem 2: Tax treaties between rich and poor countries based on the OECD model are inequitable

When states negotiate tax treaties, they look to model tax treaties. Countries can pick and choose clauses from these documents which operate like templates. The OECD model is the most influential, followed by the UN model. Even a treaty between two non-OECD countries is more likely to follow the OECD model than the UN model.[5] States may also draw from other model tax treaties or draft their own clauses. In Africa alone, SADC (the Southern African Development Community), COMESA (the Common Market for Eastern and Southern Africa) and the EAC (the East African Community) have each developed their own model tax treaties.[6] The African Tax Administration Forum (ATAF) is soon to release its own model treaty.

Where there is investment between a developing country and a developed country, the developing country will generally rely on source taxation more than residence taxation.

Source taxation **is payable where the income generating or business activity happens.** ***Residence taxation*** **is payable to the investor's State of residence on the investor's worldwide income, ie including where the income earning activity happens outside the investor's State of residence.**

Multinational investments between a developed and a developing country are more likely to involve an investor from the developed country making investments into the developing country than the other way around. Because the developing country will often have relatively few residents investing overseas, it will not be able to levy significant residence taxation on their overseas investments; and will instead rely more on source taxation of foreign investors into its country.[7]

Without a tax treaty, the developing country retains all of its source taxation rights – allowing it to tax activity in its own country without limitation. All tax treaties involve states giving up source taxing rights. Following the UN model leads to forfeiture of some source based taxing rights. Following the OECD model leads to forfeiture of significantly more. The result of entry into a treaty based on the OECD model is that while the income earning activity takes place in the developing country, the developing country's ability to tax it is severely restrained. Referring to the OECD model treaty, the Indian Government noted in 2012:[8]

"It is inconceivable as to how a standard developed by governments of only 34 countries can be accepted by governments of other countries as a 'standard' of sharing of revenue on international transactions between source and resident country particularly when it only takes care of the interest of developed countries and has seriously restricted the taxing power of source countr[ies]."

While developed countries could collect more residence taxation (on the worldwide earnings of their residents) than developing countries, in recent decades developed countries have increasingly chosen not to. The most important impact of tax treaties therefore is their suppression of source taxation rights, rather than their impact on residence taxation rights.

Developing countries should not sign OECD model treaties with developed countries. The UN model treaty is more source based than each of the SADC, COMESA and the EAC model treaties.[9] However, the terms of the UN model are not a best case scenario. The CARICOM Double Taxation Agreement (between Caribbean States) provides for income to be taxed overwhelmingly in the country of source. Some developing countries, for example Nigeria, have negotiating positions which aim for more source based taxing rights than the UN model treaty.

Problem 3: Tax treaties limit the ability of developing countries to collect taxes

Tax treaties carve up taxing rights between the countries party to the treaty. Each country is banned from levying taxes in circumstances where the other country has the right to do so. Where the country with the taxing right refuses to impose the tax, the income earner goes untaxed.

Tax treaties narrow the ability of source countries to levy taxation in two ways. First by *narrowing the class of activities taxable at source*. For example, the definition of "permanent establishment" determines the breadth of source based taxing rights on business profits. Source country capital gains taxing rights are also narrowed in tax treaties. Both are discussed further below. Second, treaties cap taxation *rates* on certain source based (withholding) taxes.

Because treaty law generally sits above domestic law, treaty definitions and rate caps overrule the tax regime otherwise applicable in the country. For example, the 2014 tax treaty between Denmark and Ghana caps withholding taxes at rates lower than the domestic Ghanaian rate. Withholding tax on certain dividends are capped at 5% (otherwise 8% under Ghanaian law); and on royalties and technical services fees at 8% (otherwise 15% under Ghanaian law).[10]

Treaties supress global taxation because more treaties mean more tax options for accountants and lawyers. In a 2014 study Van Reit and Lejour estimate that treaty shopping lowers world-wide average withholding taxes on dividends by 5%.[11]

Do not assume that a treaty will increase foreign investment into a developing country

Tax treaties are generally signed by developing countries in the belief that they will stimulate inward investment. The available evidence regarding the relationship between entering into a taxation treaty and increased overall foreign investment is however inconclusive; different studies reach different conclusions. While a number of recent studies find a positive correlation between inward investment and entry into a tax treaty, other studies have found a neutral or negative correlation.[12] There is indication that any investment benefits which might flow are more likely for middle income countries than other countries.[13] Any alleged investment benefits of a particular treaty must be publicly scrutinised and weighed against the treaty's costs.

4. Suggested negotiating priorities for developing countries

Recommendation 3 – Where a tax treaty between a developed and a developing country gives the lion's share of taxing rights to the former, that treaty should be renegotiated. If renegotiation does not lead to improvements, the developing country should consider withdrawal from the treaty.

Recommendation 4 – Developing country negotiators should ensure that they get a good deal on:

A: Withholding taxes
B: Permanent establishment definition
C: Capital gains tax
D: Anti-abuse clauses
E: Arbitration

Countries should identify objectives and best case scenario negotiating positions on all relevant treaty terms. The comments below are a starting point for country negotiators wishing to identify development friendly treaty terms.

The negotiating government should compare the negotiating text to both UN and OECD models to identify which model the proposed text follows: does it impose significant limits on source taxation rights like the OECD model (likely to favour the developed country); or does it allow the same or more source taxation rights than the UN model (likely to favour the developing country)?

Outlined below are five sets of issues to look out for in negotiations or renegotiations. Tables are provided to summarise some of the important differences between the OECD, UN and "better than UN" positions. This is not an exhaustive summary of key features. Descriptions are general rather than detailed.

A. Ensure that caps on withholding taxes are as high as possible and that source countries may levy withholding taxes on royalties and technical service fees

Relevant (OECD/UN model) clause?

Art.	**10**	***11***	***12***	***(usually) 12 or 13***
Income type	Dividends	Interest	Royalties	Technical & managerial service fees, eg consultants

Withholding taxes are taxes collected from the transferor (of a payment) as money leaves the transferor's country.[14] They are levied on dividends, interest, royalties and services fees and are an example of source taxation. They are a defence against elaborate tax avoidance because they are levied on the kinds of transactions relied on by companies who use transfer mispricing.

It is very difficult to assess how much a company in a source country should pay a related overseas company for the use of brands or other intellectual property. Because of this, the payment of royalties for the use of IP by members of a corporate group to each other is commonly used to minimise profits (and therefore profit based tax liabilities) in source countries and increase profits in tax havens where the related owner of the IP is based. This practice is known as transfer mispricing. Withholding taxes on royalties disincentivise it. Even if transfer mispricing continues, the fact that withholding taxes are applied to gross payments rather than profits means that tax can be collected even though profits are being kept artificially low by the transfer mispricing.

While the OECD model treaty does not allow withholding (source) tax on royalties, in practice the overwhelming majority of tax treaties (87%) do provide for a limited withholding tax on royalties.[15] 0% withholding taxes on royalties should not therefore be accepted by developing countries.

Some treaties allow service fees paid to a resident of the other State to be taxed in the source country.[16] Such a "technical services fee" clause is advisable for developing countries.

The following table shows how Ghana's right to collect withholding tax on cross-border income has been progressively squeezed through treaties signed between 1993 and 2014.

Maximum withholding tax rates permitted on cross-border income in Ghana's tax treaties

Ghana treaty with:[17]	**UK**	**France**	**South Africa**	**Belgium**	**Germany**	**Italy**	**Barbados**	**Netherlands**	**Switzerland**	**Denmark**[18]
Year signed	*1993*	*1993*	*2004*	*2004*	*2004*	*2004*	*2008*	*2008*	*2008*	*2014*
Interest	12.5	12.5	10	10	10	10	7.5	8	10	8
Royalties	12.5	12.5	10	10	8	10	7.5	8	8	8
Dividends (FDI)[19]	7.5	5	5	5	5	5	5	5	5	5
Dividends (portfolio)	15	15	15	15	15	15	7.5	10	15	15
Management/technical services fees[20]	10	10	10	10	8	10	7.5	8	8	8

Ghanaian domestic withholding tax rates were reduced in the mid-2000s. While these changes may have happened anyway, it seems likely that the downward trend in tax treaties contributed to the domestic reductions.

Fair treaties will ensure that source countries can levy adequate withholding tax on royalties and technical fees. While the levels of taxation are important, the definitions also matter. The UN model's definition of "royalties" is wider than the OECD's including, for example payments for TV broadcasting and rental payments for the right to use industrial, commercial or scientific equipment.

OECD position	UN position	Better than UN position	Possibilities
Source country can tax dividends and interest only, low max rates (between 5% and 15%, depending on the type of income) Source country cannot tax royalties	Source country can tax dividends, interest and royalties, no maximum rates specified	Some treaties & SADC model allow for source country tax on services / management fees, in addition to dividends, interest and royalties ASEAN model - 15% for all passive income	Andean model does not set any restrictions No tax treaty – no restrictions on WHT tax *US domestic withholding tax rates are 30%*

B. Ensure a broad definition of permanent establishment (PE)

Relevant (OECD/UN model) clauses?
Art. 5 – definition of permanent establishment. Art. 7 – profits attributable to a permanent establishment can be taxed.

If a multinational registers a subsidiary company in a developing country, the company is resident in the developing country meaning that the developing country can tax profits of the company on a residence basis. But what if a multinational generates income in the developing country without incorporating a subsidiary? In these circumstances, tax treaties permit source countries to tax the profits of foreign investors if their local branch falls within the treaty's definition of a PE.

Foreign companies may avoid local (source country) tax by ensuring that their activities do not satisfy the definition of PE. For example, a building site being disbanded just before it meets the minimum time threshold to become a PE.

The definition of PE affects a developing country's tax sovereignty (ie taxing options) because it affects the class of activities taxable on a source basis. A narrow (high threshold) definition of PE is favourable to residence countries and generally favourable to foreign investors. **A wider (lower threshold) definition of PE is advisable for countries which rely on source taxation, ie developing countries.**

The OECD model provides that a fixed place of business, such as an office or factory, is required if the source state is to tax the activity. The UN model's approach to "fixed place" PEs is slightly wider. The UN model also includes a source country right to tax services where there is no fixed place of business so long as the activities continue in the source country for more than a certain number of days; this is known as a "services permanent establishment".[21]

Under the OECD model, only activities or functions formally undertaken by the PE can be taxed by the source country. The UN model contains something known as a "limited force of attraction" rule. This means that if a multinational investor has a PE in a source country, that country can bundle together all the profits made by that multinational from activities that are "of the same or similar kind" to those undertaken directly by the PE, and tax them. As well as expanding developing country taxing rights, the limited force of attraction rule makes administration easier and prevents potential abuse.

OECD position	UN position	Better than UN position	Possibilities
Narrow PE definition based on 'fixed place of business' Construction site is a PE after 12 months (Optional services PE, see commentary)	Wider 'fixed place of business' PE, incl. eg stock maintenance for purpose of delivery. Construction site is a PE after 6 months "Services PE" - provision of services a PE after 183 days in any 1 yr period even if no fixed place of business	Definition captures a broader class of mining activities, eg exploration[22] Provision of services a PE after agreed remuneration threshold India-Switzerland treaty: provision of services a PE after 90 days within 1 yr (unrelated parties) or after 30 days within 1 yr (related parties)	Andean model does not restrict source country taxing rights to presence of a PE Shorter (or no) time threshold
Only activities formally linked to the PE are taxable, ie no "force of attraction" rule	The same investor's activities 'of the same or similar kind' of those formally linked to the PE are taxable, ie "limited force of attraction"		All an investor's activities in a country bundled together with PE in the same country, ie "full force of attraction"

The OECD's has proposed changes to its definition of PE as part of the BEPS Project. Although the proposed changes are a step forward, they will not prevent the artificial avoidance of source country taxation through PE abuses[23] and they will not equalise the distribution of taxing rights. Developing countries can aim higher when negotiating PE definitions in tax treaties.

C. Ensure that the treaty allows the source country to collect capital gains tax on all local (source country) property; including moveable property and shares in a local company

Relevant (OECD/UN model) clause?
Art. 13 governs the extent of a source country's rights to tax capital gains

This may be the most overlooked aspect of tax treaties signed by developing countries, despite being at the heart of some of the most prominent examples of treaty abuse. Capital gains tax is levied at the time of sale. It is applied as a percentage of the increase in the property's value (the gain) during the period between its purchase or creation by the taxpayer and its sale.

The starting position under both the OECD and the UN model treaties is that the residence country has the right to tax capital gains earned by is residents on a worldwide basis (ie wherever they occur). These rights are subject to exceptions where the source country has the right to tax capital gains. The OECD model gives narrower source capital gains taxation rights than the UN model. Under both model treaties, the source country can tax capital gains of foreigners on the sale of immovable property (eg land, buildings) in the source country and assets of a PE in the source country.

Since 2003, the OECD model has followed the UN model in allowing the source country to levy capital gains tax when a foreign resident sells shares, if more than 50% of the value of those shares is derived from immovable property in the source country. This is to protect against the sale of immoveable property in the source country (otherwise subject to capital gains tax at source) happening via a company in order to avoid that source taxation. It is disappointing that a significant number of treaties between non-OECD countries continue to omit this measure.[24]

The UN model allows a source country to levy capital gains tax when a foreign resident sells shares in a local company if that stake has exceeded a certain percentage (agreed between treaty partners) at any time in the preceding 12 months. A lower percentage is beneficial to the source country. Even better is Ethiopia's treaty with South Africa, which allows the same but without setting any ownership threshold. This prevents companies from structuring their shareholdings (under the threshold) so that they are immune from source country capital gains tax upon the sale of their investment.

OECD position	UN position	Better than UN position	Possibilities
→			
Residence country can tax worldwide capital gains of a resident except the following source country taxing rights: gains from 1) sale of immovable property in source country, 2) shares if > 50% of value from immoveable property in source country & 3) moveable property of a PE.	Same as OECD model, but source country can also tax foreign resident on sale of shares in a local (source country) company if the foreign resident's stake in the company exceeds an agreed threshold.	Some treaties do not set a min ownership threshold for sales of shares, eg *Ethiopia-South Africa tax treaty does not set a min ownership threshold*	Andean model gives the source country exclusive capital gains taxing rights over sale of property (including moveable property) situated in the source country.

Treaties can be used to avoid capital gains tax in the source country, as in the example below.

"Round tripping" to avoid capital gains tax in India

Under the terms of the India-Mauritius treaty, most capital gains taxing rights are reserved for the residence country. This means that in respect of investments into India by Mauritian companies, Indian capital gains tax is severely limited. While Mauritius has the right to tax capital gains under the treaty, it does not. Given that the treaty also lacks an anti-abuse clause, Indian companies avoid paying capital gains tax in India by establishing companies in Mauritius and then making the investment from a Mauritian company. This is known as "round tripping". The Indian government has estimated that it costs India some $600m annually.[25]

The India-Mauritius treaty is currently being renegotiated and a revised version is said to be almost finalised.[26] There is speculation that the new treaty will address 'round tripping'. India has also announced a domestic general anti-abuse law to be introduced in 2017.

D. Ensure strong anti-abuse provisions

As discussed above, tax treaties create numerous opportunities for investors to minimise tax. Issues of particular concern for developing countries include treaty shopping, round-tripping (both discussed above) and thin capitalisation. This is where a related overseas company finances a local company with debt, resulting in interest payments from the local company to the overseas company. This in turn reduces the local company's taxable profits.

Often these behaviours can be addressed in domestic anti-abuse (also known as anti-avoidance) laws. There are, however, some anti-abuse articles that are becoming more common in treaties, and developing countries should consider emulating the best of such articles. For example:

- **A "main purpose" article** denies the benefits of a treaty provision where taking advantage of it was the main purpose of an activity; this appears in a number of UK treaties. If treaty benefits are denied, income then becomes taxable under domestic law.
- "**Limitation of benefits" articles** deny treaty benefits to corporations which do not have an adequate connection to a treaty country.[27] These clauses are pursued by US negotiators and are aimed squarely at combatting the use of conduit countries to minimise tax.
- "**Subject-to-tax" articles** remove treaty limitations to one jurisdiction's taxing rights over cross-border income if that income is not in fact subject to tax in the other jurisdiction. If the income is not taxed in one, it may be taxed in the other.

Anti-abuse articles in treaties should work with national law, and need to be tailored to local circumstances including domestic anti-abuse provisions.

The OECD's Base Erosion and Profit Shifting (BEPS) Project is supporting the introduction of main purpose articles and / or limitation of benefits articles into tax treaties.[28]

E. No mandatory binding arbitration unless you are experienced and can pay for it

Relevant (OECD/UN model) clause?
Art. 25 – Mutual agreement procedure.

The OECD model treaty includes an option for mandatory binding arbitration to resolve allegations of double taxation. The arbitration proposed by the OECD is *binding* in that states are bound by the arbitrated decision (if the taxpayer elects to have it applied), and *mandatory* in that if states agree to include it in their treaties, it does not require state consent to be invoked. It involves states giving up some sovereign power over taxation to a foreign arbitral body.

The uptake of arbitration clauses in tax treaties to deal with double taxation has been relatively limited with a correspondingly small number of matters having been resolved this way. However, in light of the OECD's recent proposal that mandatory binding arbitration no longer be an optional clause in the model treaty,[29] the role of tax arbitration is set to expand.

Tax arbitration authorised pursuant to tax treaties deals with a taxpayer allegation of double (too much) taxation. It does not deal with alleged tax minimisation or failure to pay enough tax.

There is no capacity for tax arbitration to deal with tax evasion. In this way, the regime is inherently one sided.

Tax arbitration may lead to unjust outcomes given the disparity of resources and/or arbitral experience as between states. Tax arbitration is inter-state; the taxpayer is not a party. A tax payer, resident in one treaty partner lodges a request that the two treaty partners resolve the alleged double taxation.[30] If that is not done consensually, the tax payer may refer the unresolved matter to arbitration after two years. While the taxpayer is not party to the dispute itself, the position of the taxpayer invariably aligns with one state, meaning that in important respects one state operates in the shoes of the taxpayer.

A 2012 OECD study found that the average cost of investment dispute settlement – a different but comparable form of arbitration – was US$8 million.[31] Given the monstrous legal fees, uncertainty and foreign currency demands[32] associated with arbitration, even a threat to arbitrate may lead to costly settlements in which the less well-resourced country gives up valuable revenue. A US official has noted that, “the prospect of impending mandatory arbitration creates a significant incentive to compromise”.[33] Where mandatory binding arbitration applies, **the large and uncertain costs of arbitration will weigh heavily on poorly resourced countries. This may lead to unfair settlements.**

It is also difficult to be certain that appointed arbitrators will operate fairly given that the OECD’s proposal would maintain secrecy regarding arbitral decisions and procedures.[34]

For these reasons, governments with limited resources and limited arbitral experience should ensure that any tax treaty entered into does not include mandatory binding arbitration.

5. Public scrutiny

Recommendation 5 – All Governments should publish an impact assessment for all tax treaties prior to ratification and every five years thereafter.

Recommendation 6 – Draft versions of tax treaties should be made public prior to signature.

Tax treaties are costly. They limit a country's ability to collect tax, create opportunities for multinationals to tax minimise and increase inequality between states by restraining source country taxing rights. Comprehensive and regular democratic scrutiny is essential. Impact assessments should be published prior to ratification and every five years thereafter. They should consider:

- historical/anticipated revenue losses given investment flows between treaty partners;
- whether the treaty has/will increase aggregate investment;
- whether double taxation occurs between the treaty partners and if so, whether alternative domestic measures could prevent it;
- the restrictions that the treaty will place on each party's sovereign ability to amend tax policy and/or raise taxes in future;
- whether there are alternative ways of meeting the treaty's stated objectives; and
- (for treaties with EU countries) consistency with Policy Coherence for Development.

Treaties generally trump domestic law. As a result, they should be subject to at least the same level of scrutiny and debate as any other law.

The creation of a tax treaty involves negotiation, then signature and then ratification. Tax treaties are recognised in domestic law after ratification. They become effective (creating rights and obligations) on an agreed date after both countries have ratified. In most, but not all countries,[35] ratification involves some parliamentary action. Even if the treaty goes before Parliament however, the debate is often superficial, not delving into the treaty's actual implications.

In practice, treaties are not amended during ratification; merely accepted or rejected. The treaty as signed is therefore the final version. Given that crucial decisions are made in the lead up to signature, scrutiny is necessary at this point. Draft versions of negotiated treaties should be released for public comment, giving all affected by the treaty a reasonable opportunity to respond. To adopt the form of words used by the UN, stakeholders should be consulted on the progress of tax treaty negotiations "after the general pattern of the new treaty has been established but before final decisions are made".[36]

It is our belief that most countries give private sector actors who may benefit from by a proposed treaty a direct or indirect opportunity to provide comment on the direction of negotiation prior to signature. Other members of the community should be afforded the same opportunity.

6. Revisiting tax treaties – examples

South Africa was recently successful in renegotiating its treaty with Mauritius, allowing South Africa to collect more withholding tax and to collect capital gains tax where a Mauritian company sells shares in a company which derives more than 50% of its value from immoveable property in South Africa.[37] Neither was possible under the previous treaty. **Rwanda** also renegotiated its old treaty with Mauritius. The new treaty allows a 10% WHT on dividends, royalties and interest and a 12% withholding tax on management fees.

In 2013, ActionAid showed that **Zambia's** tax treaties with Ireland and the Netherlands were used by food giant Associated British Foods to dodge tax in Zambia.[38] In March 2015, a renegotiated treaty between Zambia and Ireland was signed. A renegotiated version of Zambia's treaty with the Netherlands was signed in July 2015.

In June 2014, **Uganda** decided to suspend negotiations of new tax treaties until there were clearer guidelines on how the country should benefit from such agreements.

Mongolia cancelled its tax treaty with the Netherlands in 2011 on the basis that it was preventing it from recovering a fair share of the tax from mining activities in Mongolia.[39] Since that time, **the Netherlands** has offered 23 of its least developed country treaty partners the opportunity to renegotiate the anti-avoidance provisions in their Dutch tax treaties.[40] The offer for re-negotiation relates to anti-avoidance terms only, not the balance of taxing rights between source and residence countries.

7. Recommendations

This briefing calls upon states to adopt a sceptical and evidence based approach to tax treaties which considers their development impacts and their distributional (equity) impacts. Both developed and developing countries have a responsibility to make tax treaties fairer.

1) All Governments should cancel tax treaties with tax havens and refuse to sign new treaties with tax havens.

2) Developing country Governments should not sign tax treaties based on the OECD model.

3) Where a tax treaty between a developed and a developing country gives the lion's share of taxing rights to the former, that treaty should be renegotiated. If renegotiation does not lead to improvements, the developing country should consider withdrawal from the treaty.

4) Developing country negotiators should ensure that they get a good deal on:

    A: Withholding taxes
    B: Permanent establishment definitions
    C: Capital gains tax
    D: Anti-abuse clauses
    E: Arbitration

5) All Governments should publish an impact assessment for all tax treaties prior to ratification and every five years thereafter.

6) Draft versions of tax treaties should be made public prior to signature.

[1] For example, it is estimated that developing countries lost €770 mil in 2011 from treaties with the Netherlands, not including foregone royalties revenue, McGauran, K. *Should the Netherlands sign tax treaties with developing countries?* SOMO, 2013, p 40; see also Keen, M et al. *Spillovers on International Corporate Taxation*, IMF, 2014, 27.

[2] Because of this, tax treaties are often referred to as "double taxation treaties" (DTTs) or "double taxation agreements" (DTAs).

[3] ActionAid, *Deloitte in Africa – Advising big businesses on how to avoid tax in some of the world's poorest countries*, 2013, http://www.actionaid.org.uk/sites/default/files/publications/deloitte_in_africa_1.pdf.

[4] Keen, M et al. op cit, 27.

[5] Wijnen, W and de Goede, J. 'The UN Model in Practice 1997–2013', *Issue: Bulletin for International Taxation*, 2014 (Vol 68), No. 3.

[6] Examples from other regions include the Model Convention for the Avoidance of Double Taxation between Member Countries and Other Countries outside the Andean Subregion (also known as the "Andean model") and the Association of South East Asian Nations (ASEAN) model treaty.

[7] There are exceptions. Some developing countries like China and South Africa have large outbound investments and will therefore be in a position to collect significant residence taxation relative to their treaty partners.

[8] Letter from the Central Board of Direct Taxes, Ministry of Finance, Government of India to the UN Financing for Development Office, 12 March 2012, http://www.un.org/esa/ffd/tax/2012ICTM/LetterIndia.pdf.

[9] Hearson, M. *Tax Treaties in Sub-Saharan Africa: a critical review*, Tax Justice Network Africa, 2015, 28.

[10] ActionAid Denmark, *Denmark's Tax Treaties: Time for Change*, 2014, http://www.ms.dk/sites/default/files/udgivelser/denmarks_tax_treaties_-_time_for_change.pdf, p 14.

[11] van 't Riet, M and Lejour, A *Ranking the Stars: Network Analysis of Bilateral Tax Treaties,* CBC Netherlands Bureau for Economic Policy Analysis, 2014, 17. This study relies on 108 jurisdictions for which sufficient tax data was available. While these countries account for almost 95% of global GDP, most of them are high and upper middle income countries.

[12] For a summary of the available evidence, see Keen, M et al. op cit, 26, 67-68; Weyzig, F. *Taxation and development: Effects of Dutch tax policy on taxation of multinationals in developing countries*, 2013, 91-95. For analysis of recent evidence see Hearson, M. 'Do tax treaties affect foreign investment? The plot thickens', 19 June 2014, https://martinhearson.wordpress.com/2014/06/19/do-tax-treaties-affect-foreign-investment-the-plot-thickens/.

[13] Keen, M et al. op cit, 67.

[14] Technically, withholding taxes are levied on the recipient of the payment – however they are collected from the payer who in turn deducts taxes paid from the amount transferred to the overseas recipient.

[15] Wijnen, W and de Goede, J. op cit, 129.

[16] See eg UK-Ghana Treaty signed 1993, Art 17; US-India Treaty signed 1989, Art 12. The Nigerian Model Tax Treaty also contains a similar "technical services fees" article, Obuoforibo, B. 'Nigeria', *BRICS and the Emergence of International Tax Coordination* (2015) 315, 322.

[17] ActionAid understands that Ghana has also signed tax treaties with Montenegro and Serbia. As they are not publicly available, they have not been included here.

[18] This treaty was ratified by the Danish Parliament in 2015. The writer was not able to ascertain whether Ghana has ratified.

[19] Foreign direct investment (FDI) is distinguishable from foreign portfolio investment. FDI involves the investor exerting some degree of control over the entity. An investment is FDI if the investor holds more than a stipulated percentage (depending on the definition) of the investment.

[20] This row reflects max withholding rates established by the relevant treaties on either management fees or technical services fees. These two categories are not synonymous.

[21] A services PE is included as an alternative provision in the commentary to the OECD model rather than in the body of the text itself.

[22] The Nigerian model treaty classifies any place used for any activity relating to the exploration of natural resources as a PE as long as the activity endures for more than 60 days in any 12 month period, Obuoforibo, B. op cit, 321.

[23] See Picciotto, S and Kadet, J, *Comments on BEPS Action 7: Revised Discussion Draft on Preventing Artificial Avoidance of PE Status,* BEPS Monitoring Group, 2015, https://bepsmonitoringgroup.files.wordpress.com/2015/06/ap-7-pe-revised-dd.pdf.

[24] Wijnen, W and de Goede, J. op cit.

[25] Johnston, D. 'Tax gateways to India', *Reuters*, 9 August 2011, http://blogs.reuters.com/david-cay-johnston/2011/08/09/tax-gateways-to-india.

[26] 'DTAA with Mauritius will be revised soon: Revenue Secretary', *CBNC,* 10 July 2015, http://www.moneycontrol.com/news/economy/dtaamauritius-will-be-revised-soon-revenue-secretary_1889121.html.

[27] See eg US-Netherlands Treaty signed 1992, Art 26; see also US Model Income Tax Convention, 2006, Art. 22.

[28] OECD, *Discussion Draft BEPS Action 6*, 22 May 2015, http://www.oecd.org/tax/treaties/revised-discussion-draft-beps-action-6-prevent-treaty-abuse.pdf.

[29] The OECD is proposing to remove from their model convention wording which makes mandatory binding arbitration optional, OECD, *Public Discussion Draft: BEPS Action 14,* 2014, http://www.oecd.org/ctp/dispute/discussion-draft-action-14-make-dispute-resolution-mechanisms-more-effective.pdf, Option 22.

[30] The process to resolve tax disputes between States is known as known as the Mutual Administrative Procedure (MAP).

[31] See http://www.oecd.org/daf/inv/investment-policy/ISDSconsultationcomments_web.pdf.

[32] Arbitral costs are often paid for in foreign currencies, which is not always readily available to developing countries.

[33] Testimony to Senate Committee on Foreign Relations on Pending Income Tax Agreements, United States Senate, 17 July 2007, HP-494 (John Harrington, Department of Treasury International Tax Counsel).

[34] OECD, *Public Discussion Draft: BEPS Action 14,* op cit, Option 28.

[35] For example, Tanzania, Mauritius and Australia do not require Parliamentary ratification.

[36] This wording is taken from the UN Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (2003, as revised), 224. The UN makes this recommendation in relation to "interested parties in the private sector". There is however no reason why other interested citizens should not be treated the same.

[37] Double Taxation Treaty between the Republic of South Africa and Mauritius, 2015, Art 13(4).

[38] Lewis, M. *Sweet Nothings: The human cost of a British sugar giant avoiding taxes in southern Africa*, ActionAid, 2013,

[39] Deutsch, A and Edwards, T. 'Special Report: In tax case, Mongolia is the mouse that roared', *Routers,* 16 July 2013, http://www.reuters.com/article/2013/07/16/us-dutch-mongolia-tax-idUSBRE96F0B620130716.

[40] See *Dutch Government's Response to the Report from SEO Economics Amsterdam and IBFD*, 2013, http://www.government.nl/documents-and-publications/parliamentary-documents/2013/09/09/government-s-response-to-the-report-from-seo-economics-amsterdam-on-other-financial-institutions-and-the-ibfd-report-on-developing-countries.html.

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