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countries in negotiating their tax treaties. Report of the Rome meeting summarizing the main findings is available at http://www.un.org/esa/ffd/tax/2013CBTTNA/Summary.pdf.

Following the Rome meeting the outlines were revised taking into account feedback received from representatives of developing countries. Subsequently, the authors drafted their papers.

The draft papers were then presented by the authors and discussed during the technical meeting on "Tax treaty administration and negotiation" (New York, 30-31 May, 2013) with the participation of 32 representatives of developing countries, several members of the Committee, as well as representatives of international and regional organizations.

Each paper was presented by the author and had a designated lead discussant, representing relevant authority in developing country, who commented on relevance of the given paper in view of the experience of his/her country and proposed specific revisions/additions to the paper. The comments by the lead discussant were followed by an interactive discussion among participants, chaired by a member of the Committee or a representative of an international organization during which additional revisions to the papers were proposed with a view to ensuring that they adequately address the actual skills gaps and challenges faced by developing countries. Report of the New York meeting summarizing the main findings is available at:
http://www.un.org/esa/ffd/tax/2013TMTTAN/Newsletter5_2013.pdf

Following the New York meeting, the authors revised and finalized their papers taking into account feedback received during the meeting.

These papers are attached to this note and are now presented to the Committee as possible input to the United Nations Manual for the Negotiation of Bilateral Tax Treaties.

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Social Council (ECOSOC) noted that it was "[c]onfident that tax treaties between developed and developing countries can serve to promote the flow of investment useful to the economic development of the latter, especially if the treaties provide favourable tax treatment to such investments on the part of the countries of origin, both by outright tax relief and by measures which would ensure to them the full benefit of any tax incentives allowed by the country of investment".[1]

The economic benefits of treaties between two developing countries, though relatively small, may encourage development more generally within a region and may be a valuable tool in preventing cross-border tax avoidance and evasion. Tax treaties may also have other benefits, such as political benefits.

Countries enter into tax treaties for a variety of reasons. For each country, and indeed for each treaty entered into by that country, the reasons are likely to be different, depending on the economic and political situation of the country and its relationship with the potential treaty partner country. The priority that would be given to each reason will differ, depending on the circumstances prevailing in each country, and having regard to the relationship between the two countries. In some countries, the desire to attract foreign investment will be paramount, whereas in other countries, revenue or political considerations may be more important.

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reducing excessive source taxation;

Before treaty negotiations can commence, both countries must consider that a tax treaty would benefit them, and must be in a position to commence negotiations.

The reasons for entering into tax treaties are explored further below.

2. Facilitation of cross-border investment and transfer of skills and technology

Relief from double taxation and prevention of tax discrimination have as their main aim the removal or reduction of tax obstacles to cross-border trade and investment. Prevention of fiscal evasion serves to support and protect the revenues of the treaty partner countries, especially where cross-border investment or dealings are involved.

2.1 Relief of double taxation

The primary purpose of tax treaties is commonly stated or understood to be ‘for the avoidance of double taxation’ of income arising from cross-border transactions. Until recently (2011), the United Nations Model Double Taxation Convention between Developed and Developing Countries (“United Nations Model Convention”) specifically referred to avoidance of double taxation in its title.[2] A similar reference was found in the title of the Organisation for Economic Co-operation and Development’s Model Tax Convention on Income and on Capital (“OECD Model Convention”) prior to 1992. The Commentary on the OECD Model Convention, while acknowledging that elimination of juridical double taxation is the main purpose of tax treaties, notes that this reference was deleted from the title because tax treaties also address other issues such as the prevention of tax evasion and non-discrimination.[3] Presumably, the reference was deleted from the title in the United Nations Model Convention for similar reasons. Nevertheless, many countries continue to include a reference to avoidance of double taxation in the title of their conventions.

Double taxation arises where the same income or capital is taxed in both treaty partner countries. Juridical double taxation, that is to say taxation of the same income in the hands of the same person in more than one country, occurs where:

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[2] “Convention between (State A) and (State B) for the avoidance of double taxation with respect to taxes on income and on capital”.

[3] Introduction, paragraph 16.

cross-border dealings. It may also clarify whether certain 'presumptive' income taxes - typically based on turnover and applying to small businesses - are to be credited by the other country. Tax treaties may also provide additional double tax relief benefits to taxpayers that are not available under domestic law (or are only available under domestic law where a treaty is in effect), for instance by providing for exemption of certain foreign income where domestic law would otherwise provide only for foreign tax credits.

Allocation of exclusive taxing rights to one or other country has the dual benefit for the recipient of the income, or the owner of the capital, of ensuring no double taxation and simplifying that person's tax affairs. However, such provisions will also have revenue effects for the treaty partner country. Where, as is generally the case, sole taxing rights are given to the country of residence, the provisions will result in a loss of revenue for the source country.

For countries where the economic flows are approximate

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Non-discrimination rules apply to all taxes, not just income taxes and capital taxes covered by the treaty.[11]

Tax discrimination of the kinds addressed under treaties could be removed unilaterally by countries wishing to attract foreign investment, and many countries seek to ensure that their domestic tax laws are non-discriminatory. However, by including non-discrimination rules in tax treaties, countries are able to provide a measure of certainty to potential investors that they will not be subject to tax discrimination in the event of future changes to domestic law.

2.4 Providing certainty and simplicity

One of the main ways in which a developing country can attract foreign investment is by ensuring that the tax environment for investors is clear, transparent and certain. Tax treaties can assist in achieving this by setting well-recognised and widely-adopted rules for the allocation of taxing rights over different types of income and for the determination of profits attributable to a permanent establishment or in dealings between related enterprises. Such rules can help to reduce complexity for taxpayers with cross-border activities, particularly where the treaty provides for taxation only in one country.

Since tax treaties usually continue for an extended period (often 15 years or more), they also provide a level of comfort to taxpayers that the tax treatment afforded to the income from their activities or investments in the other country will be reasonably stable. In the absence of a treaty, tax treatment under domestic law can, and often does, change frequently. Treaties do not preclude such changes, but they do impose limits on source taxation of certain types of income, and provide certain protections such as relief from double taxation, the application of the arm's length principle and non-discrimination rules. (As discussed below, while this is an advantage for investors, it does restrict policy flexibility of the treaty countries.)

Importantly, tax treaties also provide a mechanism for tax administrations to agree on how to interpret or apply treaty provisions, and to resolve disputes. Article 25 of the OECD Model Convention and the two versions of Article 25 put forward in the United Nations Model Convention set out a procedure pursuant to which the competent authorities of the treaty partner countries can reach mutual agreement.

Under this procedure, a taxpayer who considers that the treaty has not been, or will not be, correctly applied may, in addition to any domestic law remedies, initiate the mutual agreement procedure. The competent authority in his country of residence would then review the case and, if the taxpayer's

[11] Paragraph 6 of Article 24 (Non-discrimination)

2.5 Maintaining or accessing benefits of domestic tax concessions

One of the most important benefits that may be available to developing countries under a tax treaty is what is known as ‘tax sparing’. Tax sparing occurs when another country gives foreign tax credits for tax

economic level of which is considerably below that of OECD Member States. It also recommended the use of 'best practices' to minimise potential for abuse.[15]

In negotiations with some of the least developed countries, developed countries may be prepared to agree to tax sparing provisions, particularly if the provisions are drafted in a way that limits the potential for abuse. Examples of such limitations that are found in some tax treaties include:

1. A precise description of the incentives for which tax sparing is sought (for instance, a reference to legislation which sets out which income or projects are eligible for the incentive);
2. Limitation of eligible incentives to certain types of investment or activities (for instance, genuine investments aimed at enhancing the domestic infrastructure of the developing country);
3. Application only to active business income (not passive income such as interest, royalties or leasing payments);
4. Inclusion of an anti-abuse provision (for instance, where the two competent authorities agree it would be inappropriate to grant tax sparing);
5. Inclusion of a 'sunset' clause (for instance, a provision that states that tax sparing will only apply for a limited period, or until a certain level of economic development is reached, unless further extended by agreement between the two countries).

3. Prevention of fiscal evasion

One of the main reasons that a country may wish to enter into a tax treaty with another country is to improve co-ordination and co-operation between tax administrations in order to address tax avoidance or evasion. Through the exchange of information and, in some cases, assistance in collection of taxes, tax administrations are able to assist each other in ensuring the proper application of tax treaties, as well as enforcement of domestic laws.

While it is often developed countries that have the most to gain in terms of revenue from assistance provided under tax treaties, it is in the interests of both developed and developing countries to minimise cross-border tax evasion and avoidance. Both devel

International or regional obligations or expectations may also influence decisions to enter into negotiations. These may be as a result of membership of international organisations, or economic or trade arrangements, or bilateral agreements.

OECD member countries, for example, are expected to enter into tax treaties with each other.[21] While there is no equivalent recommendation for United Nations countries,[22] member countries are certainly encouraged to do so.[23]

Regional economic or trade communities involving developing countries often require or encourage member countries to enter into tax treaties with each other. For example, in 2007 the Association of Southeast Asian Nations (ASEAN) Finance Ministers agreed to "accelerate the completion of bilateral agreements on avoidance of double taxation and co-operation on other tax matters".[24] The Southern African Development Community (SADC) has similarly agreed that "Member States will take such steps as are necessary to establish amongst themselves a comprehensive (tax) treaty network".[25]

Countries may also agree to enter into tax treaty negotiations as part of arrangements to enhance bilateral relations or in the context of close trade or econom

5. Summary of costs and benefits to developing countries of having tax treaties

5.1 Benefits

- Increased foreign investment

By providing a clear, transparent, non-discriminatory and predictable tax environment, developing countries may facilitate and encourage foreign investment. While it seems self-evident that taxpayers looking to invest in another country will be encouraged to do so when they have confidence in the tax system of that country, there is little empirical evidence to show the extent to which the entry into a tax treaty will result in increased foreign investment. Nevertheless, it would appear that, for developing countries, a link can be made between conclusion of a tax treaty and increased foreign direct investment.[26]

Provision for tax sparing under the treaty may be of particular benefit to developing countries to the extent that it prevents revenue forgone by the country under its tax incentives being soaked up by the country of residence of the foreign investor.

However, tax treaties alone will not ensure increased foreign investment if the underlying legal and economic infrastructure does not effectively support such investment. For example, a lack of suitable investment protection (for instance, where there is a

developing countries, especially between neighbouring countries or members of a regional economic community) tax treaties can provide the benefits of increased certainty with respect to taxation, and may resolve particular issues that have arisen between two countries. While there may be little likelihood of attracting significant additional foreign investment through such treaties, the existence of a treaty would be expected to facilitate and encourage cross-border investment flows and economic activity between the two countries.

- Improved consistency of tax treatment

absence of a permanent establishment, fixed base or long-term presence), the actual revenue forgone may not be significant.

The revenue cost of source tax limitations imposed by tax treaties will largely depend on the capital flows between the countries. However, it is important to consider not just the existing flows, but also the

means also that the revenue impacts of early treaties may be greater than the current level of investment from these countries may suggest. While these risks can be reduced by the inclusion of certain treaty provisions such as Limitation of Benefits articles and anti-avoidance provisions in Articles 10, 11 and 12, treaty abuse and treaty-shopping are difficult to eliminate entirely.

- Risk of double non-taxation

Tax treaties can create unintended double non-taxation where a treaty provision precludes taxation in one country of income or capital that is not taxed in the other country. For example, the treaty may preclude source taxation of certain capital gains. If the other country does not impose capital gains tax, the result will be that the capital gain is not taxed in either State. While in some cases the contracting States may deliberately provide that certain income is not subject to tax in either country (for instance, in the case of short-term visits by foreign teachers), tax treaties are generally not intended to create double non-taxation.

Tax treaties with low-tax countries may also result in double non-taxation and/or in reductions in revenue without reciprocal benefits in the other country. Tax treaties with low tax countries may provide a competitive advantage to investors from such countries over domestic investors or investors from other treaty partner countries, since the overall tax burden on investors whose income is not subject to tax (or is subject only to very low tax rates) in their country of residence will be significantly lower than the tax burden on investors who have to pay ordinary taxes. Treaties with low-tax countries are also likely to encourage treaty-shopping through those countries. For these reasons, and in the absence of a risk of significant double taxation of cross-border investment from low-tax countries, developing countries should carefully consider whether tax treaties with such countries are in their best interests. Any tax administration concerns with these countries might be better addressed through Tax Information Exchange Agreements.

- Changes and/or clarifications to domestic law

Certain changes to, or clarifications of, domestic law may be required to ensure that the treaty can be properly applied and administered. It may be necessary to enact law that provides that, in the event of any inconsistency between the treaty ashort-term vrsD .0008 Topbetween the a[(c-1.or)admin5.4(6n 268 [(sh.(

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Papers on Selected Topics in Negotiation of Tax Treaties for Developing Countries

Paper No. 2-N

Tax Treaty Policy Framework and Country Model

Ariane Pickering

International tax consultant, former Chief Tax Treaty Negotiator, Australia

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Tax Treaty Policy Framework and Country Model

Ariane Pickering

1. Introduction

All countries would find it beneficial to develop a tax treaty policy framework and a model treaty before entering into negotiations. You have to 'know what you want'.

The policy framework should set out the main policy outcomes that your country wishes to achieve under its tax treaties. It should identify:

- policy outcomes that are most beneficial to your country;
- outcomes that must be achieved in any negotiation; and
- how much flexibility negotiators have on other issues, including what is their 'bottom line' (that is to say, the minimum outcome that must be achieved).

The model treaty should reflect the country's key policy and drafting preferences, having regard to international treaty norms and to domestic law.

This paper seeks to provide guidance to developing countries on how to develop a tax treaty policy framework and their own model tax treaty.

2. Policy framework for developing countries

2.1 General

i. As far as practicable, countries should follow the international norms for tax treaties, with respect to structure and policy positions.

For developing countries, these international norms are mainly set out in the United Nations Model Double Taxation Convention between Developed and Developing Countries ("United Nations Model Convention"). The Organisation for Economic Co-operation and Development's Model Tax Convention on Income and on Capital ("OECD Model Convention") is also important and, for some countries, a

the country may prefer to include a provision that provides for source taxation on a gross basis, even if the tax rate provided under the treaty is lower than the domestic law rate.

A right to tax under a treaty that cannot be exercised under domestic law, or that cannot be collected in the ordinary course of tax administration is likely to be of little value to a country. For example, there would be little revenue benefit to be gained by providing for source taxation of pensions (in accordance with Article 18 (2) (Alternative B) of the United Nations Model Convention), if such pensions are not taxable under domestic law. There may however be circumstances in which a country would wish to preserve a taxing right that cannot currently be exercised under existing domestic law (for instance, where it is anticipated that future governments may wish to change that domestic law).

In some circumstances, non-tax laws may be relevant. For example, social security pensions may not be payable to non-residents. If this is the case, that country will not pay cross-border social security payments and negotiators should insist on source taxation of these payments.

v. Countries should take into account the ability of their tax administrations to comply with treaty obligations.

For example, some treaties require tax administrations to collect taxes on behalf of a treaty partner. If the tax administration does not have the legal or practical ability to do so, that country may wish to consider not including the article, amending it, or delaying its implementation.

2.2 International norms

x Coverage

Tax treaties apply to individuals and entities that are residents of one or both of the treaty partner countries. Generally, residential status will be determined by the domestic law of each country. However, for treaty purposes, the United Nations Model Convention (like the OECD Model Convention) specifies that the person must be "liable to tax" in the country by reason of particular criteria.

Treaties apply to all income taxes, including capital gains taxes, taxes on profits, withholding taxes and tax on salaries. In some circumstances, other taxes such as tonnage taxes, or minimum taxes may also be covered.

The United Nations and OECD Model Conventions also apply to taxes on capital, such as wealth taxes.

x Distributive rules

Capital: The allocation of taxing rights over capital generally mirrors the allocation of rights to tax income.

- Elimination of double taxation

Where source taxation is permitted under the tax treaty, the country of which the taxpayer is a resident is required to relieve any resulting double taxation. This may be achieved by exempting the income that is taxed at source (exemption method), or by providing a credit for the foreign tax against the tax liability of the taxpayer in the country of residence (credit method).

Though not included in the United Nations Model Convention itself, some treaties entered into by developing countries include tax sparing provisions. Developing countries may seek to attract foreign investment by offering tax incentives with respect to certain activities. However, if the country of residence of the investor provides relief using the credit method, the benefit of the tax incentives may be effectively passed to the foreign treasury instead of the investor. To preserve the benefit of the source country tax incentives, tax sparing provisions provide relief from taxation in the country of residence as if tax had been paid in the source country.

- Non-discrimination

International tax treaty rules prevent either country from applying discriminatory tax rules in certain circumstances. These are:

- nationals of the other country may not be taxed more harshly than the country's own nationals;
- tax discrimination against stateless persons is not permitted;
- a permanent establishment of an enterprise resident in the treaty partner cannot be taxed less favourably than a local enterprise;
- payments to a resident of the other country must be deductible under the same conditions as if paid to a local resident;
- foreign-owned resident companies cannot be taxed more harshly than locally-owned resident companies.

- Mutual agreement procedure

A key benefit of tax treaties is that they allow the tax administrations to consult together on the application and interpretation of the treaty and to reach agreement on how best to achieve the aims of the treaty, especially removal of double taxation. The mutual agreement procedure is most commonly

invoked in the context of transfer pricing and profit allocation. The two tax authorities may agree on the allocation of profits within a multinational enterprise operating in both countries.

In the case of disputes as to the proper attribution of such profits, taxpayers themselves may seek agreement between the tax authorities of the two countries under the mutual agreement procedure.

A recent addition to the United Nations and OECD Model Conventions is a provision for binding arbitration in treaties (for instance, paragraph 5 of Mutual agreement procedure Article of the United Nations Model Convention).

- Exchange of information

A tax treaty authorises and requires tax administrations to exchange relevant tax information, including information held by financial institutions. This is a very powerful tool in preventing fiscal evasion by taxpayers.

Some countries seek to include an article in their treaties that provides for reciprocal assistance between the two tax administrations in collecting outstanding tax liabilities. This helps to ensure that revenue claims in both developed and developing countries can be enforced.

2.3 Designing a policy framework

A developing country's tax treaty policy framework should take into account international norms. At a minimum, the treaty should cover elimination of double taxation on income, non-discrimination, mutual agreement procedure and exchange of tax information. The OECD Model Convention and United Nations Model Convention provisions on these aspects of a tax treaty should be accepted as representative of the international standard by any country if it wishes to enter into tax treaties, although there may be room for negotiation with respect to certain details (which are discussed further below).

Other aspects of a tax treaty may be open to negotiation, such as coverage of capital taxes, and levels of source taxation permitted under the treaty. Departures from the international models will almost always increase the difficulty of negotiating a satisfactory treaty. Accordingly, countries, especially those with limited negotiating capacity, should deviate from the international norms only sparingly (for instance, where there is a clear national interest in doing so). On these aspects, each country should determine:

a. its preferred position;

b. the priority the country places on achieving that position; and

c. the degree of flexibility available to negotiators and any fixed ‘bottom line’.

2.4 Distributive rules

The allocation of taxing rights between the source and residence countries is generally the most controversial part of tax treaty negotiations. The distributive rules of a treaty, which are set out in the United Nations Model Convention in Articles 6 to 22, determine how the taxing rights will be allocated with respect to different categories of income. In developing its tax treaty policy framework, it is important that each country decide its preferred position on the balance of source and residence taxation, the priority it gives to maintaining that preferred position and, where flexibility is appropriate, the bottom line for negotiators.

A developing economy with minimal outbound investment

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Example: Article 16 of the United Nations Model Convention provides for taxation of directors' fees in the country in which the company is a resident. Some countries may not be able to exercise this taxing right unless the director's activities are performed in that country.

Is the proposed source taxation treatment consistent with the method of taxation of that category of income under domestic law (for instance, net taxation by assessment, withholding, etc.)?

Example: Article 7 of the United Nations Model Convention provides for net taxation of business profits. However, certain payments that are classified for treaty purposes as business profits (for instance, fees for technical services) are taxed on a withholding basis under the domestic law of some countries. Such countries may wish to consider whether to adopt a different approach under their treaties.

3) *Ease of administration*

Does the proposed treatment present any particular difficulties for the tax administration of your country? Such difficulties may include issues relating to administrative burden, especially where tax liability is determined by assessment by tax authorities (rather than self-assessment or withholding), or relating to interpretation or application of treaty provisions.

Example: Difficulties can arise where an undefined term used in the United Nations Model Convention (for instance, "paid" in Article 11) is interpreted in the Commentary in the way that is contrary to the established meaning of the same term for purposes of domestic law.

Is relevant information that is necessary for the administration of the provision readily obtainable?

Example: Article 8 (alternative B) of the United Nations Model Convention allows a country to tax "an appropriate allocation of the overall net profits" of a non-resident shipping enterprise. Determination of such profits vant infblished nis1.7322 Ttoprinaep

Example: Many countries choose to simplify compliance by taxpayers by not including the ‘force of attraction’ provisions of the United Nations Model Convention in Article 7(1). Others may consider that the provisions of Article 5(3)(b) of the United Nations Model Convention relating to the existence of a deemed services permanent establishment create an undue compliance burden on taxpayers.

Countries are well advised to follow the provisions of the United Nations or OEC/(pro64)ionTc .1481 To1(m)7-s

How much of a priority is it for your country that this outcome be achieved, vis-à-vis other issues? Is this an outcome that must be achieved, or something that is highly desirable but not essential, or is achieving this outcome not of particular importance to your country?

As far as possible, departures from the international norms should only sought for important issues. If a policy outcome is preferred, but not important, countries with limited negotiating skills and experience may be better off focussing those resources on achieving key outcomes.

3) Achievability

Is this treatment likely to be readily accepted by the treaty partner country? Is it consistent with regional norms? Have other countries sought or accepted this approach in their treaties?

4) Flexibility

Is your government prepared to allow negotiators any flexibility on this issue? Is this a deal-breaker? Is there scope for compromise (for instance, different time threshold, different rate limit, exclusion/inclusion of certain provisions)?

If no flexibility is possible at the time of negotiation, would negotiators be permitted to agree to a Most-Favoured-Nation provision? Such a provision could create an obligation to provide similar treatment if a more favourable position is agreed in a treaty with another country.

5) Fall back positions

If there is scope for compromise, what fall-back positions would be acceptable to your government? What is the bottom line?

Finally, countries should be forward-looking in designing their policy framework and Model. Treaties usually last for many years – often decades. Renegotiation of a treaty is time-consuming and expensive, so it is worthwhile to consider policies that are robust and sustainable in the long term, and that have regard to likely developments within the country and in the international tax context.

If possible, the policy framework and Model should be agreed on a whole-of-Government basis. In particularly, the support of the Ministry of Finance or Treasury is important in ensuring that the treaty policy is consistent with the Government's objectives. Other ministries, such as those responsible for foreign policy or trade, may also be relevant.

Policy concerns that are commonly encountered by developing countries, and the issues that they raise for designing a model tax treaty, are discussed in more detail below.

3. Designing a Model Tax Treaty

Countries should develop a model tax treaty (Model) that reflects the key

their domestic law. Deviations from the text of the United Nations or OECD Model Conventions may well be taken to signal that the negotiators intended to achieve a different outcome to that provided under the Models. By adopting the text used in the relevant Model, countries are able to demonstrate their

Where doubt exists, it may be useful to clarify in the country Model whether such entities are to be regarded as a “person” or a “resident” for treaty purposes.

3.2 Taxes covered

Capital taxes

While both the United Nations and OECD Model Conventions cover capital taxes, some treaties do not. The decision whether to include capital taxes in a treaty depends on whether such taxes are imposed in both treaty partner countries. If both countries impose capital taxes, then double taxation can arise where capital belonging to a resident of one country is taxed by the other country. In these circumstances, provisions to eliminate such double taxation should be included in any treaty between the two countries.

However, not all countries impose capital taxes under their domestic law. In designing their Model, countries that do not themselves impose capital taxes will need to consider whether they wish to cover capital taxes.

If a developing country that does not currently impose capital taxes decides to include this Article, and is concerned about limitations on future policy options with respect to capital taxes, one option may be to provide, in respect of capital that is not otherwise specifically dealt with under the article, for taxation in the country where the capital is situated. This would ensure that, if in the future that country introduces capital taxes, the treaty would not limit their application (other than with respect to capital represented by ships and aircraft used in international traffic).

Some treaties provide, for example, that all other capital may be taxed in both countries. If double taxation arises as a result, the country of residence of the taxpayer would be required to provide relief. An alternative approach is to provide for taxation only in the country where the capital is located. However, this is likely to be more difficult to negotiate since few countries are prepared to give up taxing rights over their own residents.

3.3 Distributive rules

Treaties provide for different methods of source taxation and for certain minimum thresholds for taxation of income derived by non-residents. The method and threshold depends on the category of income derived.

Business activities

Treaties generally provide an exemption from source taxation for income derived from temporary or preliminary business activities of non-resident enterprises. The aim of these provisions is to reduce the tax compliance burden of such enterprises unless they have a substantial participation in the economy of the host country. The relevant thresholds for source taxation are as follows:

Fixed place of business

Business profits of a non-resident will be taxable in the source country only if the non-resident enterprise has a permanent establishment (PE) in that country and the profits are attributable to that PE. A PE is primarily defined as a fixed place of business through which the enterprise conducts its business. A place of business will generally be regarded as 'fixed' if that place is at the disposal of the non-resident enterprise for at least 6 months.

This threshold for source taxation is widely accepted by both developing and developed countries for most non-service business activities (for instance, manufacturing, hotels, mining, retail, etc.). For service activities, the United Nations Model Convention includes an additional time threshold (see below).

Countries with significant natural resources, especially off-shore resources such as gas or petroleum reserves, may consider that a lower threshold is appropriate. These countries often include special provisions in the definition of "permanent establishment" (such as provisions to deem substantial equipment or natural resource activities to be a PE) or include an Offshore Activities Article which provides a shorter time threshold in respect of such activities.

Some treaties also provide an exception to the fixed place of business threshold in respect of insurance activities. For example, countries that impose tax on a basis of gross premiums paid to non-resident insurers under domestic law may preserve the operation of this law under tax treaties, sometimes with the rate of tax being capped to a certain percentage (for instance, 5% or 10%) of the gross amount of the premiums.

Construction sites

While the OECD Model Convention provides for a 12-month threshold for construction and assembly projects, a 6 month threshold is provided under the United Nations Model Convention and is widely accepted internationally. Some developing countries seek a shorter time threshold in their treaties (for instance, 90 days).

In designing a Model, the time threshold should not be less than any domestic time threshold for taxation of such activities. Doing so could lead to double-taxation of income of non-resident construction or assembly enterprises in treaties with countries that apply an exemption system (that is to say, where the income that may be taxed in the host State under the treaty is exempted from tax in the other State). This is because, while the treaty accords the host State the right to tax income, that State would not be able to exercise that right if the construction site lasts less than the domestic law time threshold.

Services

Income from services is commonly dealt with under a number of different articles of a tax treaty. Under the United Nations Model Convention, services are deemed to constitute a PE (and therefore be taxable under Article 7 unless dealt with under another specific article) where:

Supervisory activities in connection with a building site or assembly project etc. are carried on in the State for more than 6 months; or

Services are performed in a State for the same or connected project for more than 6 months.

These additional threshold provisions, though not part of the OECD Model Convention, are widely accepted in treaties with developing countries.

Another threshold that is not found in either the United Nations or OECD Model Conventions, but is found in a few treaties, deems a PE to exist where substantial equipment is used in a State. This additional threshold is particularly relevant to countries with off-shore natural resources, since large mobile equipment such as oil rigs may not meet the criteria for being a fixed place of business. As noted above, a lower time threshold is provided where the equipment is used for natural resource activities. The substantial equipment provision may also be relevant to domestic transport operations.

Specific types of services are dealt with under the following provisions. Where these provisions apply, they will have priority over the general rules provided in respect of services income in Article 7.

Profit Attribution

Treaties seek to avoid the double taxation that can arise as a result of differing attribution by the two countries of profits to a permanent establishment under Article 7 (Business profits) or to a related enterprise under Article 9 (Associated enterprises). While the arm's length standard is common to virtually all tax treaties, countries need to decide the extent to which dealings between different parts of an enterprise should be taken into account. In this regard Article 7 of the United Nations Model Convention differs from the OECD Model Convention in that it generally disallows deductions for amount "paid" by a permanent establishment to another part of the enterprise such as the head office.[30] Countries that wish to adopt the more limited approach to profit attribution should be careful to follow the wording of the United Nations Model Convention Article 7.

The United Nations Model Convention also provides limited 'force of attraction', which allows the source country to tax, in addition to profits attributable to a permanent establishment, profits arising in that country from sales of the same or similar goods, or the provision of the same or similar services. Although this approach is not commonly found, even in treaties of developing countries, those countries that wish to provide for such force of attraction should include in their Model the additional wording found in the United Nations Model Convention.

International traffic (Article 8)

Article 8 of the United Nations and OECD Model Conventions deal with income from international transport separately from other business profits, primarily because the usual rules for taxation of business profits would be difficult to apply in the context of international transport operations since airlines and shipping operators would be likely to have a PE in many countries. Furthermore, the calculation of the

30 See discussion in paragraphs 1–3 of the Commentary on Article 7 of the United Nations Model Convention.

profits attributable to each PE is very difficult, since much of the income derives from activities carried out on or above international waters.

International treaty practice is to provide for profits from international transport by air, or by boat in inland waterways transport, to be taxed only in the country where the place of management of the enterprise is situated. The OECD Model Convention Article 8 and United Nations Model Convention Article 8 (alternative A) provide for similar treatment of profits from international shipping. United Nations Model Convention Article 8 (alternative B) provides a different approach which allows the source country to tax a percentage of the overall profits from the shipping operations if such operations in that State are more than casual.

Another approach found in some treaties is to allow the source country to tax income from international shipping in accordance with domestic law, but to reduce the tax payable by 50 percent. This allows those countries that apply source taxation on a gross basis to the freight payable on goods or passengers shipped in that country to continue to do so, albeit at a reduced rate of taxation.

Developing countries will need to decide which approach they should adopt for international shipping, having regard to their policy preferences, administrative capacity and their domestic law. They may also want to consider whether profits from international road and rail transport should be dealt with under this Article, or in accordance with the usual rules of Article 7 for business profits.

Income from independent personal services (Article 14)

reason, some countries like to clarify that this article applies only to individuals, while others extend its scope to activities performed by entities such as companies.

Since Article 14 refers to 'income', countries that tax independent personal services incomes on a gross basis under their domestic law are not precluded from doing so under this article. However, as the majority of countries apply Article 14 to net income, countries that wish to apply gross basis taxation should clarify this during negotiations.[31]

Some treaties include a third threshold which allows a country to tax income from independent personal services where income exceeding a monetary threshold is paid by a resident of that country or a PE situated in that country. Such a threshold was previously found in the United Nations Model Convention but was deleted in 1999. Countries considering whether to include such a provision should note that monetary thresholds are difficult to administer and the amount becomes meaningless over time.

Independent personal services income may also be dealt with under provisions dealing with fees for technical services (see below). Where a treaty includes technical services provisions, the relationship between the two articles should be clarified, for instance by excluding such fees from the scope of Article 14.

Fees for technical services

Under their domestic law, many developing countries collect withholding tax on fees for technical services paid by one of their residents or borne by a PE situated in their country. The application of the usual tax rules for business profits provided under Article 7 may present an administrative problem for fees that are taxed on a withholding basis under domestic law, since there may be no mechanism for reporting this income or allowing deductions against it. Accordingly, these countries often wish to include a provision in their treaties that allows them to continue to apply their withholding taxes.

Provisions to allow withholding on fees for technical services generally extend similar treatment to such fees as is provided in respect of royalties. This is achieved either by including fees for technical services in the definition of 'royalties' in Article 12, or by including a separate article dealing specifically with such fees and drafted along similar lines to the royalties article of the United Nations Model Convention. A limit (generally around 10 - 15 percent of the gross amount of the fees) is imposed on source taxation.

Although such a provision is not currently included in either the United Nations or OECD Model Conventions, it can be found in a significant number of treaties of developing countries. The United

[31] See paragraphs 10 and 11 of the Commentary on Article 14 of the United Nations Model Convention.

Nations Committee of Experts on International Cooperation in Tax Matters (“The United Nations Committee of Experts”) is currently considering whether to add a provision to the United Nations Model Convention to deal with fees for technical services.

Since this provision is not consistent with current international treaty norms (which would require a PE or fixed base threshold, or at least a minimum time threshold), it may be resisted, particularly by countries

Entertainment (Article 17)

In international tax treaty practice, unlimited source taxation of income derived by artistes and sportsmen from their entertainment activities is permitted. Taxation on a gross basis is not precluded under this article, but countries should consider whether they wish to include in their Model, or would be prepared to agree in negotiations to, provision for:

- net taxation only;
- a minimum monetary threshold; and/or
- an exemption from source taxation for remuneration of entertainers who participate in a cultural exchange funded by Government.

Professors and Teachers

Although neither the United Nations nor OECD Model Conventions includes a separate provision dealing with income derived by visiting teachers or professors, a limited exemption is often found in treaties of developing countries that wish to attract the services of foreign educators.

The Commentary on Article 20 of the United Nations Model Convention includes a discussion on issues that should be considered in preparing a provision dealing with remuneration of teachers and professors, including:

- the possibility of creating double exemption (for instance, if the teacher ceases to be a resident for tax purposes in the other country);
- the inclusion of a time limit (normally 2 years) and the application of that limit;
- the possibility of limiting the exemption to teaching services performed at ‘recognised’ institutions or research performed in the public (v. private) interest;
- whether an individual should be entitled to benefits under the article in respect of more than one visit.

Since these provisions are often difficult to administer and the same benefit could be achieved with more precision through domestic law, consideration should be given to whether any benefit or exemption for such remuneration should be provided under domestic law.

Withholding taxes on dividends, interest and royalties

Dividends and Branch Profits Tax

E

the branch profits, to ensure maximum consistency between taxation of profits of subsidiaries and branches.

Interest

The United Nations Model Convention does not provide specific figures for limits on interest withholding tax rates. However, treaties with developing countries generally limit withholding tax on interest beneficially owned by a resident of a treaty partner country to 10 or 15 percent. Some regional models such as the ASEAN Model specify 15 percent.

Developing countries should decide what rate they would consider appropriate for their Model, bearing in mind that high rates of withholding may deter investment or may result in the tax cost being passed on to resident payers through increased interest rates.

Consideration should also be given to whether, either as part of their Model or as a concession as part of

have costs associated with it, and even a fairly low withholding tax rate imposed on the gross amount of the income may well result in excessive taxation which would discourage cross-border equipment leasing or may be passed on to resident lessees. A limit of about half of the general rate for royalties may be appropriate.

Capital gains

Treaties generally ensure that tax imposed on capital

account, inter alia, the ability of the tax administration to collect source taxation on pensions paid to non-residents. Countries that tax pensions by withholding under domestic law, for instance, are more likely to be able to collect source tax in accordance with Article 18 (alternative B).

3.4 Relief of double taxation

- Elimination of double taxation

The United Nations and OECD Model Conventions require the country of residence to relieve double taxation that arises in cases where source taxation is permitted under the treaty. The residence country has the option of relieving such double taxation either by the exemption method or the credit method.

A policy decision should be made as to which of these methods is preferred in relation to the different categories of income. Most countries prefer to align the method of relief to their domestic law relief provisions. However, some countries that relieve double taxation by the credit method under domestic law may provide for exemption of certain categories of income under a tax treaty in order to simplify compliance and administration.

- Tax Sparing

Tax sparing is an arrangement under which one country will agree to provide a credit for another country's tax, notwithstanding that the tax has not actually been imposed because of tax incentives provided by that other country. The purpose of tax sparing is to ensure that the benefit of the incentive is not 'soaked-up' by the country of residence of the taxpayer.

The treaties of many developing countries include a tax sparing provision to protect the application to residents of the treaty partner country of tax incentives.

While some countries are prepared to agree to such provisions with their least developed treaty partners, others are more resistant, especially since the OECD published a report recommending caution in agreeing to tax sparing provisions in treaties.[33] Nevertheless, this can be an important benefit to developing countries of entering into tax treaties with countries that provide relief from double taxation through the credit method.[34] Developing countries that wish to seek tax sparing would be well advised to consider how important the inclusion of such provision is to them, and the extent to which they might be prepared to consider limitations such as limitations on the activities to which the tax sparing provisions would apply, or limitations on the duration for which the provisions would apply.

[33] OECD Tax Sparing: A Reconsideration, 1997.

[34] See the discussion of Tax Sparing provisions in section 2.5 of Paper No. 1 Why Negotiate Tax Treaties?

3.5 Non-discrimination

Rules to prevent tax discrimination are designed to encourage inbound foreign investment in a State and protect investment abroad. The non-discrimination rules in the United Nations and OECD Model Conventions apply to all taxes, including national and sub-national level taxes, income tax, VAT, property taxes, petroleum taxes etc. In some countries, there may be constitutional or other barriers to applying the non-discrimination rules to all taxes. While it is desirable that the rules apply as widely as possible, these countries may need to limit the application of these rules in their treaties to taxes covered by the treaty, or to those taxes and other major taxes imposed in the two countries.

Countries should review their domestic tax law to determine whether discrimination of the kind precluded by tax treaties exists. In conducting this review it should be noted that different treatment of residents and non-residents exists in most countries and is not prohibited, provided that there is no discrimination of a type that would breach the tax treaty non-discrimination rules.

If a domestic law would potentially breach the non-discrimination rules, and for good policy reasons (such as the prevention of tax avoidance or evasion) the country considers that the law must be maintained, the country Model should clearly specify the laws that are to be excluded from the operation of the treaty rules.

3.6 Mutual agreement procedure and arbitration

In accordance with usual tax treaty practice, a country's Model should provide an avenue for taxpayers to seek solutions to tax issues arising out the treaty, such as transfer pricing issues, through the mutual agreement procedure. Under this procedure, the taxpayer can request the Competent Authority of his country to try to resolve such problems, either alone or in consultation with the Competent Authority of the other country. The second sentence of paragraph 4 of United Nations Model Convention Article 25 allows the competent authorities to develop 'appropriate bilateral procedures, conditions, methods and techniques' for the implementation of the mutual agreement procedures. Developing countries should consider the procedural issues discussed in Section C of the United Nations Commentary on Article 25, having regard, in particular, to the administrative capacity and resources of their tax administration and competent authorities.

Interpretive provisions are particularly useful where there might otherwise be doubt as to the intended operation or application of a tax treaty provision in one or both countries. This may occur, for example, where domestic law or jurisprudence in one country requires an interpretation that would not be followed in the other country. In this case, the two countries may agree during negotiations on a particular interpretation and set this out in the Protocol.

4 Conclusions

By developing a tax treaty policy framework, countries will be in a much better position to ‘know what they want’ out of treaty negotiations and to achieve outcomes that are in the best interests of the country. Such a framework will also assist countries in designing their country Model, which should reflect the policy outcomes sought.

Both the policy framework and the country Model should be reviewed regularly to ensure that future tax treaties continue to provide beneficial and appropriate outcomes for the country and remain up to date with international developments.

ADVANCE UNEDITED DOCUMENT

Papers on Selected Topics in Negotiation of Tax Treaties for Developing Countries

Paper No. 3-N

Preparing for Tax Treaty Negotiation

Odd Hengsle

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Preparing for Tax Treaty Negotiation

Odd Hengsle

1. Introduction

Preparations are an extremely important part of the negotiation process. Without adequate preparations the team will be at a disadvantage during the negotiation and will most probably not achieve an optimal result for the country they are representing. In the following paragraphs some of the important aspects of the negotiation preparations are detailed.

2. Prepare your model treaty

When the decision to negotiate tax treaties has been made, the first step will be to prepare a model treaty. Before drafting a model treaty it will be necessary to agree on policy in order to decide on important issues that have to be taken care of in the treaty.[41] Study the United Nations Model Double Taxation Convention between Developed and Developing Countries ("United Nations Model Convention"), the Organisation for Economic Co-operation and Development's Model Tax Convention on Income and on Capital ("OECD Model Convention"), regional model (if any) and models made by countries you would prefer to be compared with. When drafting your model's provisions, it is advisable to follow the recognised wording used in international models unless you have good reasons to use alternative wording. Such good reasons can for example be found in relation to industries where the employees are working on a rotation basis. For example, activities on the continental shelf is usually based on people staying at a platform for two weeks at a time, then spending the next four weeks in their home country. In such a case the 183 days test in Article 15 of the United Nations and OECD Model Conventions will not work properly and new wording may be necessary either by reducing the number of days or look at the days of employment rather than the days of presence.

If a provision in your model deviates from recognized wording used in international models, such provision may nevertheless be introduced in your model unless there is good and valid reason to have the wording introduced in an additional protocol. A protocol is mainly used to set out important interpretation or administrative provisions. One should, however, be ready to explain the reasons behind such deviations.

[41] See Paper No. 2-N, Tax Treaty Policy Framework and Country Model, by Ariane Pickering.

However, different wording can create issues, such as arguments over whether the commentaries to that provision will apply. It may also create uncer

3. Obtain authority to negotiate

Familiarity with your country's constitutional and legal requirements for negotiating and giving effect to treaties is essential. The process varies from country to country. In some cases an approval from the Ministry of Foreign Affairs is required. In some cases it is the prerogative of the Ministry of Finance or Treasury. Some countries prefer to submit a priorities report to the Ministers that seeks approval for the negotiation work programme for the next year or for the next few years. This really comes down to what will work within your country's legal and political framework. An approval of the work program may then replace an individual approval. In other countries an authority to negotiate is given in response to individual requests either from other countries or from industries in

4. Logistics

When a decision to proceed with negotiations is made, there are several issues that have to be decided.

- *How to communicate.* The initial approach requesting negotiations will usually be made through diplomatic channels or by a request made directly from the Minister in charge for negotiation of tax treaties in one country to the relevant Minister in the other country. To continue to approach each other only through diplomatic channels should be avoided. The aim should be to open a more informal dialogue between lead negotiators through email and/or phone calls so that the logistics can be more easily worked through. Most countries have an updated directory of persons that are allowed to act as competent authorities in relation to tax treaties. It is always useful to obtain such a directory from the other country, even if such directory does not tell who will be part of the forthcoming negotiation team. Such updated directory will, however, be more useful after the treaty has become effective and you for some reason need to get in direct contact with persons that are allowed to act as competent authorities. However, during the preparation period, direct contact with persons in the other country that are responsible for the preparation of the treaty at hand is preferable.
- *When will the negotiations take place?* A date for the negotiations to commence has to be agreed. Since all negotiations require preparation, time for such preparation should be allowed. A minimum of 6 weeks for preparation is desirable to enable a comprehensive

one to take comprehensive notes. One team member needs to be made responsible for maintaining the agreed text. This matter is made easier if the text can be electronically displayed on a screen. If that is not possible, accurate paper drafts need to be kept. In countries where the tax administration is separate from the policy department, it is advisable

There is much work to be done during the preparations and it is important that each member of the team, as early as possible, knows what will be his/her responsibility in the preparations.

The leader of the team should be a senior official with the authority to make important decisions during the negotiations. Such decisions include accepting or rejecting the other team's proposals, making his or her country's own proposals, and finding and accepting compromises, even if they are ultimately subject to approval by senior authorities. A senior official should always lead the team; otherwise the other country may get the impression that the negotiation is regarded as of little or no importance. This may create misunderstanding and a negative atmosphere.

It is preferable that the leader has comprehensive knowledge of domestic tax legislation and the interaction of domestic legislation and tax treaties. If not, at least one of the other members of the team should have such knowledge. Experience in treaty negotiations is also highly desirable.

It is the leader who should lead the discussions and present the team's arguments. However, the leader may decide to ask one of the other members of the team to present an argument, explain a position or a special feature in domestic legislation. In such a case this should, if possible, be agreed on within the team beforehand. It could, from time to time, be advisable to let a junior member of the team to do some presentation, as this will help him/her to gain experience and to give him/her a more direct feeling for being responsible for the final result. The senior officer should use all opportunities to train his/her team to negotiate. In general, it is advisable that members of a negotiating unit take part in training courses organised either by the country itself or by international organisations. It is important that the whole unit doing tax treaty negotiations achieve experience and knowledge. It could mean a serious setback for the unit if the unit is dependent on one senior officer and he/she for some reason leaves, either because he/she moves to a different position, leaves for private practise or retires.

In some countries the team is sometimes led by the most senior official of the negotiating authority who may not necessarily have the specific expertise required. This can create problems during the negotiations and it may be advisable for that person to indicate that the majority of the discussion will be led by a team member who has the relevant expertise.

It is important that at least one of the members of the team has the responsibility for taking notes of the discussions and any agreements reached during the meeting. Notes are important if a second round of negotiations is needed, and when preparing the treaty for signature and subsequent ratification. It is also important to have such notes when the competent authority at a later stage may

need to interpret issues arising from the treaty. The responsibility for taking notes should not be given to a junior without experience, because such a person will often have difficulties in understanding and deciding on what is important and what is of less significance. It is unusual to record the discussions, and it should never be done without agreement in advance with the other team in advance.

It is advisable to take note of the reaction of the members of the other team during discussions to see

to consult with your embassy in the other country. They may have important information in economic as well as non-economic areas that can be of value in the preparations.

7. Prepare the draft model used for a particular negotiation

Many countries will always use their general model treaty without making any changes. Although this indicates what they will regard as their preferred treaty, it should always be open for negotiations. Other countries will take into consideration particular inputs they have received from different sources, such as previous negotiations or public submissions. Some developed countries may even have prepared a specific draft for negotiations with developing countries, allowing more taxation rights for the source State.

Whether a country uses a general model treaty or a draft specially prepared for the negotiation at hand, the team must have a clear understanding of all the articles in the draft model they have prepared for the negotiation. It is important to understand all the articles and how they interact. The model may have been changed in some areas subsequent to previous negotiation and the team should be aware of where and why such changes have been made, and the effects of these changes.

The team should have a clear understanding of why the articles have been drafted the way they are and be able to explain them. The articles may be derived from the United Nations Model Convention, the OECD Model Convention, a regional model, or be specifically drafted by the ministry. They may also be found as alternatives in the commentaries to the models mentioned above. However, it is vital that the team is aware of and can explain any provisions that do not follow the United Nations or OECD Model Conventions. Such deviations may be due to domestic legislation or to important economic areas that need special attention.

8. Prepare alternative provisions

Many countries have provisions in their models, which they know from experience the other country may find difficult to accept in negotiations. To facilitate negotiations it is advisable to draft alternative provisions, which, through experience, are perhaps more likely to be accepted by the other country. These may be provisions that have been accepted in negotiations with third countries, or provisions that the other country has previously accepted in treaties with other countries. They could also be unique provisions intended to specifically address concerns expressed by the other country. When realising that a preferred provision is not acceptable, such drafted alternative

provisions can be presented and explained. It will be easier to have alternative provisions accepted when they can be presented in writing rather than orally.

9. Non-negotiable provisions

Some countries have non-negotiable provisions in their model. This position can be due to certain business activities or industries such as mining or extraction of natural resources. It may also be related to economic incentive legislation or other areas of great importance to that country. It may also relate to policy issues such as exchange of information. Most countries have difficulty in accepting that exchange of information may be prevented by bank secrecy legislation.

Non-negotiable positions may be found in the Commentaries to the OECD Model Convention. OECD member countries that disagree with the text of the Model lodge Reservations to the Model expressing their view, while disagreements with interpretations found in the Commentaries are reflected as Observations. A number of non-OECD member countries have also set out their positions on the Model and Commentaries. Although these Reservations, Observations and Positions do not always indicate a non-negotiable position, they are a very valuable indicator of strongly held positions.

It is important to distinguish between provisions that are really non-negotiable and provisions for which the other country has a strong preference, but which, under certain circumstances can be flexible. Provisions that are only a strong preference should not be presented as completely non-negotiable.

Some countries prefer to list their non-negotiable provisions and present them to the other country during the preparations either in writing or in a pre-meeting. Presenting such provisions in a pre-meeting will give the team the possibility of explaining the reason for its standpoint. By presenting the non-negotiable provisions during the preparations one may avoid unnecessary discussions or entering into negotiations that are doomed to fail.

Other countries are of the opinion that such presentation of non-negotiable provisions may deter the other country from entering into what might otherwise be a successful negotiation. By looking at what is achieved on balance in relation to all the other provisions of the treaty during the negotiation, and by explaining why some provisions are of such importance that a superior authority or the parliament will not accept any deviation, these countries hope, based on earlier experience, that their standpoint would be accepted. If experience has shown that some non-negotiable provisions have

treaties, they also provide information about the entry into force and the termination of treaties, additional protocols, new legislation, court decisions and mutual agreements entered into by competent authorities (if made public). All very valuable information.

12. Prepare a comparison of the respective models – identify issues

After having received the draft model from a treaty partner it is important to prepare a comparison between the two drafts. This may be done in several ways, see examples enclosed in Annex 1 and Annex 2. In Annex 2 two colours are used. The use of colours simplifies the identification of the differences.

All differences between the two drafts should be identified because the small and less important textual differences have to be agreed upon during the negotiation as well as the major items. If some differences are overlooked, difficulties will arise at the time of signature, or even worse, after the treaty has entered into force. In the last case a protocol to the treaty has to be prepared and the laborious work of bringing the protocol into force has to be done.

During the comparison and identification of the differences it is advisable to decide what differences are important and what differences are of less importance. It will facilitate negotiation to concentrate more on the important issues. It will be these important issues where difficulties will be met during the negotiation. Having identified the important issues, such issues should be discussed internally to find arguments to be used, and what tactic should be followed, in the process of trying to convince the treaty partner to accept your proposal. By identifying the important issues early in the comparison process there will also be time enough to draft compromises and also to consult with a superior authority for acceptance of different anticipated solutions. If a compromise solution could be acceptable, a prepared draft may be easier for the other team to consider and accept than a compromise proposed orally at the meeting. A brief note where the origin of the draft is set out (for instance, internationally recognised models, examples found in your own or the other country's tax treaties or drafted by you specifically for this negotiation) should be included with the prepared draft. This will ensure that all members of the team are aware of and can explain its origin.

13. Identify provisions proposed in the two draft models

country. An example of such provision can be found in the tax treaty of 12 October 2000 between Norway and the United Kingdom:

"Article 33
Limitation of relief
1. Where under any provision of this Convention income is relieved from Norwegian tax and, under the law in force in the United Kingdom, an individual, in respect of the said income is subject to tax by reference to the amount thereof which is remitted to or received in the United Kingdom and not by reference to the full amount thereof, then the relief to be allowed under this Convention in Norway shall apply only to so much of the income as is taxed in the United Kingdom.

2. Where under Article 13 of this Convention gains are relieved from tax in Norway and, under the law in force in the United Kingdom, an individual is subject to tax in respect of those gains by reference to the amount thereof which is remitted to or received in the United Kingdom and not by reference to the full amount thereof, then the relief to be allowed under this Convention in Norway shall apply only to so much of the gains as are taxed in the United Kingdom."

Treaties entered into many years in the past are of less value than new treaties. Recent treaties entered into by the other country may also help the team to develop drafting that is likely to be acceptable to that other country.

During this preparation process it is important to have in mind, and never forget, that you have to look at the overall balance of the treaty and not at specific issues.

14. Study culture and habits in the other country

When preparing the draft model or when studying the draft received, it is advisable to have some background knowledge about the country you are going to negotiate with. It may be in relation to their economic situation, their Gross National Product (GNP), important industries or their relations with other countries.

If the negotiation is with a country with which you are not familiar, it is advisable to check whether there are issues you should be aware of and take into consideration. It could be related to food, alcohol, religious beliefs or what is regarded as bad behaviour. The timing of the negotiations is one example. Do not propose negotiations during important religious holidays in the other country. Awareness of the dress code when visiting the other country is another example. This may relate to

the way women dress, but also to men. Never dress informally unless there is a special reason for doing so.

It may harm an otherwise good atmosphere between the two teams if it is considered that there has been bad behaviour or someone feels offended due to the lack of knowledge of local customs. A consultation with your embassy in the other country may prevent such incidents. In general, it is advisable to have enough information not to seem ignorant or uninterested.

15. Conclusions

As you will see from this paper, preparations are essential. It may be the most important part of the whole negotiation process. If you do not come to the discussions fully prepared, what you may achieve is a treaty that is not as beneficial to your country as it might otherwise have been. It is easy to miss possibilities. It is advisable not to rush into negotiations, but take the necessary time to come prepared.

Annex 1 Example on the comparison of draft treaties

Article 15 Dependent Personal Services (B's Article 14 Income from Employment)

Nr	Country A	Country B	B's treaties with country C and D	Comments
1.	Reference to Article 16 (Directors' fees) and Article 19 (Government service)	B has reference to the same Articles, but numbered Articles 15 and 18. In addition, a reference to Article 17 (Pensions and Annuities)	B has a reference to the Article on pensions in treaties with C and D	

Annex 2 Example on the comparison of draft treaties

Red: Proposal from State A

Blue: Proposal from State B

Article 13

Capital Gains

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.
2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State

,

including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) , may be taxed in that other State.
3. Gains derived by an enterprise of a Contracting State from the alienation of ships or aircraft operated in international traffic, or movable property pertaining to the operation of such ships or aircraft shall be taxable only in that State

.

4. Gains derived by an enterprise of a Contracting State from the alienation of containers (including trailers and related equipment for the transport of containers) used for the transport of goods or merchandise shall be taxable only in that State, except insofar as those containers or trailers and related equipment are used for transport solely between places within the other Contracting State.
5. Gains from the alienation of any property, other than that referred to in the preceding paragraphs, shall be taxable only in the Contracting State of which the alienator is a resident.

Article 14

Income from employment

1. Subject to the provisions of Articles 15, 17 and 18, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless

a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve months peri

Papers on Selected Topics in Negotiation of Tax Treaties
for Developing Countries

Paper No. 4-N

How to Conduct Tax Treaty Negotiations

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How to Conduct Tax Treaty Negotiations

Odd Hengsle

1. Introduction

The object of a tax treaty negotiation is to achieve a treaty that is beneficial to both countries and meets the interests of each side as far as possible. A treaty that favours only one country will not be beneficial in the long run. If one country feels that it has been overwhelmed and possibly cheated that country may resist applying the treaty, or may not apply it in the way intended, and may create a bad relationship between the competent authorities. The treaty may even be terminated, or that country may ask for renegotiations.

It is important that the negotiations are conducted in a co-operative atmosphere with a willingness from both teams to achieve the best result for both countries. Consequently, it is important that both teams negotiate in good faith.

The treaty needs to work smoothly in practice and should be effective and not create undue difficulties in compliance issues. As a tax treaty will in most cases last for many years, it is important that it is drafted to stand the test of time.

Reaching a good agreement is dependent on many factors, including research, planning and preparations, the conduct of the negotiations and the management of the process. Preparations are very important.[43]

When the two teams meet for the first time, the first issue to decide is which draft model should be used as the working document. It is always an advantage to have one's own draft model accepted as the working document, because any change to that model has to be argued and explained by the other team and, in many cases, less important differences will be accepted without difficulty.

The host team will usually ask for its draft to be the working document. In many cases, the visiting team will accept this request. However, both drafts will be on the table and should be taken into consideration during the discussions. It is advisable to use a projector to display the working draft on a screen. If possible, a merged document which shows the text of both drafts could be screened to facilitate a full discussion. This is then updated to make it easier to see what is actually agreed.

43 See Paper No. 3-N, Preparing for Tax Treaty Negotiation, by Odd Hengsle.

When the two teams have solved all outstanding issues there are two Articles that have to be drafted, that is to say the “Entry into force” and the “Termination” Articles. These two Articles are important since there should be no doubt as to which income year the treaty should be applied for the first time, or if terminated, which income year would be the last year in which it should be applied. However, these Articles are discussed in the paper on “Post–negotiation Activities”.[44]

2. Negotiation style

Negotiation style is very important. The style can vary from soft to aggressive.

A soft negotiator may have as his objective to reach agreement on all articles as soon as possible. He may search for solutions that are acceptable to the other side and try to avoid conflicts. However, a soft negotiator may easily make unnecessary concessions.

An aggressive negotiator will have as his objective to defeat the other side on all issues. He will insist on his proposals and demand concessions. However, such an aggressive style will easily create an unfriendly atmosphere and should be avoided. In the worst case the other team will feel offended or bullied and may react by ending the discussions without further negotiation, or by insisting that the other team use a different leader.

A negotiation style somewhere in between is obviously desirable. A negotiator should be consistent in his approach, but always polite. He should be prepared for the negotiation knowing what is important for his country and proposing and explaining his preferred solutions without being aggressive.

Whatever his or her approach, a negotiator must remember that his or her style should take into account the goal of the negotiations, which is to achieve a mutually beneficial treaty. It is important to have in mind that you have to look at the overall balance of the treaty and not be blinded by specific issues.

3. Trust

To achieve a productive atmosphere during the negotiation process, it is necessary to gain the trust of the other team. Losing credibility may lead to negotiating difficulties if the other team does not trust the validity of arguments put forward and becomes sceptical of everything said.

[44] See Paper No. 5-N, Post-negotiation Activities, by Odd Hengsle.

The two team-leaders lead the negotiation. To prevent confusion or offence, no other member of the team should take the floor without being invited to by the leader. It is the leader who decides what to say and by whom it should be said. If any member of the team feels he has a valuable contribution, he should address his leader. In order for a junior member of a team to gain experience in negotiations, it could advisable to let him/her present an issue. However, this should be agreed in advance as part of the preparations.

When speaking, always address and look at the other party's leader unless it is obvious that it is correct to address someone else.

When the leader (or someone else from the other team) is presenting his arguments, listen and show respect for the arguments put forward - even if you disagree. It is bad behaviour to interrupt, shake your head or tell the other team that they are wrong. It is important to be polite in explaining to the other team why you are of a different opinion or prefer a different solution. It is your argument that should convince the other team and not by way of obvious disrespect.

5. Discussion

When time and place for negotiations are agreed, a list with the names and titles of the participants of the two teams should be exchanged, also naming the leader. In addition, when the two teams meet for the first time, both leaders should introduce themselves and their team so that both teams know who is present and what the role of each team member is. For example, the leader might introduce a team member as "Peter Smith from the revenue agency" or "Linda Jones, w.00irc]TJ 00 10.9o7y97 TD .000A0.9a3 eamien theMpinJ 03(t-5.5ray ofFinvanc"s. T hio)]TJ 9.8547 0 TD [t well alsobce the time toh and [illegible]

a difference between an “Agreement” and a “Convention”. These countries use “Agreement” in relation to a bilateral treaty and “Convention” in the context of a multilateral treaty. It is wise to check with the Ministry of Foreign Affairs if they have any preference. However, this is a minor issue and should be solved easily. If one country has a preference to use the term “Agreement”, the other team should agree where possible and move on.

It is wise to agree on the process of the discussions. If it is the first round of negotiation between the two teams, one can agree to work through all articles one by one without a deep discussion on each article. In this way issues of less importance to both parties can be settled. However, some countries prefer to deal with linked provisions at the same time (for instance, the taxation of shipping in Article 3 (Definitions), Article 8 (Shipping), Article 13 (Capital gains) and Article 22 (Capital).

By working through all the articles one by one it will be easy to ascertain where the difficult issues are and to identify the most important issues for one or both countries. It is also important to understand the value of the issue under discussion. What is important to one country may not be important to the other. Understanding the value of the issues both to you and to the other side is essential when trying to reach a compromise or doing a trade-off.

When all the articles have been worked through, it is time to concentrate on solving the remaining difficult issues. This may be done during the first round of negotiation but, depending on time, may be postponed to a second round.

Another way to begin negotiations is to initially identify which items are most important to the teams and begin by discussing them. However, this method is probably best used after the teams have had their first round of discussion of the draft as such. Deciding to begin with the two countries’ important issues when the teams meet for the first time may prove a disadvantage for the teams. It is not always wise to identify very early in the negotiations what are the most important issues to each of the teams. Even if the other team has no serious objections to a proposal (for instance, because the item is not important for them), they may defer acceptance of the proposal in the hope of achieving something in return at a later stage in the negotiations.

If a provision mostly relates to one of the countries or is a clarification of the wording of an article, it may be better to include the provision in a protocol rather than trying to draft wording to that effect in the treaty itself.[45] This might simplify the reading of the treaty text. However, if a protocol is used,

[45] See Paper No. 2-N, Tax Treaty Policy Framework and Country Model, by Ariane Pickering.

it is important to draw attention to the protocol in an explanatory note to the treaty. Otherwise the provision in the protocol can be easily overlooked.

Negotiators should remember that even if the issues, which are not agreed, are important, it is not necessarily difficult to find solutions. It may be that the two teams identify the same issues as important. In such cases it may be easy to find common solutions if both teams can reach agreement on what solution is preferable or at least acceptable. However, if both teams regard an issue as important, but disagree on the solution, a compromise may be difficult (but not impossible) to find. It may also be that an issue, which is regarded as important to only one of the teams, is not contrary to what can be accepted by the other team provided the arguments advanced are satisfactory.

For an effective discussion to take place one should introduce the item and present one's position clearly. It is not necessary to present all arguments at once. In fact, it may be wise to hold some arguments back, to be used if the other team does not agree and has explained why.

After the arguments for a position have been presented, it is wise to note carefully the reactions from other team. Sometimes it may be difficult to understand the response. In such a case one should always ask for clarification, and continue to ask until the response is clearly understood. One should never move to a new provision without having got the necessary clarification. To accept or reject a proposal without a clear understanding of the proposal put forward by the other team may lead to an unpleasant surprise in the future.

By listening carefully to the arguments put forward by the other team, you will from time to time find that the proposal they are making is actually advantageous and better than your own proposal. If this is the case, accept the proposal and make the necessary amendments to improve your own model.

A team may resist a proposal and the arguments used in its favour. When this team is arguing for a different solution, listen, and be prepared to counter. It is for this reason that is not wise to present all the arguments at the first presentation, but use them as the discussion continues. If it seems difficult to get acceptance for the proposal that is being discussed, it is time to look for alternatives, which may have been prepared before the negotiations, may be developed during the negotiation. Alternatives may also be found in the Commentaries to the United Nations Model Double Taxation Convention between Developed and Developing Countries ("United Nations Model Convention") and the Organisation for Economic Co-operation and Development's Model Tax Convention on

For the purpose of Articles 11 and 12 if a lower rate of State A tax is agreed upon with any other State than State B after the entry into force of this Convention, State A shall without undue delay inform the Government of State B in writing through diplomatic channels and shall enter into negotiations with the Government of State B with a view to include a similar provision in the present Convention".

A different way to deal with di

OECD Model Conventions. However, since the necessary legislation has not been passed by the parliament at the time of negotiations, an article the assistance in collection of taxes could not become effective until the necessary legislation has been approved. If the legislation is expected to be in place within a reasona.36ey

problem, the best way to handle such compromises is to put them in brackets for further consideration. If the issue is not too important and the wording not too difficult it may be enough to have studied the wording during a break or the evening after that day's session has ended. Depending on the importance of the issue, it may also be prudent to take it home for consultation with qualified persons.

During the discussions a team may realise that the other team has misunderstood the effect of a proposal that is made. Due to that misunderstanding, the other team may have accepted a proposal they otherwise would not have agreed to.

concluded that there were no differences in how the profits were computed and the tax calculated.[46] However, there are countries, which disagree with the report and maintain that an interpretation allows for including both individuals and companies and allows for a gross taxation.

It may also be that, during the discussions, a team realises that the other team has a different understanding of its own proposal than what is the general international understanding or that their proposal will not give the intended result.

If one team believes that the other team has misunderstood the meaning or effect of a proposal or that different interpretation of an article exists, this issue should be raised. If the issue is important to the other team and that other team realises later in the negotiation that they have misunderstood a proposal to which they have agreed, they may feel misled and want to reopen the issue. They may even lose faith in the integrity of the other team and therefore be reluctant to agree on new issues. If the misunderstanding is not realised during the negotiations, but before signature, a delicate situation may arise when the country refuses to sign the treaty or insists on renegotiation.

If a team at any time during the negotiation wishes to clarify issues or discuss arguments within the team, they should do so and ask for a time-out. It is better to take a time-out than make a wrong decision. All countries, developed as well as developing, have been in situations where a time-out has been necessary. Such internal discussion within a team does not require that a separate meeting room is available. In most cases it will be sufficient that the other team leave the meeting room during the internal discussion. However, even if the two teams speak different languages, it is not advisable to believe that someone in the other team does not understand your language. Be careful with internal discussions with the other team present.

If an issue is agreed, accept it and move forward. It is not advisable to restate the issue by informing the other team how important the solution was, or to begin repeating the arguments. Restating the issue may result in the other team changing its mind or asking for further reflection before deciding.

To avoid unnecessary misunderstanding it is important that both teams send correct signals on their attitude to the proposals put forward. One should avoid a situation when a team at the end of a

An example is the situation where a foreign company, for bona fide reasons, establishes a branch in

advisable to introduce specific anti-abuse provision in these treaties. Both the United Nations and the OECD Model Conventions discuss the use of specific anti-abuse rules found in tax treaties.

When prevention of abuse is used as an argument, it is important to use examples to illustrate why a certain wording is necessary.

An example could be the introduction of thin capitalisation rules in domestic legislation. Depending on the wording of such legislation, the rules could be argued to be contrary to the non-discrimination article in the tax treaty. To avoid a discussion of legislation to combat the use of excessive debt capital instead of equity capital to finance the establishment of a daughter company in your country, it might be useful to propose a sentence either in the non-discrimination article or in a protocol to the treaty that such provision is not in breach of the provisions of non-discrimination article.

If your domestic legislation contains other provisions that could be argued to be contrary to the article on non-discrimination, it could be wise, after you have carefully explained the domestic law provision, to propose a provision in a protocol to the treaty reading as follows:

> *" Ad Article…*
>
> *Nothing in the domestic legislation in State A at the time of the entering into force of this Convention shall be regarded as being contrary to the article on non-discrimination".*

Another example may be that a country may want to include a paragraph in the article on dependent personal services to deal with international hiring out of labour. Such a provision could be introduced to prevent the situation whereby a local company, in order to avoid taxation of its employees, hires them through a foreign company. Such wording and an explanation can be found in the Commentaries to that article both in the United Nations and OECD Model Conventions.

A third example could be a provision added as a new paragraph in the articles on dividends, interest and royalties, stating that the provisions of those articles should not apply if a dividend, interest or a royalty payment was created mainly for the purpose of taking advantage of the respective articles and not created for bona fide reasons. An example of such a paragraph in Article 11 might be:

> "The provisions of this Article shall not apply if the debt-claim in respect of which the interest is paid was created or assigned mainly for the purpose of taking advantage of this Article and not for bona fide commercial reasons."

Similar provisions could be inserted in the articles on dividends and royalties.

Another possibility could be to add an article on the limitation of benefits. An example of such drafting might be:

> *"Article ……..*
>
> Limitation of benefits
>
> *Benefits of this Convention shall not be available to a resident of a Contracting State, or with respect to any transaction undertaken by such a resident, if the main purpose or one of the main purposes of the creation or existence of such a resident or of the transaction undertaken by him, was to obtain the benefits under this Convention that would not otherwise be available".*

Some countries have introduced comprehensive Limitation of Benefits rules (LOB) in their models. The United State of America (USA) is an example of a country that has introduced such an Article in all their recent treaties. Such rules are in many cases complex and difficult to understand. It is not advisable to introduce such rules in your own model unless you are very experienced. When negotiating with countries that have such rules in their models, ask them to clarify the provision and take the time necessary to understand the implications.

An argument one frequently meets is that a proposal is based on firm policy. However, the question is how firm is firm?

A country may have found that a certain provision is not effective in relation to what they have tried to achieve. However, an argument based on this kind of experience should be illustrated by examples.

Some countries have non-negotiable provisions in their model. That can be due to certain business activities or industries such as mining or extraction of natural resources. It may also be related to incentive legislation or other areas of great importance, or it may be for policy reasons such as exchange of information. If experience has shown that some non-negotiable provisions have been a hindrance to achieve an agreement, it would be advisable to consult with a senior policy maker, the Minister or even the Parliament to see whether compromises may be acceptable.

It is, however, important to distinguish between provisions that are really non-negotiable and provisions which are only strongly preferred. Provisions that are only strongly preferred should not be presented as non-negotiable.

E

An "exchange of notes" is a record of an agreement to clarify a common understanding of an issue where agreement has been reached between governments during the negotiations of a treaty. The agreement consists of the exchange of two documents, each of the parties being in possession of the one signed by the other party. Under the usual procedure, the accepting State repeats the text of the offering State to record its assent. The signatories of the letters may be government Ministers, diplomats or departmental heads. The letters will usually be signed and exchanged at the same date as the treaty. This is a very formal document and the interpretation will usually be followed even if the document is not legally binding.

A Memorandum of Understanding (MoU) is a document of a less formal kind. It is often used for detailed or technical matters which may not easily be set out in the treaty or a protocol. It may also clarify an understanding of a provision or an issue. Such MoU is usually drafted at the end of the negotiations and signed by the negotiators at the same date as the agreed draft is initialled. It may also be made at a later date, but in such case it would probably be more correct to follow the procedures laid down in Article 25 (3) (Mutual agreement procedure) of the United Nations and OECD Model Conventions. The document is not legally binding, but should be taken into consideration when interpreting the treaty.[50]

8. Records of discussions

During the discussions it is advisable to have the working draft electronically projected on a screen that is visible to both teams. One team member needs to be made responsible for maintaining the agreed text. In this way everybody can check that the changes made are correct. When going through the working draft, article by article, all wording that is not agreed should be put in brackets. One way of doing this is to use colours. The preferred wording for both teams should be put in brackets using different colours. This would make it easier to identify where agreement is not achieved and what the position is for each of the teams. By using brackets it will also be clear to both teams what is agreed and what is not. What is not put in brackets should be regarded as agreed and closed. If there is no screen it is important to read the text before moving on to the next issue. One example of using brackets and colours might be:

(3. Gains derived by an enterprise of a Contracting State from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of

[50] See Paper No. 5-N, Post-negotiation Activities, by Odd Hengsle.

such ships or aircraft shall be taxable only in that State

)

in the Contracting State in which the place of effective management of the enterprise is situated.)

At the end of the meeting it is important to ensure that there is agreement on which issues have been resolved, and which are postponed for a second or subsequent round of negotiations. Both teams should have a printed version of the working draft as it stands at the end of discussion and one should always leave enough time to read it and check for mistakes. When the draft is based on a merged text that has been on a screen, there will be fewer possibilities for serious mistakes. Misprints can always be corrected in the correspondence between the two teams.

If it is not possible to have the working draft projected on a screen, accurate paper drafts need to be kept. This requires very careful organisation. All paper drafts should be dated so that it is clear which text is the latest.

When the two teams have agreed that the working draft is in accordance with what has been agreed, the two leaders should initial each page of the draft. Even if there are still brackets and a second round is necessary, initialling the working draft is advisable. Since several drafts may have been on the table, an initialled draft proves what has been agreed and which draft is the correct one.

When initialling a draft, begin by initialling on the left side of the page. Your initials should be found just below the last line on each page, which is not necessarily on the bottom of the page. The theory behind this is to avoid that anything should be added or removed in the text without being discovered. When all pages are initialled, exchange draft and initial on the right side. When both leaders have initialled the two drafts there will be one initialled draft for each country. The copy to bring home is the one where your initials are found first (initials on the left side of the page). However, if the initialling is done differently, it is of no importance as long as the two leaders have a draft that shows what has been agreed. The initialling of the draft has no binding effect on the countries. It shows what the two leaders have agreed and are prepared to take home to be presented

If there is to be a second round of negotiation, then open issues should be in brackets, indicating either in colours or otherwise, the positions of the two countries. It is also wise to agree on a (tentative) date for future negotiations and note this date in the minute. That date should not be too far into the future. If it takes too long between the first and second round of negotiations the members of the teams from the first round of negotiations may not be present for the second round. The result could be that issues agreed during the first round will be reopened by a new lead, which may harm the process of finalizing the treaty and create irritation and confusion.

Even if the second round of negotiations is suppo

Annex 1

AGREED MINUTE

A first round of negotiations of a Convention between State A and State B for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income was held in ….. from …. through…..Date and Year. The delegation from State A was headed by Mr ………., Director in the Ministry of Finance. The delegation from State B was headed by Mr………. Director in the Ministry of Finance. A list of both delegations is attached as Annex I.

The negotiations were conducted in a friendly atmosphere of mutual understanding and cordiality. While most Articles of the Convention were discussed in depth and agreed, some provisions were left pending and these are indicated in brackets and marked in colour. Yellow for State A and green for State B. The pending issues include Article 5, paragraph 3, Article 8, Article 11, Article 12, Article 13, Article 19, Article 21 and Article 26. These pending issues are set out in the joint draft text attached as Annex II which will be used in the future negotiations to be held in ……….., at a date to be agreed.

Done in State A on Date and Year.

For the delegation from State A:	For the delegation from State B:
Mr ………………..	Mr ……………………..
(Head of delegation)	(Head of delegation)

Annex 2

AGREED MINUTE

A second round of negotiations for the conclusion of a Convention between State A and State B for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income was held in ……. from … through … Month and Year. The delegation from State A was headed by Mr…… Director, Ministry of Finance, while the delegation from State B was headed by Mr. …….., Director, Ministry of Finance. A list of both delegations is attached herewith as Annex I.

The negotiations were conducted in a friendly atmosphere of mutual understanding and cordiality. The provisions of the Convention that were left open at the first round of discussions in ….., as well as a number of other provisions previously accepted, were discussed in depth. The discussions led to an agreement at official's level on all issues and an agreed text was initialled on .. Month and Year. The agreed text is attached herewith as Annex 2.

Done in …. on … Month and Year

For the delegation from State A:	For the delegation from State B:
Mr ………………………………….	Mr ……………………..
(Head of delegation)	(Head of delegation)

DRAFT UNEDITED DOCUMENT

Papers on Selected Topics in Negotiation of Tax Treaties for Developing Countries

Paper No. 5-N

Post-negotiation Activities

Odd Hengsle

Former Director General, Tax Treaties and International Tax Affairs, Norway

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Post-negotiation Activities

Odd Hengsle

1. Introduction

This paper deals with several issues that have to be dealt with after agreement is reached on all major issues. The first issue regards the drafting of the two Articles on “Entry into force” and “Termination” where several problems may be met. The paper then continues with a discussion of how to proceed with the preparation for signature, including translation (if necessary), getting the authority to sign and the actual signing. Also issues related to post signing activities necessary to bring the treaty into force and obligations after the treaty has entered into force are discussed. However, questions related to the fulfilment of obligations laid down in the Articles on “Exchange of Information” and “Assistance in

2. The Convention shall enter into force on the date of the later of these notifications and shall thereupon have effect in both Contracting States in respect of taxes on income relating to any calendar year next following that in which the Convention enters into force.”

The two States may also agree that the treaty shall enter into force when a certain period of time has elapsed after the exchange of instruments of ratification, or after the later confirmation that each State has completed the procedures required for the entry into force. One way to deal with this kind of requirement is to draft paragraph 1 as follows:

“1.The Contracting States shall notify each other in writing, through diplomatic channels, that the legal requirements for the entry into force of the Convention have been complied with.

2. The Convention shall enter into force on the thirtieth day after the day of the later of these notifications and shall thereupon have effect in both Contracting States in respect of taxes on income relating to any calendar year next following that in which the Convention enters into force.”

If the initialled draft also contains an article on capital taxes, these taxes should also be covered by the entry into force provision. Some States may regard their capital gains taxes as being different to ordinary taxes on income. For those States, it is necessary to make a reference to such taxes as well. Normally, however, a capital gains tax is considered to be a tax on income.

It may also happen that the two States have different income years. If that is the case, the Article on “Entry into force” has to be drafted accordingly. One example of such drafting might be:

“1.The Contracting States shall notify each other in writing, through diplomatic channels, that the legal requirements for the entry into force of the Convention have been complied with.

2. This Convention shall enter into force upon the date of the later of these notifications and shall thereupon have effect:

a. *In State A in respect of taxes on income for any year of income beginning on or after …… (date and month) next following that in which this Convention enters into force;*

b. In State B in respect of taxes on income relating to any calendar year next following that in which the Convention enters into force.”

E

The termination notice should be in writing and sent through diplomatic channels.

It is important to have in mind that the two articles on the entering into force and the termination operate with a difference between the date the treaty enters into force or is terminated and the date from which the treaty shall be applied or eventually no longer be applied.

Depending on the wording, a treaty enters into force on the date of the exchange of the instruments of ratification or the date of the later of the notifications that all legal requirements have been complied with. However, the treaty becomes effective and shall only be applied from 1 January in the year next following the year the treaty enters into force. Since the treaty should be of great benefit to both countries it is important that the instruments of ratification or notification of legal requirements are made as soon as possible. A delay may eventually result in an unnecessary delay of the date from which the treaty shall be applied.

As for the termination of a treaty, it is important to remember that a treaty usually shall be terminated (in writing) at least six months before the end of a calendar year. A notice of termination delivered before the end of June in a year will have the effect that the treaty will cease to have effect and should not be applied on or after 1 January in the year next following. However, a notice of termination delivered in July in a year will have the effect that the treaty will not cease to have effect from 1 January in the year next following, but from 1 January a year later, a delay of one year.

If a country has a different income year than the calendar year, the date a new treaty becomes effective or an existing treaty no longer shall be applied will change accordingly.

Special problems related to Article 24 (Non-discrimination), Article 26 (Exchange of information) and Article 27 (Assistance in the collection of taxes) of the United Nations and OECD Model Conventions

In Article 24 (Non-discrimination) of the United Nations Model Double Taxation Convention between Developed and Developing Countries ("United Nations Model Convention") and the Organisation for Economic Co-operation and Development's Model Tax Convention on Income and on Capital ("OECD Model Convention"), it is stated that the provisions of that Article shall also apply to persons that are not resident of one or both of the contracting States and that the provisions of that article shall apply to taxes of every kind and description. The same applies to Article 26 (Exchange of 3716 0 TD .00S

and Article 27 (Assistance in the collection of taxes). Since the application of these Articles is not restricted to persons (Article 1) and taxes (Article 2) covered by the Convention, it is important to have a clear understanding of the entry into force and the termination of the obligations laid down in these articles.

If the Article on “Entry into force” only refers to income taxes covered by the Convention, or refer to income taxes in general without referring to the other taxes referred to in Articles 24, 26 and 27, uncertainty may arise as to the entry into force or the termination of taxes of all kind and description covered by the three Articles referred to above. It is hard to find examples where this issue has been solved in existing conventions. On the other hand, there are only few examples where this “uncertainty” has created problems.

One way to deal with this issue is to add a paragraph in the Articles on the entry into force and the termination stating that taxes covered by Articles 24, 26 and 27 shall enter into force or be terminated on the same date as taxes covered by Article 2 (Taxes covered). If such addition is problematic or seems unnecessary, the entry into force or termination of these Articles could be clarified in an Agreed Minute or a Memorandum of Understanding.[51] Such clarification can be made in connection with the signing of the convention or in writing at a later date or when the problem is raised. Even if such statements are not binding on the courts, it is stated in Article 31 (General rule of interpretation) in the Vienna Convention on the Law of Treaties[52] that such statements should be taken into consideration when interpreting the treaty even if the statements are made at a later date.

Even if the date of the entering into force of the articles on exchange of information and assistance in collection is clarified, the question arises if exchange of information or assistance in collection of taxes may be asked in relation to income years prior to the year the treaty enters into force and is applicable. Some countries are of the opinion that allowing an exchange of information or assistance in collection of taxes for income years prior to the entry into force of the treaty would give the treaty retroactive effect and should be denied. However, the general opinion is that, unless otherwise stated, such information should be exchanged and assistance given also in relation to income years prior to the entry into force of the treaty and should not be regarded as giving the treaty a retroactive effect. It is advisable to have this issue clarified during the negotiations.

[51] See Paper No. 4-N, How to Conduct Tax Treaty Negotiations, by Odd Hengsle.

[52] Vienna Convention on the Law of Treaties, signed in Vienna on 23 May 1967 and entered into force on 27 January 1980.

As for termination, when the treaty is terminated and no longer has effect, you may no longer ask for information or assistance in collection even if such information or assistance relate to income years when the treaty was still in force.

3. Preparing for signature

3.1 Introduction

When the two leaders of the teams have initialled the agreed draft,[53] the next step is to prepare the treaty for signature.

When preparing the treaty for signature it is important to note that in relation to the Title of the treaty, the Preamble and the signature block, your country should be mentioned first in your own copy or copies (if more than one language). The other country should be mentioned first in their copy or copies. In the rest of the treaty there should be no alternation, but leave the paragraphs or subparagraphs in the order agreed upon in the draft treaty.

The time gap between initialling and signing should be as short as possible. The industries in the two States will usually be aware that negotiations have taken place and are eager to know the result. The result may be of great importance to the industries when decisions on investment are made. Any delay may result in a situation whereby industries in the two States, due to time delays and uncertainty, make investments in third States instead.

However, the draft treaty is normally confidential, at least until it has been signed. To avoid the situation that treaty provisions are made public in one country while they are still confidential in the other country, it is advisable that the two negotiating teams discuss and agree on the time for publication. If one or both countries, immediately after initialling, wish to issue a press release informing the public that an agreement has been reached and is being prepared for signing, it may be advisable that the two teams agree on the wording of such press release. However, if some countries have legislation that obliges them to make the treaty public at an earlier date than signature, it may be advisable to inform the other country of such commitment.

In some countries the procedures before signing are comprehensive and time-consuming. There are examples that years have passed between initialling and signature. This is unfortunate, but is sometimes unavoidable due to these comprehensive procedures.

[53] See Paper No. 4-N, How to Conduct Tax Treaty Negotiations, by Odd Hengsle

Most countries must submit the initialled draft for comments or approval by a legal authority before they can begin the preparations for signature. Such an authority may be the Ministry of Foreign Affairs, the Ministry of Justice, the Supreme Court or an authority established for the purpose of commenting on new tax legislation proposals as well as initialled tax treaties. This authority may have comments on the drafting or on the content, which have to be presented and discussed with the other country. Even if the authority has

When the treaty has been translated into an official language, it should be transmitted to the other country for approval. It is important that the translation is correctly done and that all official versions of the treaty have similar wording and have the same result, even if the languages are different. If the persons checking the translation are not familiar with the other country's language, they should consult with the translation office in the Ministry of Foreign Affairs or any other office established for the purpose of translations. If the office checking the translation is not satisfied with the wording in the translated version, the two countries should negotiate to find wording accepted by both countries. More serious differences between the two texts may also occur, for instance, when a paragraph in an article is missing. When both countries agree that the translated drafts completely and accurately reflect the initialled draft text, the next step for the signing of the treaty will begin.

When the two States do not have a common language, the initialled draft may not necessarily be in the official language of either of the two States, or the language of the negotiated draft may be in the official language of only one of the States. When more than one language is involved, it is necessary to decide in which language the treaty will be signed. Depending on the domestic regulations in a State, it may be agreed that the treaty will be signed in one, two or three languages. To clarify the domestic regulations, it is important to consult with the Ministry of Foreign Affairs.

Only the languages used for the signed treaty are regarded as constituting the official text. However, in all States a translation into the official language(s) is normally necessary even if the treaty is not going to be signed in that language, but it will then only be an unofficial translation.

A treaty may be negotiated in the English language even if the two countries are not English speaking countries. To avoid a problem with translation errors, the two countries may agree to have the treaty

It is important to remember that a country will always have its official language mentioned first, the language of the other treaty partner menti

of Finance or any other minister or person is the person signing the treaty, that person will need a power of attorney signed by the Minister of Foreign Affairs stating that they have been given the appropriate full powers to sign. Many countries also consider that the Vienna Convention accepts that heads of diplomatic missions have the power of attorney to sign a convention, though other countries do not agree.

Some States that have not ratified the Vienna Convention recognise it as a statement of customary international law and binding upon them as such. If there is doubt about the authority of the person that is going to sign the treaty, the Ministry of Foreign Affairs should be consulted. There have been several examples of embarrassment at the signing ceremony when a document of full powers has not been presented. If the document of full powers is missing at the signing ceremony, the signing may be delayed until the document of full powers is produced. Another possibility is that the treaty will be signed, but the signature is not recognised until the document is produced. To avoid all kinds of embarrassment and delays it is wise to be aware of this potential problem.

To avoid delays in the entry into force of a treaty, it is important that the treaty is signed as soon as possible. It is generally not desirable to delay entry into force of a treaty unnecessarily, for example waiting for an official visit by a Minister. The treaty is expected to be of economic advantage to the countries concerned and any delay is a disadvantage to the economic relations between the two States. One way to avoid such delays is to remind the relevant ministers of the importance of an early signature.

Some States are of the opinion that a treaty initialled in one country should be signed in the other country or if a new treaty replaces an old treaty, the signing of the new treaty should not occur in the same country as the existing treaty was signed, but rather in the other country.

3.4 Post signing activities

In almost all countries the signed treaty has to be presented to the Parliament for final approval and ratification.

When the treaty has been signed, the Ministry of Foreign Affairs should report back to the Ministry of Finance or the authorised agency. A technical explanation will then be prepared. The explanation and the treaty will then be sent to the Parliament, where the treaty in most cases will be received by a committee, which will study it and make its comments. If necessary, the Minister or the person or persons designated thereto will be called by the committee to explain the provisions.

After the Parliamentary Committee has received all the explanations they have asked for, the treaty will, at least in most States, be presented to the Parliament with a recommendation to approve it. In the rare case where the treaty is not approved, the other country has to be informed and advised of the problems raised by the committee or Parliament. The negotiators will then meet to see if there is an easy way to solve the problem. Since the treaty is usually a result of several compromises, a solution may not easily be found. The question of renegotiation of one article might lead to the reopening of all articles in the initialled treaty and previous compromises or concessions may be lost.

The mode of dealing with the treaty in the Parliament may differ from one country to the other. A consultation with the Prime Minister's office or the administrative office of the Parliament is advisable. In many countries the approval of a tax treaty will follow the same procedures as the approval of a change in the tax legislation.

The last step in the process of the entry into force of a tax treaty is to inform the Ministry of Foreign Affairs that all legal procedures for the entry into force have been dealt with and ask the Ministry to inform the other State in accordance with the article on entry into force. If the treaty provisions require an exchange of instruments of ratification, a meeting between representatives from the two countries will take place and the relevant instruments will have to be prepared for exchange. However, in most cases the last procedure before the treaty enters into force will be a notification in writing, sent through diplomatic channels, informing the other State that all legal requirements for the entering into force of the treaty have been complied with. The treaty will then enter into force either on the receipt of the later of these notifications or at a date specified in the article.

Occasionally, a long time may pass between the approval by the Parliament and the exchange of instruments of ratification or the exchange of notes. A delay of this kind may have as an undesired result that the application of the treaty is delayed by a year because the treaty will normally only come into effect from the income year next following the year in which it enters into force. There have been occasions where the Ministries of Foreign Affairs have not been aware of this effect and have exchanged instruments of ratification or sent notes in the beginning of January of a year rather some time in the previous year. In this respect it is important to know whether the two countries have agreed that the treaty shall only come into effect after a certain period (say 30 days) after the exchange of instruments of ratification, or after the confirmation that each State has completed the procedures required for the entering into force of the treaty. The Ministry of Finance (or other relevant authority) and the Ministry of Foreign Affairs should therefore be reminded of the importance of an early

The treaty partner should inform its treaty partner of the new legislation, which may have an impact on how the treaty is applied. If the changes are significant enough, the treaty partner may even ask for negotiations with a view to proposing changes to the treaty.

In some cases it may be wise to get an explanati

treaty becomes effective. It may be easy to give priority to other important work put on your table by ministers. But one should remember the purpose of the treaty, which is to improve the economic relations between the two countries. Businesses in the two countries may be planning and waiting for a treaty in force to take advantage of the possibilities