



## Comments on the PCT toolkit on tax treaty negotiation

Martin Hearson, ICTD  
Catherine Ngina Mutava, Strathmore University  
Sol Picciotto, ICTD

September 2020

1. Thank you for the opportunity to comment on the draft PCT toolkit on tax treaty negotiation. We write as researchers who study the negotiation of tax treaties and their impact on lower-income countries. Our comments are based on interviews conducted over the past decade with treaty negotiators and other tax policy officials, as well as our own analysis of lower-income countries' tax treaties.
2. In our view, the toolkit makes a unique contribution, in two senses. First, it is admirably concise and accessible. This is valuable in resource-constrained contexts, as well as for actors across government who are not treaty specialists. The toolkit therefore complements more detailed guidance, such as is found for example in the UN negotiation manual. Second, it adopts a more balanced view of the costs and benefits of tax treaties than many publications from international organisations. This should encourage lower-income countries to conduct a thorough interrogation of existing (and potential) tax treaties that does not presuppose that they should be signed (or kept in force) at all. Such an evaluation provides a stronger basis for (re)negotiations, where lower-income countries might otherwise be at a disadvantage because negotiators feel they cannot walk away empty-handed.
3. We have divided our comments in response to question 1 into four major concerns and several minor points. Some suggested resources in response to question 2 follow.

### Major comments

#### A. References to Model Treaties

4. Throughout the toolkit, the UN and OECD models are mentioned in the same breath, but this is inappropriate. The UN model is designed for negotiations between developed and developing countries. It should be borne in mind that the UN model has been formulated by the UN Tax Committee, which consists of a balanced membership of developed and developing country experts. Hence, even the UN model is a compromise between the perspectives of capital-exporting and capital-importing countries. It should not be regarded as the optimal result for developing countries, but a possible balanced outcome following negotiations. Developing countries should be advised to formulate their own models, tailored to their own tax systems and their economic policy priorities.

5. Indeed, the toolkit makes no mention of regional models such as those of the ATAF, EAC or ASEAN. Unlike either the OECD or UN models, these are formally endorsed by groups of developing countries, and may be a more appropriate starting point for them. For example, at C7: “If applicable, it is advisable to be aware of each country’s reservations and positions on the OECD Model.” Depending on the country, it may be more pertinent to check its reservations on regional models, where they allowed, as they are for example in the ATAF and SADC models.
6. The OECD model was formulated between countries that were simultaneously capital-exporting and capital-importing, and designed to restrict source taxation in order to stimulate international investment. It is therefore not appropriate to the context of negotiations by developing countries, most of which are in an overwhelmingly capital-importing position. Indeed, its defects even for developed countries have become increasingly evident, leading to the extensive efforts to revise the model in recent years. These efforts are still continuing, and the toolkit should include a discussion of whether developing countries might be better advised to suspend negotiation of new treaties until the outcome of the continuing negotiations and debates can be seen more clearly.
7. The following statement at B1, for example, is inappropriate: “decisions to depart from specific policy choices endorsed in the UN or the OECD Models should be, if possible, exceptional and always carefully reasoned.” Domestic law, existing treaty practice and regional organisations’ models seem much more pertinent than these models, neither of which are endorsed by developing countries, and especially the OECD model.

## **B. Parliamentary and Public Involvement**

8. The toolkit states, we think misleadingly, that “In almost all countries, the signed treaty has to be approved by the parliament or legislative assembly before it can be considered that the state has given its consent to be bound by the treaty.” Parliamentary approval in most countries, especially developing countries, is usually purely formal. If there are any prior consultations, these are generally held in private with interested parties from the business sector. Normally, the decision to ratify is taken by the executive branch of government, and the treaty only has to be laid before parliament. Even where parliamentary scrutiny exists, it is often ineffective, for two main reasons. First, because it occurs at the level of individual treaties that have already been signed, rather than at earlier stages where some scrutiny by the legislature can have a more meaningful impact. Second, treaties are technical documents, and it is rare for legislatures to be provided with any adequate explanation or impact assessment of a treaty.
9. The Toolkit should explain that tax treaties generally take direct effect as law, and create legally enforceable rights for non-residents, overriding other provisions of domestic tax law. It should therefore stress the need for adequate and informed public and parliamentary debate before entering into tax treaties, in view of their important impact on taxation and on public revenues. Countries should have a public treaty policy statement, which is debated in parliament and consulted on not only with business but also civil society. Comments on specific treaties should ideally be invited between agreement on a text at official level and the decision on signature, when changes are still possible. They should be presented to parliament together with a full explanation of their provisions, and the reasoning behind them, as well as an appropriate impact assessment.

## C. Revenue Authority Involvement

10. The toolkit emphasises the need to adopt a whole-of-government approach, but limits itself to mentioning the ministries of finance and foreign affairs. Many of the most problematic treaty negotiations that we are aware of resulted from the failure to involve the revenue authority either at the policy stage or even at the negotiation stage. The toolkit should emphasise much more strongly that expertise on treaty content often resides in the revenue authority, and further that revenue authority involvement can safeguard against the worst effects of politically motivated treaty negotiations. It is usually only revenue authorities that have direct experience and knowledge of the application of tax treaty provisions and the potential difficulties that they cause. We suggest that the toolkit should stress that revenue authority involvement in tax treaty negotiations at every stage is essential.

## D. Existing Treaty Networks

11. The toolkit is written with no regard to countries' existing treaty networks. Yet countries need advice on how they should handle treaties that may have been poorly negotiated in the past, could be significantly outdated, and may even date from prior to the country's independence. There are two main impacts from these treaties: their direct revenue impact, and their impact on future negotiations through precedent. We consider that a whole section in its own right is needed on this topic, since it differs significantly from the advice given on fresh negotiations. For example, what should a country that does not have the capacity to renegotiate, as set out in the toolkit, do about its existing problematic treaties?
12. This is all the more important in view of the extensive changes that have been made to treaties in recent years, starting with the expansion of the provisions on administrative cooperation, and then the revisions to both the UN and OECD models, many of them resulting from the BEPS project.

## Minor comments

13. A1. The opening statement is "Typically, tax treaties are negotiated with the objectives of encouraging cross-border trade, investment and the transfer of skills and technology" As mentioned in A2, the evidence for these effects is in fact mixed, so it would be appropriate to underline this upfront.
14. A2. "The proper negotiation and practical application of tax treaties may require substantial resources from a tax administration. That said, treaties' provisions on dispute resolution, exchange of information and assistance in collection will make it easier for tax administrations to apply their countries' laws to cross-border transactions." As this section discusses, all of these entail resource commitments, and so the language of "make it easier" is inappropriate. "Enhance their ability to" may be better.
15. A2. One impact not mentioned is that, depending on the provisions used, tax treaties may constrain countries' policy space by binding them into the application of certain norms and standards, notably the arm's length principle and OECD Transfer Pricing Guidelines.
16. B. This section considers prerequisites for negotiation in terms of a policy on treaty content. The toolkit should do the same in terms of process. For example, in the absence of adequate negotiating capacity, countries should be advised not to enter into negotiations.

17. B. This section should discuss the sequencing of negotiations. Countries beginning a (re)negotiation programme would be well advised to start with negotiations in which the stakes are lower. This can allow them to learn from experience and acquire useful precedents for subsequent negotiations. The temptation to begin with the most important treaty partners should be resisted.
18. B1. The list of provisions is one-size-fits-all. For example, for a minerals-rich country, different objectives may take priority. We suggest the list is removed, or at least points out the need for countries to develop their own list of priorities that may differ from this list as part of the policymaking process. It seems odd, for example, that a MAP-based tiebreaker appears high up the list, but assistance in the collection of taxes is not mentioned.
19. C. This section should recommend that countries prepare by gathering data on economic transactions with the negotiating partner, to inform negotiating priorities.
20. C4. Consultation beyond business – for example with civil society and academia – should be mentioned here.
21. D2. Negotiating style is also influenced by power dynamics created by mismatches of experience and expertise. Negotiators from lower-income countries should be ready for countries and individuals with long histories of negotiation and intimate knowledge of OECD and UN deliberations to emphasise this experience as part of their negotiating strategy.
22. D5. If MFN clauses are to be mentioned here, there should be some discussion of the dangers: we consider them inappropriate in most circumstances.
23. D5. The term “grandfathering” should be replaced with an alternative that does not have the same connotations. As the entry in Merriam Webster dictionary explains, this term originated as “a provision in several southern state constitutions designed to enfranchise poor whites and disenfranchise blacks by waiving high voting requirements for descendants of men voting before 1867.”

## Additional resources

24. ICTD’s tax treaties dataset is already mentioned at A1, but the citation can be updated to the 2020 version available at <http://treaties.tax>, which contains over 2000 treaties and will soon move out of ‘beta’ phase.
25. Some relevant references are:
  - a. [Section A] Brooks, K. & Krever, R. (2015). The Troubling Role of Tax Treaties. In Michielse, G.M.M. & Thuronyi, V. (eds.), *Tax Design Issues Worldwide*, Series on International Taxation, Volume 51 (Alphen aan den Rijn: Kluwer Law International), 159-178. [Open access link](#)
  - b. [Section A] Hearson, M. & Kangave, J. (2016) *A Review of Uganda’s Tax Treaties and Recommendations for Action*. ICTD Working Paper 50, Brighton, IDS. [Open access link](#)
  - c. [Section A]. ActionAid (2016). *Mistreated: The tax treaties that are depriving the world’s poorest countries of vital revenue*. Johannesburg. [Open access link](#)
  - d. [Section B] Mutava, C. N. (2019) *Review of Tax Treaty Practices and Policy Framework in Africa*, ICTD Working Paper 102, Brighton, IDS. [Open access link](#)

- e. [Section D] Hearson, M. (2017). The UK's tax treaties with developing countries during the 1970s. In: Harris, Peter and de Cogan, Dominic, (eds.) *Studies in the History of Tax Law*, volume 8. Hart Publishing, Oxford, UK. [Open access link](#)