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TAX TREATIES BETWEEN DEVELOPED AND DEVELOPING COUNTRIES

Progress report of the Secretary-General

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I. PURPOSE AND OBJECTIVES OF THE AD HOC GROUP OF EXPERTS
ON TAX TREATIES BETWEEN DEVELOPED AND DEVELOPING
COUNTRIES

1. This report is submitted in response to resolution 1273 (XLIII) on tax treaties between developed and developing countries, by which the Council requested the Secretary-General to set up an "ad hoc working group consisting of experts and tax administrators nominated by Governments, but acting in their personal capacity, both from developed and developing countries and adequately representing different regions and tax systems, with the task of exploring, in consultation with interested international agencies, ways and means for facilitating the conclusion of tax treaties between developed and developing countries, including the formulation, as appropriate, of possible guidelines and techniques for use in such tax treaties which would be acceptable to both groups of countries and would fully safeguard their respective revenue interests". The Council further requested the Secretary-General to submit a report on the progress of the group's work after its first session.
2. The Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries met in Geneva from 2 to 13 December 1968. Experts participating in the meeting were: Carlos C. Martínez Molteni (Argentina); Ricardo Bustos (Chile); Pierre Kerlan (France); Helmut Debatin (Federal Republic of Germany); A.N.E. Amissah (Ghana); K.S. Sundara Rajan (India); Simcha Gafni (Israel); Jiro Yoshikuni (Japan); W.H. van den Berge (Netherlands); Qamarul Islam (Pakistan); Ambrosio M. Lina (Philippines); Hamzah Merghani (Sudan); S.E. Brodén (Sweden); Kurt Locher (Switzerland); Mohammed Sbaa (Tunisia); Adnan Baser Kafaoglu (Turkey); J.A. Johnstone (United Kingdom); Stanley S. Surrey (United States of America).
3. Mr. Merghani (Sudan) was elected Chairman, Mr. Bustos (Chile) and Mr. Brodén (Sweden) were elected Vice-Chairmen and Mr. van den Berge (Netherlands) acted as the Rapporteur of the meeting.
4. The report of the Ad Hoc Group of Experts on its meeting, together with the report submitted by the Secretary-General as a basis for the Group's work, as revised in the light of the discussions, are also before the Council (E/4614).

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II. PROGRESS ACHIEVED BY THE AD HOC GROUP OF EXPERTS AND ITS CONCLUSIONS

A. Major conclusions

5. As indicated in its report, the Group unanimously agreed that the initiative taken by the Council in convening the meeting had been of great use and importance. They pointed out that although the flow of private investment to developing countries was affected by many factors besides taxation, the climate for investment in those countries was influenced to a considerable extent by the international tax treatment of foreign investment.
6. The members of the Group generally agreed that the objectives and formulation of tax treaties between developed and developing countries should be examined in the context of the special economic relationships between these countries, the desire to facilitate trade between them and the need to promote foreign investments in developing countries.
7. It was pointed out that technical tax problems and the various mechanisms for avoiding double taxation were not the only important issues to be settled in treaty negotiations. They could not be considered an end in themselves but must be seen also as an instrument for promoting and accelerating development of the economies of developing countries. This goal was clearly in the best interests of the developed countries also.
8. Negotiations between a developed country and a developing country were strongly influenced by economic, technical and other considerations which differed, to a certain degree, from those on which treaties between developed countries were based. The concept of reciprocity underlying treaties between developed countries was not equally valid where the Contracting States were at vastly different stages of economic and technological development. A loss of revenue which might be of relatively less importance to a developed country could constitute a heavy sacrifice to a developing country. For many countries, the scarcity of foreign exchange was of even greater importance than sacrifices of revenue. Consequently, a developing country would hardly enter into a tax treaty under which its revenue from locally produced income was reduced and its foreign exchange resources were affected, unless those losses were compensated by some direct economic advantages flowing from the treaty.

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9. The Group emphasized, however, the desirability of tax treaties between developed and developing countries. It was noted that progress in this area was slow and had not kept pace with the expansion of international trade and the requirement for a steadier rate of growth in developing countries. Therefore the Group felt that that situation required special examination.

10. One main reason for the slow progress was that the pattern of tax treaties followed for some time by the developed countries did not seem to accommodate the needs of the developing countries. While giving full recognition to the important work done in the past in the field of international tax relations, especially by the Organization for Economic Co-operation and Development (OECD), the Group believed that real progress in the area of tax treaties between developed and developing countries could be accomplished only if there were a forum in which experts from both sides would have an opportunity of explaining and exchanging their opinions with a view to examining new and more appropriate patterns. In this connexion they considered it important to examine the possible obstacles to a greater use of such treaties and to seek solutions where appropriate.

11. Although the Group felt that the OECD Draft Model Convention had been drawn up by experts from countries at approximately equal stages of economic development and that it seemed, in its current form, less suited for treaties between developed and developing countries, it nevertheless accepted the Model as the best available framework for its discussions, to be considered together with other documents circulated. This offered the most expeditious way in which the particular problems could be explored.

B. Specific issues discussed

12. In addition to having a general discussion on the role of tax treaties between developed and developing countries, the Group considered the following specific issues: (a) business income (business profits: permanent establishment, apportionment; sea and air transport profits); (b) personal service income and cultural exchanges; (c) administrative co-operation and assistance; (d) investment income (interest, dividends, royalties); (e) general relief measures (foreign tax credit, exemption etc.) and special incentives for investment in developing countries (tax sparing, investment credit, and other incentives).

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13. The areas in which considerable progress was achieved were inter alia personal service income, business income, and air transport profits. In the field of investment income there was the general feeling that some sort of compromise might be worked out particularly on royalties and interest, after further study of the expense component of those items had been carried out. In addition to these and a number of other questions related to the items on its agenda, the Group agreed to consider further the question of tax incentives (which was the subject of considerable discussion) and to add to its agenda the questions of capital gains, non-discrimination, tax treatment of personnel and immigrant labour and international tax treatment of losses.

14. The report on the meeting of the Group of Experts reviews in greater detail the consensus reached on some of those issues, and identifies areas for future consideration.

C. Final recommendations of the Ad Hoc Group of Experts

15. The Group found the exchange of views extremely valuable especially since a great deal of ground had been covered, considerable progress achieved in identifying, analysing and narrowing down points of difference, and basic understanding and agreement reached with respect to a number of issues.

16. Even more important than the fact that agreement had been reached on some points was the fact that there was understanding and due recognition for the basic differences in the Group of Experts. This might induce a more flexible attitude and pave the way for the conclusion of more balanced tax agreements.

17. In view of the demonstrated usefulness of the first meeting and in particular of the important results achieved, the Group strongly recommended that the discussions should be continued. In order not to lose the momentum and the co-operative attitude that had characterized the first meeting, the Group felt strongly that the next meeting should be convened as early as possible and not later than the autumn of 1969. The Group also felt that, should the Council approve its recommendation that the work be continued, it would be useful to circulate the report on its first meeting to all tax administrations for their information and comments.

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III. RECOMMENDATION OF THE SECRETARY-GENERAL

18. The first meeting of the Ad Hoc Group of Experts revealed that when the discussion was geared to specific problems, high-level experts from developed and developing countries were able to narrow down their differences and to **reach** a broad consensus on a number of issues.

19. Moreover even in the areas where progress was more limited, alternative solutions were proposed and discussed as possible guidelines for bilateral negotiations. Thus, significant and encouraging progress was made toward the goals of the undertaking.

20. The meeting thus proved very useful and would serve to accelerate the conclusion of tax agreements between developed and developing countries. Such agreements would in turn serve to promote investment and accelerate the development of the economies of developing countries in the best interest of both developed and developing countries.

21. The report on the first meeting of the Ad Hoc Group of Experts already contains many important guidelines and the Secretary-General fully concurs with the recommendation of the Group that its report should be given wide circulation among the tax administrations, as it may render valuable technical assistance to those engaged in the process of negotiating tax treaties between developed and developing countries.

22. On the basis of the report, the recommendations it contains and the very encouraging results achieved, it is recommended to the Council to request the Group to continue its work toward the formulation of possible guidelines and techniques for use in tax treaties which would be acceptable to both developed and developing countries and would fully safeguard their respective revenue interests.

23. The Secretary-General would also urge that the second meeting of the Group should take place not later than the autumn of 1969, as recommended by the Group, and that the appropriate financial allocation should be made to enable the Group to continue its work.

24. The Secretary-General also wishes to inform the Council that the high-level United Nations Panel on Foreign Investment in Developing Countries, which met at Amsterdam from 16 to 20 February 1969, indicated in its final agreed statement

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that "bilateral tax treaties provide an important medium in defining the scope of tax liability in both the host and residence countries, eliminating double taxation and avoiding the negation of incentives afforded by the host country". The Panel went on to recommend that "the specific tax issues should be considered by the United Nations Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries which initiated its meetings in Geneva". The Panel comprised ministers and governors of central banks from developing countries, high-level executives of financial and manufacturing enterprises in the industrialized countries and senior officials of international and regional financial institutions and organizations.
