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How treaties are developed: practical issues

Tax treaty process for developing countries

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Summary

At its fourth session, in 2008, the Committee of Experts on International Cooperation in Tax Matters, in considering the agenda for its fifth session, accepted an offer by Victor Thuronyi to prepare the present background paper. The paper addresses some of the issues that may be relevant for the Committee's consideration of the agenda item "How treaties are developed: practical issues".

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I. Introduction: tax treaty process and a subgroup

1. At its fourth session, in 2008, the Committee of Experts on International Cooperation in Tax Matters, in considering the agenda for its fifth session, accepted an offer by Victor Thuronyi to prepare the present background paper.[1] The paper addresses some of the issues that may be relevant for the Committee's consideration of the agenda item "How treaties are developed: practical issues".

2. The paper explores the process for concluding tax treaties[2] involving developing countries. This process issue is closely connected to the United Nations Model Double Taxation Convention between Developed and Developing Countries, which is intended to provide guidelines for developing countries in negotiating their treaties. The text of the Model and of the Commentary thereon include draft treaty language. The tax treaty process deals with how that language is or might be used in treaty negotiations. This paper looks at various aspects of the treaty process. One idea arising from it is that it would be useful for the Committee of Experts to form a permanent subgroup to further examine some of these issues. The discussion in the paper is therefore intended to be preliminary, the objective not necessarily being to reach conclusions but rather to raise questions and outline some of the issues that such a subgroup might address. In general, the subgroup could address any aspects of the tax treaty process that go beyond the formulation of specific language for the articles of the Model and the Commentary.

II. Use of the United Nations Model

3. Of relevance to the United Nations Model is the extent to which its provisions are used in treaties being negotiated today or recently negotiated. For this purpose, it would be instructive to examine treaties negotiated relatively recently to determine how widely particular provisions of the United Nations Model are used, and in what contexts.[3] Such an analysis may suggest priorities for future Committee focus, and may lead to removing provisions that are not used, better explaining the impact of particular provisions, and analysing why they may or may not be chosen as options, particularly as compared with other options to achieve similar policy outcomes.

4. Also of interest is whether treaties concluded by developing countries have included provisions that are found neither in the United Nations Model nor in the OECD Model. If they are, the Committee may want to discuss such provisions to ascertain whether guidance should be provided by:

(a) Including alternatives in the Model or the Commentary that are seen as providing an effective response to the needs of particular relationships and negotiations;

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[1] See report on the fourth session, E/2008/45, para. 82.

[2] While many types of treaties relate to taxation, for the sake of simplicity, this paper uses the term "tax treaty" or "treaty" to refer to a full double tax treaty similar to the Organization for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital or the United Nations Model Tax Treaties, unless the context otherwise requires.

[3] This has already been suggested by the Committee of Experts at its fourth annual session. See E/2008/45-E/C.18/2008/6, para. 71.

(b) Pointing out some of the difficulties that specific alternatives found in actual treaty-making practice may create, especially for developing countries; or

(c) Concluding that some alternative approaches that respond to the individual needs of specific countries are not necessarily of broader interest and therefore do not need to be referred to in the United Nations Model or Commentary.

5. An initial step might be to prepare a background report summarizing the experience with treaties, differentiating those signed in recent years from older ones that remain in force. In this respect, it is worth bearing in mind that the United Nations Model should continue to play a guidance role in respect of treaties that do not reflect more recent negotiation policy and practice, but remain in force and must be administered.

III. Negotiation guidance

6. One of the functions of the United Nations Model is to provide a framework for treaty negotiation between developed and developing countries; in other words, to provide guidance on treaty negotiation. The Model does so largely by providing suggested language for the treaty, but perhaps more can be done explicitly by providing guidance for negotiators, beyond the provision of specific treaty language.

7. In this respect, an interesting aspect of negotiating policy is the extent to which developed countries should try to gain a negotiating advantage.[4] It is quite likely that OECD countries often do make efforts to protect the interests of their developing country treaty partners and do not try to take full advantage of their position. It would be interesting to learn whether this attitude of restraint is in fact significant in negotiations and, if so, whether it could be brought more to the forefront; specifically, whether guidelines could be formulated on the extent to which OECD countries should concede source taxation to non-OECD countries. For example, can we see evidence in particular treaties where some OECD countries are negotiating provisions that allow their companies to escape source country taxation (perhaps escaping taxation altogether) in specific cases?[5] In other words, to what extent are treaties between OECD countries and developing countries being used as instruments to enhance the competitive position of companies headquartered in the negotiating OECD country by giving them the opportunity to achieve double non-taxation? Is this appropriate and, if not, what can be done to minimize the occurrence of such cases?

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[4] See generally Kim Brooks, “Tax treaty treatment of royalty payments from low-income countries: a comparison of Canada and Australia’s policies”, *eJournal of Tax Research*, vol. 5, No. 2 (2007), pp. 168-197. In many cases, the OECD country partner may have a general foreign policy interest in supporting the development of a robust revenue-raising system of the non-OECD member. The OECD country may also be providing direct budgetary support to the other country. From the perspective of the whole relationship between the countries, it is therefore often the case that the OECD country has an interest in strengthening, rather than undermining, the revenue-raising potential of the other country’s tax system. In this context, it may be counterproductive to negotiate a treaty that does the latter (an extreme example might be a treaty with no limitation on benefits provisions and a zero withholding rate on interest income.

[5] See, for example, Rick Krever’s discussion of the Canada-Mongolia treaty in Arthur J. Cockfield (ed.), University of Toronto Press, “Globalization and the impact of tax on international investments” (forthcoming).

8. Another area where guidance may be helpful for developing countries is the extent to which the United Nations Model is relevant for treaties between one developing country and another. A negotiation between two developing countries may differ from a negotiation between a developed and a developing country because flows of capital and trade "... may be much more balanced between two developing countries". This suggests that a developing country may be much less interested in insisting on source-based jurisdiction than when it negotiates with a developed country. The contrary argument, however, is that there may be a strategic reason for developing countries to adopt a uniform policy, regardless of the negotiating partner, so as to minimize treaty shopping and avoid setting a precedent for future negotiations with other countries. In other words, in negotiating a specific treaty, a country needs to be aware of potential implications for its treaty network as a whole. These are some of the issues on which a subgroup could develop guidance for developing country treaty negotiators that could help developing countries formulate a treaty negotiating strategy.

9. Another aspect of treaty strategy on which guidance could be provided is the renegotiation of existing treaties. What criteria should be used in deciding whether an existing treaty should be renegotiated (or even terminated)?

IV. Enhancing negotiation capacity

10. In formulating guidance to developing countries, it may be useful to look at a number of issues. How many developing countries have negotiating teams that are fully capable of negotiating treaties? What should countries without such teams do when they face the prospect of negotiating a treaty? Would it make sense for them to routinely use outside advisers with the requisite negotiating experience and expertise? How often do countries do this? Can the Committee of Experts provide advice or guidelines on this point?

V. Assessing administrative capacity

11. How many developing countries are in a position to properly administer tax treaties? If they lack such capacity, what are the implications for the extent to which it is desirable for them to enter into treaties? If this capacity is lacking or needs improvement, what — if anything — should be done?

VI. Developing a treaty strategy

12. The number of treaties differs significantly between developed and developing countries.[6] The Member States of the United Nations can be divided into three major groups in this respect. Group I, consisting of 66 countries, is composed of the OECD countries plus others that have at least 34[7] treaties. On average, Group I countries have 59 treaties each and Group II countries (those with 10-33 treaties)

[6] See Drevet and Thuronyi, "The tax treaty network of the U.N. Member States", *Tax Notes International*, p. 783 (June 1, 2009). The statistics in this paragraph are based on the situation as at the end of 2008. The numbers should be treated as estimates only.

[7] The number of treaties of the OECD member with the fewest of treaties (New Zealand).

19 treaties each. Finally, Group III countries, 89 of which have fewer than 10 treaties, average only 3 treaties each (an average that is lowered by some 30 countries with no treaties at all).[8]

13. While many developing countries are actively engaged in treaty negotiations and have extensive treaty networks, this is obviously not the case for many others. Even most countries in Group II have a fairly low number of treaties and the developing countries in Group III have none or very few. Thus, the typical developing country has relatively few treaties. Is this appropriate? How many treaties does a country need, and with which partners?

14. The proposed subgroup could address these questions and, more generally, provide guidance for developing countries in determining their treaty strategy. This guidance could include a discussion of the considerations that developing countries could take into account in formulating a strategy for tax treaty negotiation. In other words, how can developing countries strategically use their scarce negotiating resources? To some extent, technical personnel in developing countries may already know the answer to this question, but having the considerations spelled out explicitly by a multilateral body may give them justification to, for example, resist calls from their Ministry of Foreign Affairs to negotiate a treaty with country X when, from a tax policy standpoint, such a treaty would not be needed.

15. Presumably, most countries could benefit from additional treaties.[9] However, treaties are not free goods, since their negotiation and administration involves opportunity costs in terms of human resources and expenses. The fact that many countries are not actively engaged in negotiating and signing treaties could mean that they have higher priorities, lack sufficient negotiating capacity or face other obstacles to the negotiation process.

16. One obstacle could be that a potential treaty partner's negotiation team may be busy negotiating or renegotiating other treaties. A potential partner may also be unwilling to negotiate a treaty that does not follow their preferred model, which may be unacceptable to the country in question.

17. Also relevant are the length of the negotiation period, the expense of establishing a treaty network in terms of time, skills and money, and the limited capacity of countries for treaty negotiation. This is the case even for large countries. For example, in recent years, Canada has been entering into treaty negotiations with

[8] Alternatively, a Group IV could cover the countries with no treaties, in which case Group III would consist of 53 countries with an average of about 4 treaties each.

[9] The attitude of the Committee of Experts seems to be that it would be desirable to have more treaties; for example, paragraph 46 to the Commentary to the United Nations Model (2001) states: "It is hoped that the United Nations Model Convention will contribute to the conclusion of an increasing number of bilateral tax treaties, not only between developed and developing countries but also between developing countries." The benefits and effects of treaties are, however, by no means clear. See Ronald Davies, "Tax treaties and foreign direct investment: potential versus performance", *International Tax and Public Finance*, vol. 11, No. 6 (2004), pp. 775-802; Tsilly Dagan, "The tax treaties myth, 32 N.Y.U. J", *Journal of International Law and Politics*, vol. 32, No. 939 (2000) (arguing that treaties are not needed to eliminate double taxation and may not be advantageous on balance for developing countries). Eric Neumayer, "Do double taxation treaties increase foreign direct investment to developing countries?", *Journal of Development Studies*, vol. 43, No. 8 (2007), pp. 1501-1519, provides a positive answer to the question, but only for higher-income developing countries.

about three countries per year.[10] The United States Treasury Department has stated: "The primary constraint on the size of our tax treaty network may be the complexity of the negotiations themselves. Ensuring that the various functions to be performed by tax treaties are all properly taken into account makes the negotiation process exacting and time consuming" (statement of Michael Mundaca, 10 July 2008). In recent years, the United States has signed less than half a dozen treaties a year, most of which are amendments of existing treaties[11] (see United States Treasury Department website) and concluded with OECD countries.

18. It is fairly clear that the pace of treaty negotiation is so slow that it would take several decades for many OECD countries to expand their treaty network to include even most non-OECD countries. Therefore, even if countries were to decide that it would be a good idea to substantially expand the existing treaty network, it would not be feasible over the short term.

19. Each country should develop a treaty strategy in the light of the above factors. In deciding whether to enter into negotiations on a particular treaty with a particular partner, a country may appropriately ask:

(a) What problems, if any, exist in relation to this country that need to be resolved by a treaty? Is there an alternative way of resolving these problems?

(b) Is the level of trade, investment or other relevant transactions between the two countries concerned high enough that the problems are substantial?

(c) Will the costs of negotiating a treaty to resolve the problems be justified? Are there other more pressing priorities? Are there obstacles relating to the potential treaty partner suggesting that a treaty may not be successfully concluded?

20. A subgroup could appropriately flesh out these considerations to help developing countries formulate a strategy for strategically using their limited negotiating skills.

21. In addition, the issue of negotiating new treaties can be viewed at a more global level. In this context, one could reasonably assume the following:

(a) Most developing countries (many of the countries in Group II and most in Group III) lack the capacity to negotiate a substantial number of treaties;

(b) On the whole, the capacity of many developing countries to administer treaties is weak. Their tax administrations are typically challenged in terms of human resources, to the extent that even if they had staff who could properly negotiate and administer treaties, such activities would be unlikely to constitute the best use of staff time;

(c) It would take a lifetime for most developing countries to negotiate a substantial number of treaties;

[10] See the website of Department of Finance Canada at http://www.fin.gc.ca/treaties-conventions/treatystatus_-eng.asp.

[11] In a 2007 report, the United States Treasury Department explains that a continual process of amendment of existing treaties is needed to protect against abuse of the existing treaty network, in response to the "evolutionary nature of tax planning". See United States Treasury Department *Report to the Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties*, p. 87 (2007).

(d) Applying the criteria above, most developing countries probably do not have a compelling need for a full-fledged treaty with most other countries.

22. An implication of the above is that it makes little sense to envisage substantially expanding the treaty networks of most developing countries. If this premise is accepted, the question arises of whether other measures exist to fulfil the goals of treaties: the elimination of double taxation and the prevention of tax evasion.

VII. Unilateral measures

23. Double taxation can be largely eliminated on a unilateral basis in each country's domestic law. In fact, most countries have already adopted unilateral measures to this effect, although some fine-tuning is likely needed. A subgroup could usefully develop guidance on this point.

24. Thus, each country could either grant a foreign tax credit (with appropriate limitations) or exclude some or all foreign-source income from tax (virtually all developing countries already have such unilateral rules: very few tax foreign-source income without granting a foreign tax credit).

25. In terms of taxing non-residents, each country could provide that a non-resident is taxed on income from doing business in the country only if the non-resident has a permanent establishment in the country (virtually all countries already have such rules). The main issue here would be the definition of permanent establishment. Guidelines and options (including references to country examples actually in use) could be provided for this purpose (this would largely involve translating the provisions of the United Nations Model into domestic law, and so should not be too difficult to develop).

26. Typically, countries tax non-residents on income from immovable property located in the jurisdiction, and in this case, no special provisions would be needed because treaties generally allocate jurisdiction to tax in the source country.

27. For dividends, interest and royalties, the main role of treaties is to limit the rate of withholding. Countries can achieve the same result unilaterally by exercising moderation in setting the rate of withholding tax, which they may find an appealing option for attracting international capital. This may suggest the need for a coordinated approach to setting limits with which developing countries could feel comfortable. Any such internationally coordinated limit would presumably be solely a recommendation and not binding. In practical terms, a coordinated limit may serve as a floor more than as a ceiling. In other words, the existence of a coordinated tax rate may encourage countries to tax up to this amount. There would be no need to define interest, dividends or royalties for the purposes of such a limitation, since the definition would be provided in domestic law.

28. For capital gains, unilateral provisions taxing non-residents on capital gains could follow the United Nations Model. This would allow for the taxation of gains from the disposition of: property that is part of a local business; interests in immovable property located in the jurisdiction; indirect interests in such property (such as through real property holding companies); and shares in resident companies. Other capital gains of non-residents would not be taxed. Again, the

details of how these gains would be defined (for example, the definition of indirect interests) would be part of local law, not part of a treaty.

29. Concerning employment income, a unilateral measure similar to article 15, paragraph 2, of the United Nations Model could be taken exempting the income of an employee who is present in the jurisdiction for less than half of the year, where the remuneration is paid by a non-resident (and is not being deducted by a resident). Similarly, a unilateral exemption for payments for government service similar to article 19 of the United Nations Model could be included in local law.

30. Some countries assert their source jurisdiction fairly strongly, with the view that treaties will cover their important trading partners and that the resulting withholding taxes will fall largely on payments to countries that are not treaty partners. This approach may work particularly well for countries having an extensive treaty network. Countries wishing to take this kind of approach could do so even without a treaty network, by identifying in their domestic law the countries to which certain provisions would apply. For example, it is quite common to apply controlled foreign corporation rules to subsidiaries located in low-tax jurisdictions. In other words, countries can compile lists or groups of countries unilaterally, without relying on the proxy of a country's treaty status.

31. Guidance could also be provided for the appropriate formulation of source rules, so as to avoid source-source jurisdictional overlaps. For example, if a country wishes to impose a withholding tax on interest paid abroad, what should be the scope of application (a typical answer may be to impose the withholding tax on interest that is deductible as a business expense in the source country)?

32. Another topic for the envisaged subgroup could be to provide guidance for the unilateral exercise of taxing jurisdiction by developing countries. Such guidance need not take the form of recommended positions; rather, the subgroup could serve as a forum for the technical discussion of issues and reviews of country practice, so that each country would have sufficient information to independently determine how to proceed.

VIII. A "light" treaty

33. Some issues cannot be addressed on a unilateral basis. It may be instructive for the subgroup to consider the utility of a more limited treaty that could be signed by many countries. Theoretically, a light treaty would have to be designed in such a way as to avoid having to delve into the details of each country's tax system.

34. Ideally, a light treaty would be multilateral (and universal — a set of regional multilateral treaties would be of some use but not as good as a single treaty including most countries or, albeit less desirably, a set of bilateral treaties). Given that it would be a general treaty and, as such, its purpose would not be to coordinate all aspects of the tax systems of the treaty partners, there would be no particular advantage to structuring it as a set of bilateral treaties. In practice, however, only a few multilateral treaties have been concluded in the tax area and most tax treaties are bilateral. If, for any reason, it were considered too difficult a diplomatic matter to negotiate a multilateral treaty with many treaty partners, then a series of bilateral treaties would be a fallback solution that would be technically feasible. It would also be possible for a number of bilateral treaties to coexist with one or more

multilateral treaties with a limited number of partners, similar to some regional multilateral tax treaties today.

35. One risk of negotiating a light treaty in a bilateral format is that the negotiators could become distracted by the various issues that they may be tempted to include in the treaty, beyond the standard bare-bones provisions. Negotiations could also be prolonged by the temptation to adjust treaty language. In both cases, substantial complexity would arise from differences in treaty terms: each time a treaty was applied, its particular language would have to be studied. The use of a bilateral format would require a level of restraint that may be unrealistic to expect. In the absence of such restraint, negotiations could go off-track or take an undue amount of time.

36. A multilateral treaty would minimize this risk (although countries could still include bilateral protocols). A multilateral treaty could also be signed by a smaller group or by groups of countries, for example on a regional basis.

37. A light multilateral treaty might address only a few issues, such as:

(a) Exchange of information;

(b) Administrative cooperation in tax collection (enforcement of tax judgements in another country's courts);

(c) Non-discrimination (article 24 of the United Nations Model);

(d) Residence tie-breaker rule;

(e) A mutual agreement procedure.

38. In a multilateral treaty, the first three elements could be similar to the relevant contents of the current OECD or United Nations Models (or of tax information exchange agreements, or TIEAs[12]), and so do not need extensive discussion here. The tie-breaker rule and mutual agreement procedure would be somewhat different from the current provisions in the Model for bilateral treaties.

39. In a multilateral treaty, a tie-breaker rule could be designed in such a way as to exclude dual residence for tax purposes, at least in respect of those countries that are willing to do so among themselves. Such a provision would be particularly useful in triangular cases. However, if not all countries agreed to apply the tie-breaker rule to all the other countries that are parties to the multilateral treaty, some cases (perhaps mostly theoretical) of dual residence could occur. For example, if country A agreed to eliminate dual residence with a group of countries that includes country C, and country B agreed to eliminate dual residence with a group of countries that includes country C (but not country A), there could still be a case where someone was a dual resident of countries A and B (although in practice this would likely be extremely rare). This could arise where an individual is considered a resident under the domestic laws of A, B and C. Under a multilateral treaty, if applying the treaty between A and C, residence might be assigned to country A, and if applying it between B and C, residence might be assigned to country B, with the result that both

[12] See OECD, Agreement on Exchange of Information on Tax Matters (2002) (taking the form of both a bilateral and multilateral agreement), available on the OECD website: http://www.oecd.org/dataoecd/15/43/2082215.pdf.

A and B would tax the individual as a resident.[13] While this is somewhat inelegant, it is a result of the fact that countries A and B (for any given reason) did not choose to include each other in the group of countries with which they would agree to apply the tie-breaker rule.[14] In principle, in this situation, the elimination of double taxation could still be accomplished under the mutual agreement procedure if needed.[15]

40. A residence tie-breaker rule would be effective in eliminating double taxation, as long as countries unilaterally refrain from asserting extensive jurisdiction over non-residents. For example, suppose an individual is a resident of both States A and B under their respective domestic laws, but is a resident only of State B under the tie-breaker. Suppose further that the individual does not have a permanent establishment in State B. There is nothing to prevent State B from taxing the individual on business income earned in State B, but if B unilaterally adopts the principle that a non-resident without a permanent establishment is not taxed in B, then the individual will be taxed only in State A.

41. Provisions for a mutual agreement procedure in a light treaty could be consistent with article 25, paragraph 3,[16] of the OECD and the United Nations Models. The procedure could be used not only to resolve “any difficulties or doubts” that may arise in the application of the treaty, but also to avoid double taxation “in cases not provided for” in the treaty.[17] However, the expression “in cases not provided for in the Convention” could have a broader function than it does under

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[13] Assume that X, a national of A, is a resident of countries A, B and C under the domestic tax laws of these countries. X does business in these countries. Managing his businesses requires him to spend a significant period of time in each of these countries. During these periods, X, together with his wife and a young child, lives in the permanent homes they own in each of the three countries. Because his family always follows him and he has investments in each of these countries, suppose that X’s centre of vital interests cannot be determined. X has a vacation home in B, which would be considered an habitual abode. Under the A-C treaty, X is a resident of A because he is a national of A. Under article 4, paragraph 3 of the United Nations Model, given that he has a permanent home in both countries, his centre of vital interests cannot be determined, and he has an habitual abode in both States or neither, he is considered a resident of the country where he is a national. Under the B-C treaty, X is a resident of B because he has an habitual abode in B. If A and B have no treaty with each other, X will be a resident of both A and B.

[14] Not all countries routinely agree to tie-breaker rules. For example, the United States Model Income Tax Convention of 15 November 2006 does not contain a tie-breaker rule for companies, and the tie-breaker rules for individuals included in United States treaties have only a limited application. See article 1, paragraph 4, technical explanation of the Model, United States Department of the Treasury.

[15] Under paragraph 8.2 of the Commentary on Article 4 of the OECD Model (as revised in 2008), the same problem would arise if there were no A-B treaty: the individual would be treated as a resident of both A and B (and not of C).

[16] Article 25 paragraph 3 of the OECD and the United Nations Model Conventions provide that “The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

[17] A number of treaties contain the second sentence of article 25, paragraph 3 of the OECD and the United Nations Model Conventions (see, for example, treaties between the United States and Japan; the United States and the United Kingdom; the United States and Germany, Austria and Germany, Canada and Denmark, and Canada and the United States).

existing treaties,[18] in which this expression typically refers to situations that are within the spirit of the treaty although not specifically covered. In contrast, in a light treaty, the expression could refer to any cases of double taxation not envisaged in the treaty. Because the light treaty would have very few substantive provisions, the number of potential cases eligible for the mutual agreement procedure would be much greater in principle. For example, in a bare-bones treaty, transfer pricing is an obvious example of where double taxation can occur. The idea of a mutual agreement procedure would be to give the competent authorities the power to address inconsistent transfer pricing determinations. No country would be forced, however, into making a concession under a mutual agreement procedure against its will (a light treaty presumably would not include an arbitration provision).

42. Because the light treaty being suggested would contain exchange-of-information provisions, it could substitute the need for TIEAs. That is, if two countries agreed to the light treaty, then they would not need to negotiate a TIEA between themselves. Negotiation of a multilateral treaty with exchange-of-information provisions might be a much better course of action than bilateral TIEAs, in part because of the time that would be required to establish a treaty network for TIEAs. Currently, there are few TIEAs in force. While the TIEAs signed since 2002 generally follow the structure of the OECD Model Agreement on Exchange of Information on Tax Matters, the language varies from one to another. The development of an extensive network of bilateral TIEAs would consume a great deal of negotiation time and use up resources that could be allocated elsewhere. It would also result in a complex series of agreements with slight differences in wording, thereby raising questions of interpretation and complicating the application of these agreements. It would seem far more preferable to negotiate a single universal agreement with a standard form and a single meaning.

43. Developing countries would want to see the benefits of a light treaty before entering into one. As discussed above, most double taxation issues can be addressed unilaterally, so the function of a light treaty would be limited. Such a treaty could provide a legal basis for the avoidance of double taxation by including a residence tie-breaker and a mutual agreement procedure. In addition, the treaty could provide a framework for developing countries receiving assistance from developed countries by facilitating (a) the exchange of information; and (b) the enforcement of tax claims. Developed countries could be of substantial assistance in these areas. Wealthy individuals and corporations from developing countries often have bank accounts and other assets in developed countries, and in many cases are likely not disclosing all information about these holdings to their own Governments. If the practical problems of information exchange can be solved, developed countries are in a position to provide useful information to developing countries. Similarly, if a developing country is seeking to collect tax from someone with assets located abroad, it will seek assistance from the jurisdiction where the assets are located.

[18] See, for example, the United States-Japan treaty: in its technical explanations of article 25 of the United States-Japan treaty, the United States Treasury Department states that the provision “They may also consult together for the elimination of double taxation in cases not provided for in the Convention” “permits the competent authorities to deal with cases that are within the spirit of the provisions but that are not specifically covered.” See also the technical explanation issued by the United States Treasury Department on article 26 of the United States-United Kingdom treaty.

44. Developing countries may be concerned that an exchange of information agreement would impose burdensome requirements on their tax administrations. One solution to this would be to put in place provisions for reimbursing the costs of responding to an information request. In addition, the extent of the administrative burden could be reduced if information were provided automatically by financial institutions (analogously, information concerning account holders and payments made to them is reported using a standard format under the European Union Savings Directive). Automatic provision of information could substantially benefit developing countries, since it would provide them with information even in the absence of an investigation.

45. Procedures must be developed to make both information exchange and collection assistance work for developing countries. For that purpose, however, a legal framework first needs to be established, and a light multilateral treaty can provide that framework.

46. The conclusion of a light multilateral treaty would allow developing country treaty negotiators to focus their negotiation efforts on what is perhaps a small handful of other countries with which a full-fledged bilateral treaty is considered important. A light treaty would not be intended to supplant a full treaty between, for example, neighbouring countries with heavy cross-border trade, or other important trading partners.

IX. Conclusion

47. As the discussion in this note suggests, there is an extensive potential agenda for a subgroup on the tax treaty process.