



Foreign and Commonwealth Office
London SW1

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7/17/11

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Telephone 01-839-8866 Ext 45

I H Harris Esq
Private Investment Consultancies Dept
Overseas Development Administration
R E 608
Eland House
Stag Place SW1E 5DH

Your reference

Our reference MMG 68/3

Date 15 January 1973

Dear Irvine

RECEIVED IN
REGISTRY NO. 47
18 JAN 1973

MMG 68/3

MATCHING TAX ADVANTAGES IN LDC'S

Further to our discussion by telephone today I comment below on the reply dated 20 December 1972 received from Mrs Smallwood to Mr Belcher's letter of 5 December.

2. The Inland Revenue gives no specific information of "the progress made in tackling the extension of matching reliefs through the renegotiation of existing double taxation agreements and the negotiation of new ones". It seems difficult to believe that no progress has been made over the past year and we would suggest that another approach should be made to pin the Inland Revenue down to giving us a detailed progress report.
3. Our understanding has been that substantial progress would be made to insert matching provisions in existing treaties by September 1972. If this schedule has indeed slipped by six or seven months, as one might assume from Mrs Smallwood's reference now to April 1973, some explanation would not be out of place.
4. We would suggest raising two specific issues in this fresh approach to Somerset House. Firstly, we should ask what progress can be expected in widening the range of tax advantages to be matched under treaties. Two specific examples might be

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mentioned:

- (i) The matching of tax reliefs geared to promoting exports - the matching of ldc export incentives, has become of greater significance since the introduction of generalised trade preferences for ldc's as from 1 January 1972, and
- (ii) Matching lower rates of foreign withholding tax - thus Brazil has lowered dividend withholding tax from 25% to 15% in a tax treaty with France, while France maintains a 20% tax credit on dividend income from Brazil.

5. Secondly, we should ask the Inland Revenue to provide a summary of the state of play country by country (a) for negotiating new treaties with countries given in our priority list, and (b) for renegotiating all existing treaties with ldc's. Furthermore the summary should contain notes referring to any limitation or snag in the matter of tax sparing which may have occurred, or which might be anticipated, in any particular case.

6. Finally, may I suggest that we get away from the unduly restrictive title "matching of pioneer relief", particularly because of our endeavours to widen the scope of tax sparing. It would seem preferable to continue these exchanges with Somerset House, in the language of the White Paper, under the more general heading "Matching of Tax Advantages in Developing Countries".

Yours sincerely

Brian Tarlton

B A Tarlton
Economists Department

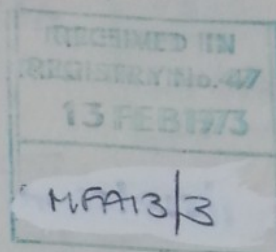
Copies to: Mr J N Stevens (ODA) Mr Gill
 Mr Kerr (FRD) Mr Lightfoot (DTI)
 Mr Burns (TRD)
 Mr Goulden (Planning Staff)

With the Compliments of

I H Harris

Foreign & Commonwealth Office,
Overseas Development Administration
ELAND HOUSE, STAG PLACE,
LONDON, S.W.1

245



SPD 209/202/01

12 February 1973

MATCHING TAX ADVANTAGES IN DEVELOPING COUNTRIES

In Ronald Belcher's absence overseas I am writing to thank you for your letter of 20 December, which he delayed in acknowledging in view of the then impending inter-departmental meeting on taxation of overseas income which eventually took place under Mrs Boothroyd's chairmanship on 9 January.

2. We were glad to have your general assurance that you expected substantial progress within the next few months in negotiating revised or new agreements, the stimulus of reformed Corporation Tax beginning on 1 April. However, in reporting progress to our Minister (as we are under instructions to do) we need some more specific information about the present state of play and prospects for the future. Our current information about individual countries is fragmentary; it would be helpful if your people could supply us with a summary showing the progress of developing countries already approached with relevant proposals; negotiating progress and how they are going; and your planned priorities and timetable for the future. It would be useful, too, to know of any common features emerging from negotiations so far which you think might affect future progress.

3. We should also like to raise with you a question which recent discussions have revived, i.e. the range of tax advantages to be matched under the agreements. We are encouraged to think that some progress might be possible here in view of the statement in your letter of 31 July last to your current more liberal approach to pioneer relief. We were not clear what this meant (you will remember that Maurice Macmillan, for elaboration in his reply of 21 September) and we were puzzled by the statement of the Inland Revenue representative at Mrs Boothroyd's meeting that the existing situation was the most that could be hoped for in the immediate future. We hope you will ensure that progress on this front ought not to be neglected, bearing in mind that the statement of intention in paragraph 13 of "British Private Investment in Developing Countries" (Cmd 4656) relates to tax advantages generally, not simply to pioneer reliefs. We should be grateful to know what your current position is on this.

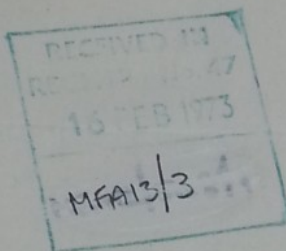
4. I am copying this letter to Mrs Boothroyd (Treasury), Gill (DTI) and to Mr Kerr and Tarlton (FCO).



Mrs A H Smallwood,
Board of Inland Revenue,
Somerset House,
LONDON WC2R 1LB

DEPARTMENT OF TRADE AND INDUSTRY
1 VICTORIA STREET
LONDON S W 1

01-222 7877



15 February 1973

Dear Mrs Smallwood.

MATCHING TAX ADVANTAGES IN DEVELOPING COUNTRIES

I refer to Irvine Harris's letter of 12 February 1973 about the negotiation or re-negotiation of double taxation agreements with developing countries, with particular reference to the matching of tax advantages on UK investment in those countries.

This is a subject of some concern to DTI, including Ministers, for what I am sure are sound commercial reasons.

In many of the developing countries, notably Brazil, it is quite clear that if British industry is to derive maximum advantage from the trading opportunities arising from economic expansion particularly in the manufacturing sector, they will have to invest, if only to overcome local regulations which, in certain circumstances, limit the import of anything for which there is a locally manufactured equivalent (the so-called law of 'similares'). In other words, trade will flow from investment, and it is imperative as a matter of national economic and commercial interest that our manufacturers and traders should not be at any disadvantage compared with the manufacturers and traders of competing countries. In this context, the taxation of investment in the host country and on repatriated earnings in the UK, as compared with taxation on equivalent investment from other countries, could well be a critical factor in determining whether our industrialists invest in the first place, and in determining whether the price they have to charge for the ultimate product of their investment will be competitive. We have already forfeited opportunities for investment in Brazil, notably to the Germans and Japan and, as a matter of commercial policy, it is important that we should not place our traders at a disadvantage when seeking out investment opportunities in the future.

Against this background, in addition to the information sought by ODA, which we too would welcome, it would also be very helpful to have an indication of the broad principles which govern Inland Revenue's approach to double taxation agreements at the present time, with particular reference to the definition of "pioneer reliefs" together with an indication of our policy on this important subject compares with that of our major investing competitors say, USA, Germany and Japan.

Yours sincerely

(J. GILL)

Mr Wogan (NENAD)

REGISTRY NO. 47
- 5 MAR 1973

I refer to your minute of 21 February.

2. As regards your question (a), I do not think it is for Economists Department to lay down the FCO position on the question of a double taxation agreement with the Sudan. This is a matter in which political considerations are important and as such should, I think, be worked out between NENAD and FRD, although naturally we are happy to advise on the technical and economic aspects.
3. There seems to be little prospect of a double taxation agreement being negotiated with the Sudan in the near future. The Inland Revenue at present seem to be more concerned with revising existing agreements (the revision being necessitated by the change in the UK's system of corporation tax), of which there are about sixty, than with negotiating new agreements from scratch. If the Sudan was a country which ranked high on our list of priorities for reaching an agreement, there would be a case for trying to induce the Inland Revenue to move it up in the queue. From an economic point of view, however, I doubt whether the Sudan should be accorded a high priority. The UK does not have substantial investments there (many UK assets having been sequestered without compensation), nor are we likely to invest heavily there in the foreseeable future.
4. On the more general point referred to in your paragraph (b), there seems to have been some misunderstanding as to the reasons behind Mr Tarlton's recommendation that we should offer the Sudanese unilateral matching relief. Briefly the situation is as follows. Many developing countries, including the Sudan, offer pioneer tax relief on income from foreign-owned investments, with a view to attracting such investment. However the benefit of such relief to the UK company making the investment is lost when that company has to pay corporation tax at the full rate on remitted profits. The UK company no longer has any fiscal incentive to invest in the developing country, although it is official UK policy to encourage such investment in general (see the April 1971 White Paper "British Private Investment in Developing Countries", Cmnd 4656 - especially paragraph 13), and the revenue forgone by the developing country offering the tax relief is in effect simply transferred to the UK Exchequer. In these circumstances the host country has an obvious incentive to cease offering the relief.
5. One way of dealing with the situation is to exempt overseas investment income from UK corporation tax within the framework of a double taxation agreement. However, to negotiate double taxation agreements with

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all developing countries of interest to the UK from an investment standpoint would take a long time, especially given the need, referred to above, to renegotiate existing agreements. Thus if we really wish to stimulate UK private investment in developing countries within the reasonably near future, the simplest way of doing it would be unilaterally* to match pioneer tax reliefs offered by developing countries. Legislation would probably be required for this and the Government would take enabling powers for this to offer matching relief to those countries to which it saw fit to do so. In practice, the countries eligible would nearly all be developing countries since, with one or two minor exceptions, other countries do not offer pioneer tax reliefs to be matched.

T R Webb

22 February 1973

T R Webb
Economists Department
G 72/G Ext G 791

*The word "unilateral", although habitual in this context, is a bit confusing. Here it simply means a relief that is not offered in the framework of a double taxation agreement. It does not mean that we are giving "something for nothing"; we are matching on our side the relief that the developing country has already offered on its side.

Copy to

Mr D Kerr (FRD) ✓
Mr B A Tarlton



2A
THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

Our Ref: PS 3888/1970
Your Ref: SPD 209/202/01


I H Harris Esq
Foreign and Commonwealth Office
Overseas Development Administration
Eland House
Stag Place
LONDON SW1E 5DH

RECEIVED IN
16 MAR 1973
MFA13/3

15 March 1973

Dear Mr Harris

MATCHING TAX ADVANTAGES IN DEVELOPING COUNTRIES

You wrote to me about this on 12 February. 

I cannot really add anything of substance to my letter of 20 December. So far as we are concerned, negotiations can go ahead quickly; but progress also depends of course on the attitude of the other country, both on timing and content. At the present moment especially, a high degree of confidentiality attaches to the progress of our negotiations with particular countries. I am afraid I must ask you to accept our assurance that our sense of urgency as regards renegotiation of new agreements is no less than yours.

On the point in the third paragraph of your letter, it was not, until recently, our policy to take the initiative in offering matching credit; we included it only if we were satisfied that there was a reasonable balance of concessions in the agreement as a whole. As you know, this restrictive approach has been abandoned in the current round of negotiations as we are now taking the initiative in offering matching credit to all developing countries, and we are not seeking any alterations in the balance of existing agreements on that account. This was the change I had in mind in referring to our more liberal approach to pioneer relief in my letter of 31 July.

As regards the scope of the relief which we are prepared to match, it is very much a question of looking at each piece of legislation the partner country wants matched on its merits. We must ensure that the legislation falls within the enabling power (Income and Corporation Taxes Act 1970 Section 497(3)) we also want to be sure that the United Kingdom tax given up will encourage new investment rather than accrue mainly to

the benefit of investors in existing projects, and that the relief granted in the developing country is reasonable having regard to its purpose. As a practical exercise, you might like to examine some of our agreements which include matching credit to see whether those countries have any provisions which you feel should have been matched but which were not.

Copies of this go to the recipients of your letter.

Yours sincerely

Anne Smallwood

Mrs A H Smallwood



Our Ref: PS 3888/1970

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

J Gill Esq
Department of Trade & Industry
1 Victoria Street
LONDON SW1

MFAB/3

MFAB/3 15 March 1973

Dear Mr Gill

MATCHING OF PIONEER RELIEF

In your letter of 15 February you asked for an indication of the broad principles which govern Inland Revenue's approach to double taxation agreements at the present time. This would require a fairly lengthy dissertation and I hope you will forgive me if I confine myself to what is evidently your main concern - our position on pioneer relief compared with that of other major investing countries.

Our own position is set out in my letter of today's date to Mr Harris (ODA). As regards the other countries referred to in your letter, I hope that you will find the following information helpful. It is taken from 1972 publications and should be up to date, but it might already be inaccurate in detail where new treaties or legislation have recently come into effect or existing treaties have been terminated or modified.

United States

The United States currently have only one double taxation agreement with a developing country (Pakistan). That agreement provides for matching credit; but it was ratified by the United States only because the Pakistan exemption provision which it matches had expired after the agreement was signed. In the past both matching credit for pioneer relief and the investment credit (a deduction from the taxpayer's domestic tax bill on the proportion of his capital investment in the developing country) has been unacceptable to the United States Administration and/or United States Senate, and treaties containing such provisions (eg with Brazil) have in consequence not been ratified. At the end of 1970 the Foreign Relations Committee of the United States Senate rejected a limited investment incentive provision negotiated by the Treasury in a treaty with Trinidad, and indicated that it was uncertain as to the wisdom of encouraging investments in developing countries.

Germany

Germany has seven treaties with developing countries which provide matching credit relief (Argentina, Ceylon, India, Greece, Iran, Israel, Pakistan). The relief applies only to limited classes of income; only four of the agreements, for example, deal with dividends. More generally, however, Germany normally provides in its double taxation agreements for the profits of overseas branches of German companies and the income from 25 per cent subsidiaries of German companies to be exempt from German tax. They have also introduced recently a unilateral provision which apparently has the effect of exempting from German tax dividends from 25 per cent subsidiaries in developing countries; but we have not yet been able to find out the precise conditions on which this relief is given.

Japan

Japan also currently has seven treaties with developing countries which provide for matching credit (Brazil, Ceylon, Korea, Pakistan, Singapore, Thailand). The Japanese provisions are less generous than the United Kingdom provisions in a number of respects: several, like the German treaties, are limited to specific forms of income. Usually they apply only to legislation in force in the developing country at the time the treaty was concluded, whereas our agreements permit us to cover future incentive legislation as well. More important, credit for underlying tax is covered in only three of Japan's treaties and in two of those is limited to companies which have at least a 25 per cent holding in the overseas company. In contrast, credit for underlying tax is given in all but two cases by the United Kingdom, and by reference to a holding of only 10 per cent.

I am copying the letter to the other recipients of yours.

Yours sincerely

Anne Smallwood

Mrs A H Smallwood

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FOREIGN AND COMMONWEALTH OFFICE
OVERSEAS DEVELOPMENT ADMINISTRATION
ELAND HOUSE
STAG PLACE LONDON SW1E 5DH
Telephone 01-834 2377

Minister.

c.c. Mr. Marshall
Mr. Keble
Mr. Parsons
Mr. Wright
Mr. Craig

From the Minister

30 April 1973

Rec'd 39/4

My dear Indian

Thank you for the aide-memoire you sent me on 27 March about the way we tax British private investors in the Sudan and other developing countries. I have also seen Lord Limerick's letter of 13 April.

The general question is one on which my Department, supported by the Foreign and Commonwealth Office and the Department of Trade and Industry, has been pressing the Treasury and the Inland Revenue ever since 1971, against the background of the White Paper on British Private Investment in Developing Countries. I myself wrote to the Chancellor of the Exchequer in December 1971 and told him I was concerned by the implications of the new structure of Corporation Tax for companies whose investment is mainly undertaken in developing countries. My officials have been pursuing with the Inland Revenue the question of matching tax advantages to which you make particular reference in your aide-memoire.

Devices like special bilateral arrangements, exemption, and unilateral British action have all been put forward, but have been rejected by the Inland Revenue. They have insisted that the only method they are willing to use is the negotiation and re-negotiation of Double Taxation Agreements with developing countries. I agree with you that this is a slow process, and the Inland Revenue have so far declined even to provide my officials with basic information about their priorities and progress.

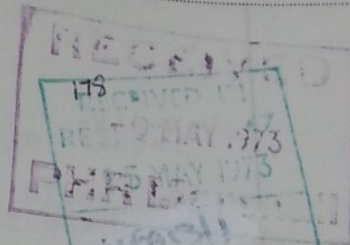
This is most unsatisfactory and I am sure that we ought to consider some further joint action, possibly at Ministerial level. Perhaps it would be best, as the subject matter is complicated, to ask our officials, as Lord Limerick suggests, to meet and discuss such an approach, and then report to us. If you agree with this, we will go ahead.

Yours ever

Richard

✓ Mr Marshall

Mr. Keele.



DOUBLE TAXATION AGREEMENTS

1. As a result of correspondence which he has exchanged with Lord Limerick and Mr Richard Wood, Mr Amery has asked us to arrange for officials of the three Departments to meet to discuss an approach to the Treasury, possibly at Ministerial level.
2. We can certainly organise such a meeting and invite Mr Harris of ODA and Mr Gill of DTI to come along and discuss this subject. But we should perhaps first agree within FCO the scope of such a meeting.
3. I think Mr Amery's minute of 27 March to Mr Wood itself provides most of the agenda. As I see it, this falls fairly neatly into two main questions:

a. the Inland Revenue list of priorities for Double Taxation Agreements; and

b. whether there is action which HMG can take outside Double Taxation Agreements to enable our firms to enjoy the full benefit of taxation reliefs and low rates of tax offered by developing countries.

4. On the first issue there is no doubt but that we must recommend that Ministers should challenge the Inland Revenue's view that "confidentiality" precludes them from either revealing their priorities to us or discussing them with us. This is sheer nonsense. I have no doubt that we must strongly recommend that all three Departments should be closely associated with the determination of priorities for Double Taxation Agreements. They cannot be decided solely on grounds of maximising revenue. They necessarily have an effect upon our total economic relationship with the country concerned.

5. There no doubt are ways, apart from Double Taxation Agreements by which we could ensure that we do not "claw back" to the Inland Revenue the difference between the developing countries' rates of tax and our own. This would probably involve legislation and we would need to examine whether provisions might be added to a Finance Bill under which British firms would enjoy the full benefit of all reliefs and low rates of taxation offered by developing countries. The objective, as I see it, would be to insert a requirement that full

/relief would

A.D. de 8 de

D M Kerr

Financial Relations
Department

9 May 1973

Copied to:

Mr Webb)
Mr Tarlton) (Economists Department)

Mr. Keeffe

I should be happy to take this meeting, unless you
yourself wished to do so.

Peter Randall

9 May 1973

I should be grateful if you
would take it. But let us be
clear that our objective is maximum
benefit to the totality of UK interests.

Mr Kerr

R. 10/5

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SECURITY CLASSIFICATION

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FROM

The Secretary of State
Telephone No. Ext.

PRIVACY MARKING

Department

In Confidence

cc. Secretary of
State for Trade
& Industry

Minister for
Overseas
Development

TAXATION

In April 1971 John Davies, as Secretary of State for Trade and Industry, and I presented a White Paper to Parliament on "British Private Investment in Developing Countries" (Command 4656). In that White Paper we spoke of the rôle played by British private investors in the development of the Third World and we outlined a number of measures which the Government intended to take to encourage further investment. In the two years which have elapsed there has been substantial progress on most of these measures. But I am sorry to say that both Peter Walker and I feel the same cannot be said of taxation.

2. Paragraph 13 of the White Paper referred to situations where tax advantages offered by developing countries were frustrated by the incidence of UK taxation on profits remitted to this country. Some relief has been possible through double tax agreements but this was and still is limited in respect of both the foreign tax advantages matched, and the number of countries covered. Thus for example tax relief is provided only for narrowly defined pioneer concessions and not for low taxation rates per se, and the incomplete coverage does not for example take /in

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important markets such as Spain and Brazil. There is much to be said for unilateral action by the UK, which would provide universal coverage, but the Inland Revenue have insisted on a piecemeal approach through the re-negotiation of existing double tax agreements, which is necessary in any event to take account of the change in the UK corporation tax system. Unfortunately the Inland Revenue have fallen well behind schedule in their negotiations and very little progress is in sight. Peter Walker and I feel that the present position is unsatisfactory and that a fresh and more comprehensive approach to the problem should no longer be deferred.

3. We think that the present system may harm British interests in several ways. If we frustrate foreign tax advantages we may damage our relations with the host countries concerned. Indeed, we ourselves offer tax incentives for regional and other investment to foreign and to domestic investors without discrimination, and are at present pressing the USA not to apply fiscal measures which would effectively deny the benefit of some at least of our incentives to American investors in the UK. Countervailing taxation such as the USA are proposing and which our own system presently embodies may be particularly resented by developing countries (because of their relatively greater financial need) when they see that the revenue which they forgo to attract British investment is diverted to benefit the UK exchequer. This has led some host countries to withdraw tax concessions to UK firms. There is also the danger that our export performance

/may

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PLEASE WRITE IN THIS MARGIN

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may be adversely affected, since, as we see it, overseas investment will play an increasingly important part in international exchanges of goods and services particularly as the developing world seeks a greater share of manufacturing facilities. Moreover if we countervail tax concessions offered to British-owned companies operating abroad, this puts them at a competitive disadvantage against other foreign-owned firms whose governments do not countervail such concessions. There is evidence that, as a result, some firms are now channelling new investment in the developing world through third countries whose tax regimes are more favourable than ours. Such investment is attributed to the third countries and the profits are remitted to them rather than to the United Kingdom. I think that we need to consider carefully whether this situation is in our overall interest.

4. Secondly, there is the question of the UN 1% target for total flows to the developing countries. We have taken a strong line in resisting a separate target for official flows. Our success in this depends on success in encouraging private investment. We told the UNCTAD III Conference in Santiago last year that if it looked as if we were going to fall below the target which we have accepted of 1% gnp for total flows to developing countries, we should be prepared to consider an increase in the aid programme. I am sure that you will agree that we should review very carefully any aspect of our taxation policy that might help to bring about such a situation by causing British investment to be less than it would otherwise have been

/or

...the European angle is also important. Especially as we are emphasising the importance of private flows in discussion with our partners, we must not be seen to be behind them in our taxation policy. Several of them give matching reliefs. Indeed, our present system of giving double tax relief is out of line with that of our major EEC partners. Moreover, given the Community's policy on liberalisation of cross-frontier investment, it will become easier for British firms faced with this situation to route their investment outside Europe through other member countries of the Community.

6. The issues involved in all this are complex and will require very thorough interdepartmental discussion at official level. But both Peter Walker and I believe that such discussion should commence now so that a report can be completed in time for its conclusions to be embodied in next year's Finance Bill, should this prove necessary. We would hope that it will prove possible to reach agreement on changes which might be made then to give further encouragement to our investors and exporters, ensure that profits come back to Britain instead of going to third countries and enable us as a country to get full credit for all flows from Britain.

7. There is another matter to which we should like to draw your attention in the field of taxation. It concerns the programme for the negotiation of double taxation agreements and the priorities underlying this programme. I am sure that we could help the Inland Revenue in assessing the priorities as between countries

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and advising them on the programme which should be adopted. I would like there to be a full dialogue between my officials, those in DTI and the Inland Revenue about this. We should of course be very willing to make available to the Revenue our assessment of the political situation in countries proposed for double taxation agreements and our judgment on how the actual negotiations might most profitably be conducted in the light of our political relationship with the countries concerned. May I suggest that as a first step the Inland Revenue should make available to my officials details of the programme which they have in mind and the reasons for the priorities underlying that programme.

8. I am copying this minute to Peter Walker and to Richard Wood.

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