

Mrs Smallwood

cc Mr Stewart

*Mr Hopkins*  
*We discussed*  
*I agree*  
*Att 9/11*  
UK/BRAZIL DOUBLE TAXATION TALKS

1. By far the most important matter for discussion during next week's talks with the Brazilians is their proposal that the UK should give credit for the Brazilian tax given up under the Dividends, Interest and Royalties Articles. On balance I feel we should resist this while fully exploring other possible ways of meeting them in their desire to maintain their principle of taxation at source. Brazil is however one of the more important of the developing countries and <sup>we</sup> will come under fire from several quarters if we fail to reach an agreement. What follows is an attempt to put the matter in <sup>pers</sup>pective.
2. Pressure for an agreement with Brazil comes from the DTI, ODA, our Embassy in Brazil and, although perhaps to a lesser extent, from the CBI, in particular RTZ. They believe that an agreement would encourage British investment there and that British trade with Brazil can only expand if there is increased British investment.
3. We have to accept that an agreement - any agreement - would improve the prospects of British investment, and the Brazilian proposals with regard to credit for Brazilian tax would undoubtedly provide British companies with more ~~than~~ incentives than our normal credit rules. What is more debatable is the weight which should be attached to promoting this investment. At the meeting of the Tax Reform Committee on 23 July Mr Wass representing the Treasury expressed the view that the present balance of payments situation does not allow any high priority to be given to overseas investment in the next year or two. He said that on the long term effects there was little empirical evidence but the Treasury view was that in the long run overseas investment competed with domestic investment. He pointed out that as foreign exchange earnings from exports were much greater than those from overseas investment much larger scale operations overseas would be needed to compensate for the loss of exports. If substantial manufacturing capacity were shifted abroad, industrial potential at home would be reduced and imports would increase.
4. It would be prudent therefore to conclude that the Treasury would not regard the encouragement of overseas investment as of paramount importance, and that, while we ought to aim at securing the maximum possible benefits for UK based businesses in a double taxation agreement, we should certainly not allow this aim to take precedence over other considerations.
5. The advantages we would derive from an agreement with Brazil would not of course consist solely of inducements to British investment there, but against these advantages must be weighed the possible repercussions of our acceptance of the Brazilian proposal on credit. These could be far reaching.
6. No-one would believe that we would not be prepared to concede similar terms to all other developing countries, and the Brazilian agreement would be looked on as a model for our future agreements with those countries. We would be seen to have radically altered



our approach to the treatment of overseas income in a very wide field. We would be regarded as having taken a major step towards total exemption of overseas profits. (With the present rates of tax in Brazil and a 50 per cent corporation tax rate in the United Kingdom, the proposed rules would in fact be tantamount to exemption in the case of trade dividends and branch profits.)

7. We could it is true point to the differences between the Brazilian proposals and outright exemption, but many of the arguments which we have used against the exemption method can also be used against the Brazilian proposal. It would for instance mean a further serious breach of their principle that as far as possible incomes should be taxed equally in the UK irrespective of source. The cost of including similar provisions in all agreements with developing countries could be substantial.

8. We have only very recently reviewed our policy in this field and our conclusion that we should stick to the credit method was approved by the Tax Reform Committee and apparently by Ministers. To accept proposals which have much in common with the exemption methods would inevitably weaken our position and could prove particularly embarrassing at a time when we may be coming under pressure from our EEC partners and the Commission to abandon the credit method. This pressure may force us one day to change our policy but as Mr Lord pointed out in the Tax Reform Committee we would want to get something in return and we should not throw away in advance what could be a useful bargaining counter.

9. We could not include the Brazilian's proposal in an agreement under our existing enabling powers. We would have to seek an extension of the scope of Section 497(3) in next year's Finance Bill. I understand that Ministers are very reluctant to include anything in the Finance Bill unless there are very pressing reasons for doing so: even if we came to the conclusion that the Brazilian proposal should be accepted I very much doubt whether we could make out a sufficiently strong case for including the necessary enabling legislation in the Finance Bill. Brazil, although important economically, is the only developing country which has put forward this proposal on credit and we have no reason to believe that any of the other countries at the top of our list for negotiations - with the possible exception of Mexico - will put forward similar proposals. We would not therefore be able to argue that our trading relations with a large sector of the developing world were being prejudiced by the absence of these enabling powers.

52A

D Hopkins

9 November 1973



1. Statistics and Intelligence Division (Mr N Honey)

INCOME FLOWS - UK/ Brazil

We shall shortly be entering into negotiations with Brazil for a new comprehensive double taxation agreement. For these negotiations we shall require details of income flows between the two countries and I shall be grateful if you will let me have, by 29 October, the latest figures available under the heads shown below.

2. Secretary, Taxes (Mr A G Adams Room 108 New)

1971

To the UK

From the UK

Dividends

Portfolio

(Source - C.S.O. with B. of E)

Direct investment (B.o.T's figures for \*subsidiaries' remitted income)

NIL

6.7

Interest

Portfolio (almost entirely Government and Municipal)

(Source - C.S.O. with B. of E)

From direct investment  
(Source - B.o.T)

NIL

..

Royalties (source B.o.T)

Copyright

(printed matter, sound recordings and performing rights)

NIL

..

Patent

(minerals and technological)

NIL

..

Branch profits

(source - B.o.T; all profits regarded as remitted)

NIL

..

\*Subsidiaries' profits not remitted

(source - B.o.T)

NIL

10.7

(If it is not possible to break down the figures under the various heads will you indicate which of the heads are covered by the composite figures.)

Any comments on the above figures

.. = cannot be disclosed.

Nothing recent on public income flows.

5/5/73

\*Any holding regarded as a "trade investment" is included in the B.o.T. figures for subsidiaries which also include associates whose holding we would regard as portfolio investment, but no split between the two is normally possible.



UNITED KINGDOM/BRAZIL

NOTE OF TALKS AT SOMERSET HOUSE 12-16 NOVEMBER 1973

Brazil

José Maria Vilar de Queiroz  
Francisco Oswaldo Neves Dornelles  
Pedrylvio Guimaraes Ferreira  
Pedro Paulo Pinto Assumpcao  
Dirceu Borges Nogueira  
Lygia Mendes Correa  
Mr Garcia (Brazilian Embassy)

United Kingdom

Mrs A H Smallwood  
D Hopkins  
C Stewart  
A G F Adams

Monday - AM

After the usual exchange of courtesies Mr Hopkins explained that although Mrs Smallwood did not normally attend Double Taxation talks she would like to take part in the discussions later this week in view of the importance to which the United Kingdom attached to a Double Taxation Convention with Brazil. Snr Dornelles said that his Minister, Snr de Queiroz would be arriving later in the week, but said that he had the authority to conclude a Convention without him.

Mr Hopkins said he thought the best way would be to go through the Convention Article by Article. There were a number of points on the Brazilian tax law he wished to clarify and no doubt on the other side Brazil would like to ask questions about United Kingdom tax law. Snr Dornelles agreed that they should work their way through the Convention. He said he recognised that there were two different taxation principles - Brazil was source minded while the United Kingdom favoured the residence test - but he did not want to get involved in theoretical arguments. There have been many changes since the talks in 1966 and Brazil's Conventions before then do not now reflect Brazil's current thinking. Mr Hopkins agreed that these talks would be considered on a fresh basis. The talks in March 1972 had been exploratory only.

✓ Personal Scope - Agreed

Taxes Covered - Mr Hopkins said he understood that Brazil attached great importance to the exclusion of the tax on excess remittances and the tax on activities of minor importance and Snr Dornelles confirmed that this was correct. In reply to Mr Hopkins he said that Brazil did not have a tax on capital or a tax known as a capital gains tax. However capital gains of companies or entities treated as companies under Brazilian law are considered to be normal income and subject to income tax in the usual way. Capital gains made by non-residents are taxed at 25 per cent. Capital gains by residents other than companies are not taxed at present. Mr Hopkins asked how Brazil would collect tax from non-residents on capital gains. Snr Dornelles explained that when someone wanted to make an investment in Brazil, evidence of this (eg a contract) must be registered at the Central Bank otherwise no payments abroad can be made. He confirmed that this would apply to a house.



Dnr Dornelles said that the Excess Remittances Tax applies to all kinds of income - dividends, royalties and capital gains and handed over examples showing how this would apply. Reinvestments of profits which are capitalised (ie shown in the Balance Sheet as increased capital and not merely as Reserves) would increase the amount on which the tax is calculated and therefore enable a larger amount to be remitted without incurring the tax. In reply to Mr Hopkins he said that a company could reduce its capital after 5 years without incurring a capital gain but if this was done within 5 years there might be a liability to the 15 per cent tax on Capital Reserves (which has recently been abolished).

Mr Hopkins said he thought the rates of the Excess Remittance tax were rather high. Snr Dornelles replied that where the remittance was less than 16 per cent of the capital the tax would be nil and that he thought that a return of 16 per cent was a reasonable remuneration for a foreign investor. In reply to questions from Mr Hopkins he said that the tax probably did not yield very much but Brazil thought it important in order to encourage the reinvestment of profits and to do this through the tax system rather than by other legislation.

Mr Hopkins asked if Brazil would be prepared to include this tax in the Convention as the revenue involved was not very great. Snr Dornelles repeated that the 16 per cent figure appeared reasonable and said that there was also a political aspect to this point. He would be subject to criticism in Brazil if this tax was not excluded as in all Brazil's double taxation conventions.

Mr Hopkins asked the position of a company in Brazil with Capital of £1,000 and Reserves of £1,000 on capitalisation. Snr Dornelles said that the company could issue bonus shares or revalue the existing shares and that no tax is chargeable. He asked the position of an increase in capital in a Brazilian subsidiary of a United Kingdom company. Would there be any change to United Kingdom tax on the parent company. Mr Hopkins thought not but said he would check on this. He thought there would be no liability on the parent company on the issue but there would be on any subsequent sale.

Mr Hopkins then referred to the Brazilian practice of disallowing in the computation of profits, royalty payments to a company which controls over 50 per cent of the paying company. Snr Dornelles confirmed that this was correct and said that this related to Trade Marks, Patents and Technical Assistances Fees. He added that there were also restrictions on the amounts deductible for directors remuneration (applies to all companies) to protect minority shareholders. Any amounts disallowed are treated as remittances. Snr Dornelles handed over examples and Mr Hopkins said he would like to consider this point.

Mr Hopkins asked about the tax on the activities of minor importance which Brazil also wanted to exclude from the scope of the Convention. This tax would take the form of a withholding tax on dividends and the exact details would be given in a Decree. However the tax has not yet been levied



as no Decree has yet been made although the enabling legislation exists and there is no indication in Brazil that the tax will be levied in the future. Mr Hopkins asked why, if the tax was a dead letter, Brazil could not agree to include it. Snr Dornelles said that the Convention would be subject to Parliamentary scrutiny and criticism would be levied if this tax was not excluded. He said that other countries with whom Brazil had made a Convention had not expressed any fears on this. Mr Hopkins replied that they too could be subject to criticism by Parliament if the tax was excluded but he did not see this as a major stumbling block.

Paragraph (2) in both drafts was similiar and the United Kingdom had no objections.

✓ General Definitions - Snr Dornelles asked about the scope of the United Kingdom definition of Nationals and Mr Hopkins explained that this was our standard form of words as advised by the Foreign Office and that it would not include for example Canadians. Snr Dornelles said he had no objections and that he would be happy to include the definition of Nationals in this Article rather than in the non discrimination Article. It was agreed that the Brazilian definition of nationals as in the Brazilian draft Article 24 paragraph (2) be inserted and that paragraphs (d) and (e) of the United Kingdom draft were not now required.

Fiscal Domicile - Mr Hopkins said that the difference between the two drafts in paragraph (1) resulted from the United Kingdom wish to prevent people like diplomats from claiming the benefit of the Convention on investment income. Snr Dornelles said that the normal 12 months rule for residence in Brazil did not apply to diplomats - they were regarded as residents of the other country and that he would prefer to keep the Brazilian version but said he would be happy to cover the point in a Protocol. Mr Hopkins said that although the point was not of great importance he would like to cover it. The OECD version is being revised on similar lines and we will check on the position. We would prefer not to have a separate Protocol. Mr Hopkins said he would produce an alternative form of words instead of these in the United Kingdom draft, paragraph (1) line 7 "the term does not ..... sources therein". Brazil can agree the United Kingdom version of paragraph (2).

✓ Permanent Establishment - Paragraph (2) Snr Dornelles said he preferred a six months period for a building site etc and Mr Hopkins said the United Kingdom did not feel strongly on this. Mr Hopkins said that the United Kingdom had been considering whether the Article covered an oil well and a drilling rig which was used for exploration and not production. Snr Dornelles said that Brazil thought that these would be covered by the wording of the Article and would prefer not to draw attention to this doubt by specifying them but there could be an explanatory note to cover this. It was agreed that the United Kingdom would produce a form of words to cover a drilling rig.



Paragraph (4) - Brazil agrees this paragraph in the United Kingdom draft.

Paragraph (5) of Brazilian draft. Mr Hopkins said that although the United Kingdom had a similar paragraph in other agreements we preferred to omit it. After some discussion Brazil agreed to drop this paragraph.

PM

✓ Income from Immovable Property - After some discussion Brazil accepted the word "landed" in paragraph 2(b).

#### Business Profits

Paragraphs (1) and (2) are similar and the United Kingdom can accept the Brazilian version of these paragraphs.

Paragraph (3) The words in brackets in the United Kingdom draft were intended to prevent the expenses of a permanent establishment, not allowable under the domestic law, being claimed by the other country. However the United Kingdom did not feel strongly on this. Brazil preferred not to have these words included. Mr Hopkins asked whether it was intentional that Brazil had omitted the words from "whether" to the end of the paragraph. Snr Dornelles replied that Brazil preferred to omit these words for reasons of presentation but he confirmed that Brazil would allow expenses incurred outside Brazil under the Convention based on the Brazil draft which did not have these words. Mr Hopkins said that we would prefer to include these words as otherwise people in the United Kingdom may ask if the Brazil Convention is different to others. We would like time to think about this but do not consider that this would present any great difficulty.

Mr Hopkins asked what would come within the scope of Business profits and in particular whether Management Fees would be included. Snr Dornelles replied that this would be classed as technical assistance and therefore come within the Royalties Article. Mr Hopkins said he would like to return to a discussion on this point later.

#### ✓ Shipping and Air Transport

Mr Hopkins said that although the drafts were saying the same thing he would prefer the United Kingdom version. On the other hand Snr Dornelles said that Brazil might have difficulty in establishing residence and would therefore like to retain her wording. After some discussion it was agreed to adopt the Brazilian wording with the addition of United Kingdom paragraph (2) concerning the termination of the limited agreement.



✓ Associated Enterprises

No problem arose as both drafts were the same. In reply to a question Mr Hopkins explained the United Kingdom law which enable arm's length prices to be used in place of the transfer prices.

Dividends

Mr Hopkins asked whether the Brazilians had any points to raise (apart from the rate which would be discussed later).

In reply to a question he confirmed that liability to United Kingdom tax would arise where a United Kingdom company was entitled to dividends from a Brazilian company but these dividends remain in Brazil.

Snr Dornelles said that the definition of dividends in the United Kingdom draft was wider than in the Brazil draft. Mr Hopkins explained that the reason for this had been the change in the United Kingdom law in 1965 which had made it necessary to cover all possible items. There had been a change in the United Kingdom law again in 1972 and he would check to see whether the words were still required.

Paragraph (6) of United Kingdom draft - Dividend Stripping  
Snr Dornelles asked for an explanation of this paragraph and Mr Hopkins duly obliged. He added that the importance of this paragraph had now diminished but we would prefer to retain it as such a position could possibly arise under our new system. We did not feel strongly about it and would be prepared to delete it. Snr Dornelles said Brazil would like to delete it and the United Kingdom agreed.

Paragraphs (1) (2) and (3) of United Kingdom draft. Snr Dornelles asked the meaning of tax credit and Mr Hopkins then gave an outline of the new United Kingdom imputation system.

The term beneficial owner was discussed. Mr Hopkins said he would like to use this term or use the subject to tax test.

Snr Dornelles said one problem concerned the rates of the Brazilian withholding tax. If Brazil accepted the 5 or 10 per cent the effect would be a transfer of revenue from the Brazilian Revenue to the United Kingdom Revenue as the United Kingdom at present gives unilateral credit for Brazilian tax paid. Brazil does not therefore want to make a sacrifice if the benefit does not go to the United Kingdom investor but to the United Kingdom Revenue. Mr Hopkins replied that the United Kingdom investor would benefit in certain instances eg there would be a cash flow advantage if the withholding rate was reduced (otherwise he would have to wait for the United Kingdom to give credit). Moreover a Convention was not concerned simply with the investor the other country's position must be considered - if a country was not prepared to reduce its withholding rate what was the benefit of a Convention? He referred to the 15 per cent rate in the Brazil/France Agreement and asked if the rate was negotiable. Snr Dornelles said that Brazil would be prepared



to reduce the withholding rate but only if we gave credit at a higher rate and this would only come into effect after 3 years (to attract new industries). The other alternative would be no reduction in the withholding rate as in the Agreements with Denmark and Finland. Mr Hopkins said that Mrs Smallwood would like to discuss this problem later.

Tuesday - AM

Mr Hopkins explained the use of "beneficial owner" or "subject to tax" to prevent exploitation by nominees, trusts etc. Snr Dornelles said that the problem was not as great for Brazil due to their registration system but he agreed to adopt the words "beneficial owner". Mr Hopkins said that the United Kingdom was not in favour of paragraph (5) of the Brazilian draft which enabled a tax on branches in Brazil to be levied.

Interest - Mr Hopkins said that although the United Kingdom preferred a nil rate we could accept 15 per cent as part of a satisfactory package and asked if Brazil was prepared to give exemptions. Snr Dornelles said that this would depend on the package and matching credit. Mr Hopkins explained the ECGD and asked if these loans would be exempt. Brazil was not sure about this but said that the rate of 10 per cent could be given in respect of loans for machinery or equipment over 10 years.

Mr Hopkins said that the United Kingdom could not agree to give up its taxing rights under paragraph (3)(b) of the Brazilian draft. Snr Dornelles explained that Brazil considered that commission should be treated as interest and Mr Hopkins said that we would think about this.

Snr Dornelles said that Brazil would be making a greater sacrifice than the United Kingdom by reducing the withholding rate and produced a note of the flow of interest from Brazil to the United Kingdom for 1972 showing this to be 64M US dollars.

Snr Dornelles said that he would like exemption to be given to the Bank of Brazil - although it was not the Central Bank it carried out many of its functions and was the government's financial agent. Mr Hopkins said this point was of minor importance.

Mr Hopkins said that there was a stronger case for a reduction in the rate of interest rather than dividends and gave the reasons showing that the interest was not the real profit.

Snr Dornelles explained the reason for paragraph (6) of the Brazil draft was to avoid both Brazil and the United Kingdom losing money to a third country (eg the United States) by the reduction in the rates where unilateral credit is given by the third country. Mr Hopkins said that we did not have a rigid attitude on this. Mr Hopkins explained paragraph (4) of the United Kingdom draft and Brazil will think about it although there may be administrative difficulties.



Royalties - Mr Hopkins asked if the rate was negotiable and Brazil replied that it depended on whether credit at a higher rate is given by the United Kingdom. Brazil considers Management Fees to be technical assistance and therefore to be treated as royalties. Snr Dornelles explained that Brazil do not allow the deduction in computing profits where royalties are paid by a company in Brazil to a foreign parent company with over 50 per cent control. In addition a withholding tax of 25 per cent is levied on the payment and if it is only a book transaction the tax is due when the credit is made. Mr Hopkins said that he was concerned that the genuine cases would be penalised particularly in the engineering field. Although the United Kingdom did not allow a similar deduction there were important differences - the United Kingdom definition of royalties was not as wide and royalties were exempt. The United Kingdom will probably drop paragraph (4) of her draft as it is not now needed due to changed legislation. Mr Hopkins suggested that there could be a separate management fees Article with an option to be taxed on the net profits under the Business Profits Article. Snr Dornelles said this was very difficult but Brazil would think it over.

#### Capital Gains

The difference in the two drafts is in paragraph (3).

Snr Dornelles said that Brazil taxed capital gains except those made by certain resident individuals. An investment in Brazil must be registered there and gains by non-residents are also subject to the Excess Remittance tax. The tax is due at the moment of transfer but if the register is not changed then a fine will be imposed when the tax is paid. The register cannot be changed unless the gains tax has been paid. Brazil is thinking of exempting gains where the investment is held for a certain period. Mr Hopkins said we would give this further consideration.

Independent Personal Services - In reply to Mr Hopkins Snr Dornelles agreed that Brazil had dispensed with the concept of a fixed base as she had encountered difficulties. Mr Hopkins said that paragraph (1) of the Brazil draft was too wide for the United Kingdom - it would be more acceptable if confined to services rendered in Brazil. After some discussion Mr Hopkins asked if Brazil would consider a different form of wording confined to persons in the other country for a certain period of time. Snr Dornelles however said Brazil would have practical difficulties as its local control was ineffective. Mr Hopkins said he recognised these difficulties.

✓ Dependent Personal Services - Mr Hopkins said that the United Kingdom could agree with the Brazil draft and also to a separate article for Directors Fees.

✓ Artistes and Athletes - It was agreed to delete paragraph (2) of the Brazil draft.



✓ Pensions - Mr Hopkins explained the United Kingdom view for preferring tax in the country of residence eg cost of living, personal allowances etc and said he appreciated Brazil's view that a pension was regarded as a payment of deferred remuneration. He asked if Brazil would include annuities and alimony in this Article as in the Brazil/France Convention. Snr Dornelles said that Brazil had made a mistake in the Convention with France - it had been thought that pensions were Social Security pensions. However Brazil was prepared to recognise the right of the country of residence where the amount did not exceed certain limits and he handed over a draft covering pensions and annuities. Brazil preferred not to include alimony and would not want to give an exclusive right to tax alimony to the country of residence. After some discussion Brazil said that they could agree to include alimony with the same income limit as for pensions \$4,000 US dollars. There is no limit for annuities.

✓ Government Payments - After some discussion Mr Hopkins said that he could accept paragraphs (1) and (3) of the Brazilian draft. However the United Kingdom would find it difficult to accept paragraph (2). We liked to ensure uniformity of treatment of pensioners. Mr Hopkins gave reasons for his view that there was a distinction between Social Security pensions and those paid for past services.

There could be cases of hardship and arrangements should be made easier for pensioners. After some discussion Brazil agreed that Social Security pensions be taxed only in the country of residence and it was also agreed to expand paragraph (1) of the Brazil draft. Paragraph (3) of the Brazil draft is to be deleted.

✓ Teachers and Researchers - After some discussion Snr Dornelles said that Brazil could accept the United Kingdom draft. It was agreed that the heading would appear as above.

✓ Students - Mr Hopkins said that the word "trainee" in the Brazil draft seemed to be rather wide and asked what this covered. Snr Dornelles gave an example of a doctor on post graduate study. Mr Hopkins said that if he was drawing a salary from a hospital the United Kingdom would not want to give exemption. He said we would try to think of a better form of words than "trainee".

Paragraph (2) of Brazil draft - Mr Hopkins said that this went too far and Brazil agreed to have a limit. Mr Hopkins suggested a limit of £500/600 excluding any remuneration from an employer and explained that a student in the United Kingdom would be entitled to personal allowances and was in a different position than a pensioner. He said that the United Kingdom could accept paragraph (2) of the Brazil draft with a limit and undertook to prepare a draft. Snr Dornelles said he would think about it although he felt that the limit was rather low.



Income Not Expressly Mentioned - Mr Hopkins suggested omitting this Article but Brazil preferred to retain it for administrative reasons. Mr Hopkins said that as it differed from OECD it would present the United Kingdom with presentational difficulties but we would think about it.

Capital - It was agreed to omit this Article.

Elimination of Double Taxation - Snr Dornelles clarified the Brazilian treatment of relieving double taxation. Brazil gives credit to individuals only for overseas tax paid if the other country also does this - not necessarily under a Double Taxation Agreement. No relief is given for underlying tax. Brazil handed over a new paragraph (8). Under this the United Kingdom would have to give credit to a Brazilian branch in the United Kingdom (source country) for tax paid in Brazil (residence country) Mr Hopkins thought that Brazil wanted it both ways under this proposal but said he would think about it.

He asked Snr Dornelles the purpose of paragraphs (5) and (6) of the Brazil draft.

Paragraph (5) This is a precaution against a possible future tax on non-distributed profits.

Paragraph (6) This is a precaution against a possible tax on new shares. Mr Hopkins said he would check on this. It was agreed that paragraph (7) of the Brazil draft should be deleted.

Non-Discrimination - Mr Hopkins said that the United Kingdom could accept paragraphs (3) (4) and (5) of the Brazil draft. Paragraph (2) is to be deleted. If the United Kingdom were to agree to a branch profits tax the United Kingdom would like to include in this Article the references to branch profits tax and royalties shown in the Protocol.

✓ Mutual Agreement - Certain deletions were made to the Brazilian draft.

✓ Exchange of Information - A small alteration was made to the Brazil draft.

Diplomatic and Consular Officials - Brazil preferred to include this

✓ Methods of Application - The United Kingdom has no objections to this.

✓ Territorial Extension - Both drafts are in agreement.

✓ Entry into Force - A mistake in the Brazilian draft was amended Mr Hopkins said it was usual to insert the exact dates.

Termination - Agreed - subject to any comments by the Foreign Office.



Thursday AM Mrs Smallwood welcomed the Brazilian delegation and said that it would be best to concentrate on the main issue of difference between the two sides.

Taxes Covered Mrs Smallwood confirmed with Snr Domelles that the Excess Remittance Tax applied to all industries and activities including services. She said that the United Kingdom view was that this tax should be covered in a Double Taxation Convention otherwise United Kingdom investors would have no protection against an increase in the tax either by an increase in the rate or by a reduction in the allowable percentage (effectively 16 per cent). Snr Domelles said Brazil wanted long term capital as opposed to short term and he repeated that the rate of return was considered to be reasonable. Brazil had not concluded a Double Taxation Agreement with this included. Mrs Smallwood said that she took note of this view but the United Kingdom principle is that all taxes on income and profits should be included. Mrs Smallwood then asked Snr Domelles questions on the Tax on Activities of Minor Importance. This tax applies only to non residents and Mrs Smallwood said it appeared to be a discriminatory form of taxation from which the overseas investor would have no protection under a Double Taxation Convention if it was not covered. Snr Domelles said that it depended on how one looked at this. This tax was being kept in reserve and there was no intention of introducing it. He agreed that it was in effect a surcharge on undesirable activities. Mrs Smallwood said she would give this further consideration.

#### Dividends

Mrs Smallwood said that the 25 per cent rate was higher than the United Kingdom would consider acceptable. Snr Domelles repeated his earlier arguments that if Brazil reduced the rate it was essential that the United Kingdom should give credit for the tax given up by Brazil. Otherwise he said the sacrifice that Brazil was making would go to the United Kingdom Revenue instead of the United Kingdom investor and Brazil did not want this.

Mrs Smallwood then explained the scope of the United Kingdom powers for giving matching credit and that under the present United Kingdom legislation we did not have the power to give matching credit for tax given up under a Convention. She explained the United Kingdom view on dividends (trade 5 per cent portfolio 15 per cent) and said that the Brazilian draft would not be giving any benefit to the United Kingdom investor. Mr Hopkins asked what advantage there was to the United Kingdom investor under the Brazil Article. Snr Domelles said that a Convention should be seen as an instrument to promote development and said would like to find a way to give an incentive to the United Kingdom investor without involving a transfer of revenue to the United Kingdom Revenue. Mrs Smallwood said it was questionable whether; if the rate was reduced and credit given only for tax paid, Brazil would lose revenue as economic development would probably increase. Under the Brazil draft the United Kingdom could be forgoing revenue as investments



made in Brazil might have been made in another country with which we had a more favourable double taxation provisions. Mrs Smallwood said that it was our view that United Kingdom companies should receive similar taxation treatment no matter from what country their income was derived. Snr Domelles said that Brazil could not accept a loss of revenue for the sake of a point of principle on the other side. Mrs Smallwood said that the United Kingdom accepted a loss by reducing rates as it was considered the proper thing to do. She said that the question of credit for tax given up under a Convention was new ground for the United Kingdom and would be a matter for Ministers. When we introduced matching credit for tax spared to promote development in 1961 doubts had been expressed for giving credit for tax which had not actually been paid.

Mrs Smallwood then asked Snr Domelles whether he would prefer a Convention with no dividend article. He replied that this was a new proposition and he would need to think about it. Mrs Smallwood explained the new imputation system and said that portfolio investors in Brazil would not get the tax credit unless specific provision was made in the Convention and this would have to be part of a properly balanced Convention. Snr Domelles said that he thought it better that there should be a Dividends Article to provide the tax credit for portfolio investors in Brazil as he did not want to stop Brazilians investing in the United Kingdom. He thought that separate treatment should be given for the two income flows as they were not balanced - Brazil to United Kingdom 5m US dollars - United Kingdom to Brazil - negligible. After some discussion Mrs Smallwood again said that the matter of credit for tax given up under a Convention was a novel concept and would require the agreement of Ministers and Parliament. She recognised the importance of this to Brazil and hoped that Brazil would recognise our difficulties.

### Interest

Mrs Smallwood said that the rate of 15 per cent was high from the United Kingdom point of view and asked for a clarification of the reason for Paragraph (3)(b) and Paragraph 6 in the Brazil draft.

Snr Domelles said that Paragraph (3)(b) was to compensate Brazil for the loss of revenue that would occur if Brazil reduced her withholding rate.

Paragraph (6) was designed to prevent avoidance possibilities involving third countries which had come to light after the Brazil/Japan Convention which did not have such a clause. Mrs Smallwood thought that multinational companies would be able to avoid being caught by such a clause.

### Royalties

Mrs Smallwood said that although the definition of royalties in the Brazil draft was based on OECD the extension in the Protocol



covering technical assistance payments was very wide. Snr Domelles confirmed that the reference to income in the Protocol meant gross income and agreed that a charge of 25 per cent on the gross represented a high figure of charge on the net income. He said that Brazil would reduce the rate of withholding tax provided the United Kingdom gave credit for the tax given up. He said in reply to Mr Hopkins that payments, other than dividends, interest or royalties, made by a subsidiary or branch to the parent were deductible in the normal way if reasonably related to the subsidiary or branch and incurred for the purpose of the trade. All payments to a non-resident were subject to the 25 per cent withholding tax (Article 34 of the Brazilian law). He said that Brazil had problems of an administrative nature when considering technical assistance payments paid to a company which controlled more than 50 per cent of the paying company. In the first place was the technical assistance really rendered and secondly if it was rendered was the amount claimed correct. It was therefore easier not to allow the deduction. He was prepared to make provision in the Protocol so that deduction may be made in genuine cases. In reply to Mr Hopkins he said that Brazil would consider a Management Fees Article but this would depend on the package. Mrs Smallwood thought that use could be made of the Mutual Agreement Article but said she recognised Brazil's problems.

PM Artistes Mrs Smallwood referred to the problem where the payment is made not to the artiste but to a company and thought that the Exchange of Information Article could be used to combat such cases. Snr Domelles said it would be better to have an addition in the Article and this was the reason for paragraph (2) in the Brazilian draft. Mrs Smallwood thought that this paragraph (2) might be useful and said that we should like to consider this in conjunction with paragraph (4) of the United Kingdom draft on Permanent Establishment.

#### Income not expressly Mentioned

Mrs Smallwood said the United Kingdom would like to think about the Brazil proposal.

#### Elimination of Double Taxation

Mrs Smallwood asked for a clarification of paragraph (6) of the Brazil draft. Snr Domelles said that if a Brazil company increased its capital it was not subject to Brazil tax and that Brazil wanted to ensure that where the Brazil company was controlled from the United Kingdom, no United Kingdom tax would be levied. Mrs Smallwood said there was a problem in the United Kingdom of Share Incentive Schemes and that she would think about this.

#### Non Discrimination

The question of the deduction of royalties was the only open point.



### Mutual Agreement and Exchange of Information

Mrs Smallwood said that these Articles were more important now particularly in view of the multinational companies and that they offered a good deal of scope if action was taken promptly. Snr Domelles agreed with this view. She added that there were two different forms of information. One was the exchange of information about a taxpayer's affairs but this must be covered by the treaty before we could give details. The other was information available from our Foreign Intelligence Section which had a great deal of information of the taxation laws of countries all over the world.

### Entry into Force

Both the United Kingdom and Brazil are not in favour of any retrospection and it was agreed that the earliest dates would be 1 January 1975 in Brazil and 6 April 1975 in the United Kingdom.

### Brazil's Tax Incentives

Snr Domelles explained briefly Brazil's various tax incentive programmes. Mrs Smallwood said that the relief for exports might present us with difficulties but the others seemed in principle to be acceptable to the United Kingdom. The export incentives really operated on profits retained and reinvested. The United Kingdom will however, consider whether we can match credit for these reliefs.

Mrs Smallwood thanked the Brazil delegation for taking part in talks which had been useful and had produced constructive discussion. The United Kingdom recognised the importance to Brazil of giving credit for tax given up under a Convention but she had no authority to give any assurances on this. If it was not possible for the United Kingdom to give this it would still be possible to have a Convention. There might be some delay in giving a decision and it was unlikely that the necessary legislation could be enacted before the Budget of 1975. In the meantime minor points could be settled by correspondence and revised draft articles sent via the British Embassy. Snr Domelles thanked Mrs Smallwood for the talks and said he would be pleased to welcome a United Kingdom team to Brazil for a further round of talks.





BRITISH CONSULATE-GENERAL  
RIO DE JANEIRO

13 February 1974

H M Carless Esq  
Latin America Dept  
Foreign and Commonwealth Office  
London SW1

UK/BRAZIL - DOUBLE TAXATION AGREEMENT

1. In your letter ALB 20/1 of 25 January to Donald Cape you reported on the progress of negotiations over the Anglo/Brazilian Double Taxation Relief Agreement. I have subsequently seen a copy of Gunn's letter of 1 February to Allpress in the DTI.

2. We have now had a talk with Dornelles who, as you know, has responsibility in the Finance Ministry for the negotiation of bilateral Double Taxation Agreements. In Dornelles' view the difficulties for the Inland Revenue, which had arisen in the November round of negotiations, might in part be due to a certain misunderstanding about the nature of Brazilian tax incentives and pioneer reliefs, for which the Brazilians, in their recent Double Taxation Agreements with others, had secured a tax credit from the other countries concerned. A particular problem had evidently arisen over Brazilian incentives for exports, the earnings from which are effectively exempted from corporation tax, but do bear tax if the relevant profits are distributed within Brazil or remitted abroad. He argued that it was not therefore correct to say that exports enjoyed a tax holiday. We gathered from the Brazilians that they are keen to see the UK brought into line with other major trading partners over a Double Taxation Relief Agreement as soon as possible. He is hoping that the Inland Revenue may be in a position to let him have their views on the outstanding points by May with a view to further negotiations in the middle of this year.

3. I need hardly emphasise that, from the point of view of our commercial interests in Brazil, the conclusion of a DTR Agreement becomes increasingly desirable. Brazil is now in the middle of a very substantial foreign investment boom in which once again British firms look like getting left behind. There is no lack of interest in investment in Brazil on the part of British industry and the recent CBI mission, who incidentally urged the early completion of a DTR Agreement in their report "Go to Brazil", has encouraged this trend. But we frequently find firms

/deterred





- 2 -

deterred by the incidence of the full 25% withholding tax on remitted profits and royalties. Likewise our bankers, who are otherwise well positioned to lend to Brazil, and who make very considerable earnings from this activity, are finding themselves at a disadvantage as compared with e.g. their French and Japanese competitors as a result of having to absorb the full withholding tax rate on interest payments. British consultants and others offering technical services are in the same boat. I must therefore urge most strongly that we should aim to conclude our Agreement currently under negotiation as early as possible as there are very substantial foreign exchange earnings at stake here. Moreover, we now have the Brazilians well briefed on our taxation procedures and it would be a great pity if they in their turn were to go off the boil.

R M John

cc G E Hall Esq (São Paulo)  
I P Gunn Esq (Inland Revenue)  
M J Treble Esq (CRE 2 DTI)  
D S Cape Esq (Brasilia)



Canning House

133/6

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2 Belgrave Square, London, S.W.1 Tel. 01-235 2305-7

THE HISPANIC COUNCIL  
THE LUSO BRAZILIAN COUNCIL

PRESIDENT  
THE RT. HON. LORD ERROL OF HAILE

DIRECTOR GENERAL  
S. M. MACKENZIE, C.B.E.

18 June 1973

Dear Secretary of State

When you lunched at Canning House in March, you kindly invited us to bring to your direct attention matters of special significance affecting trade between Britain and Latin America. At that time, the subject under discussion was the problem of disinvestment in Peru which we have been studying but have not quite completed the necessary documentation. In the meantime, we feel that a more pressing and important problem should be brought to your attention.

The absence of a double taxation agreement between the U.K. and Brazil is increasingly eroding the ability of the City of London to offer competitive terms in the field of international financing. Although tax relief can be obtained ultimately for withholding tax absorbed by the lending institution, in many cases this is limited and is forcing many British banks to channel business with Brazil through French or Japanese banks, both of which countries enjoy the benefit of a national double taxation agreement. As a result, part of the profit, which would otherwise accrue to the United Kingdom, has to be diverted elsewhere, thereby reducing the income from invisible exports. Furthermore, because of favourable tax credits, French banks have been known to undercut British banks by something in the region of 0.5% for an identical return on a similar financing operation with Brazil. The lack of an agreement also has an adverse effect on the profits on U.K. industrial and commercial investments in Brazil.

We believe that a double tax agreement with Brazil is in process of negotiation but, in view of the importance of the market and the large number of promotional activities that are being planned prior to the British Industrial Exhibition in Sao Paulo in August 1974, anything that can be done to accelerate the conclusion of this agreement would be much appreciated. In view of the importance of this matter, I am sending a copy of this letter to the Secretary of State for Trade and Industry.

Yours sincerely

D.B. Montgomery

D.B. Montgomery  
Chairman  
Economic Affairs Committee

The Rt. Hon. Sir Alec Douglas-Home KT, MP  
Foreign & Commonwealth Office

The FCO say that the Council is the chosen instrument of the British Overseas Trade Board for advising the Government on the development of trade with Latin America - so it has quasi-official status in this capacity.





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

SPD 343/226/01

2 May 1972

Miss A H McNicol  
Inland Revenue  
Somerset House

*Mr Brighton*

*Dear Miss McNicol,*

*4/5*

MATCHING OF PIONEER RELIEFS

1. At the conclusion of our meeting on 20 April I undertook to let you have a list of those developing countries which we, in the Whitehall and ODA wings of the Foreign and Commonwealth Office regarded as offering the best prospects for British private investment, but with which the UK has not concluded a Double Taxation Agreement. It was understood that you would then advise us on the prospects for concluding such agreements in the near future so that we could assess the need for a unilateral measure granting matching relief for tax incentives offered to new investment by developing countries.

2. We attach special importance to reaching agreement with the following countries which offer outstanding opportunities for British private investment:

Brazil  
Hong Kong  
Iran  
Korea -  
Kuwait  
Malaysia  
Mexico -  
Spain  
Taiwan  
Thailand -

3. There is also a longer list of countries offering good opportunities which we consider important. These are:

Cameroun	Colombia -
Gabon	Indonesia
India	Liberia
Ivory Coast	Morocco -
Mauretania	Philippines
Qatar	Saudi Arabia
Turkey	U A E
Yugoslavia	Zaire

4. Several of these countries are already very important for British

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investors and should have priority treatment on that ground as well. Thus the book value of British direct investment in some of them (excluding oil, insurance and banking) at the end of 1968 was:-

India	£277m
Malaysia	£173m
Brazil	£61m
Spain	£60m
Mexico	£49m
Hong Kong	£39m
Mozambique	£17m
Thailand	£12m

£688m

The total for these eight countries is equal to 41% of such investment in all developing countries. The net earnings of the investment in seven of these countries in 1970 reached £100.1m, equal to 46% of the total for developing countries. Our concern is therefore with countries of significance for the Inland Revenue as well as for new private investment.

5. We are also very much interested in improving the Agreements which do exist with certain countries, where no matching provision has yet been incorporated. Among our priority countries are:

Associated States  
Botswana  
Brunei  
Cyprus  
Greece  
Kenya  
Nigeria  
Uganda

6. We have referred separately to Mozambique, but it may be that it will need to be brought within an agreement with Portugal.

7. You will no doubt let me know what you think are the chances of an early wide round of such agreements.

8. I am copying this to Mr Tarlton in the FCO and Mr Dippitt in the DTI.

*Yours sincerely,*  
*Maurice Smith*

Maurice Smith



STAMPS AND TAXES DIVISION

cc Mr Hopkins  
Mr. Marshall  
Mr Roberts  
Mr Lewis

Mr Taylor Thompson

These notes list the representations we have had in the last year or two about non-Agreement countries and make some comments on them. For convenience a copy of the ODA's letter of 2 May 1972 is also attached.

At this stage I have not attempted to do any detailed research, and a number of the countries listed are rather unknown quantities and would need a closer look before any definite approach was made. But leaving aside Spain, Brazil and Indonesia, which are already in hand, I think a short list of the countries on my allocation might be:

Iran (to be revived)  
India  
Thailand  
Korea  
Mexico  
Morocco (to be revived)  
Egypt (to be revived)  
Sudan

C Stewart  
13 July 1973