



THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

PS 9006/74

30 December 1974

PRINCIPAL PRIVATE SECRETARY

1. In his letter of 12 December Mr Shore refers to the current negotiations about a Double Taxation Agreement between the United Kingdom and Brazil. He records his strong commercial interest in the conclusion of such an agreement and expresses the hope that he will be consulted if there is any danger of the United Kingdom being unable "to match the substance of any tax advantages which our main competitors have managed to incorporate in their Double Tax agreements with this important market".
2. Our present Double Taxation Agreement with Brazil is a limited one covering shipping and air transport profits only. It came into force in 1968 and followed unsuccessful attempts in 1966 and 1967 to conclude a comprehensive agreement.
3. The current negotiations for a comprehensive agreement started with exploratory talks in London in March 1972. These were followed by a round of formal negotiations in London in November 1973 and further talks in Brasilia last October.
4. The negotiations have revealed a number of major differences between the United Kingdom and Brazil. The most important relates to the credit to be given against United Kingdom tax for the

12
Brazilian tax on dividends, interest and royalties flowing from Brazil to the United Kingdom.

5. We are prepared to give credit for the Brazilian tax actually charged on income flowing from Brazil to United Kingdom residents against the United Kingdom tax on that income: indeed this is something we already do under our statutory unilateral relief rules. We have also offered to give credit for Brazilian tax which would be payable but for special reliefs or exemptions granted under Brazilian domestic law to encourage investment in pioneer industries there. We are empowered to do this under legislation introduced in the 1961 Finance Act and now embodied in Section 497(3) of the Taxes Act: the Section allows us in a Double Taxation Agreement to give "matching credit" as it is generally called for tax spared by the other country under its law with a view to promoting development there. It was introduced to enable us to ensure that tax incentives provided by a developing country were not frustrated when the income in question was taxed both in the United Kingdom and the developing country. Without matching credit a reduction in a United Kingdom investor's overseas tax bill on income flowing to the United Kingdom would often simply mean a corresponding increase in his United Kingdom tax liability because there would be a correspondingly reduced amount of overseas tax to set off against it. Matching credit provisions have been included in our agreement with a number of developing countries.

6. The Brazilians however want us to go further. They want us to give credit for part or all of the tax which they give up under the terms of the Double Taxation Agreement on dividends, interests and royalties flowing to the United Kingdom, and have made it clear that only if we agree to this will they reduce their tax on this income. They regard a Double Taxation Agreement primarily as a means of encouraging investment in Brazil and they do not see why they should agree to any reduction in their tax which would benefit the overseas Revenue and not the investor himself.

7. Our statutory powers simply do not enable us to accept these proposals. They allow us to give credit for tax waived under the other country's domestic law but not for tax given up under a Double Taxation Agreement, and Finance Bill legislation would be needed to widen them. We have also emphasised that acceptance of the Brazilian proposals would mean a significant departure from the policy which has been pursued under successive United Kingdom governments.

8. In granting matching credit the United Kingdom is helping to provide a fiscal incentive for United Kingdom investors to invest overseas: we are combining with the overseas country to make investment in certain industries in that country more attractive, as far as taxation is concerned, than investment in the United Kingdom. We have been prepared to do this partly in order to assist the economies of developing countries and partly in order to improve the terms on which United Kingdom companies compete with foreign rivals. Matching credit however has always been restricted to particular reliefs granted to particular industries, and has always been granted for a limited period only. What the Brazilians are proposing in effect is that we should now provide this incentive in all cases and on a far greater scale.

9. Such a move would have a number of consequences. First it could only stimulate outward investment from this country to Brazil. This would of course be welcome, as Mr Shore points out, so far as it led to increased trade between the United Kingdom and Brazil, but it would mean that we were according outward investment a higher priority than hitherto with all that that implied for the balance of payments and the domestic economy. The effects might not be significant if they were confined to the United Kingdom/Brazil situation, but other developing countries - and possibly capital importing countries generally - could be expected to make similar demands and the Brazilian agreement might become a model for all our agreements with those countries.

10. Secondly it would mean that we were largely accepting the argument that the capital importing country has the primary right to tax not only the profits earned from the investment of capital but also the dividends paid out of those profits. Our Double Taxation Agreements are based on the principle that the capital importing country accepts restrictions on its right to tax payments made to residents of the capital exporting country while in return the capital exporting country gives credit against its tax for the reduced tax charged in the capital importing country. Both countries thus share the burden of relieving double taxation; both accept reductions in their tax revenues. Under the Brazilian proposals we would bear a far larger share of the burden than under our other agreements. This would mean a loss of tax which could become significant if the Brazilian proposals become the pattern for our agreements with other capital importing countries.

11. Finally it would mean that we had moved closer to the exemption method of relieving double taxation ie the method under which a country exempts overseas income from tax. We think that the credit method is superior to the exemption method in several respects, (mainly in the control it provides against tax avoidance) but we have recently had to defend it in discussions within EEC and we would want to avoid doing anything that might weaken our position.

12. Apart from the question of credit for Brazilian tax the Brazilians have made a number of other demands which present serious difficulties for us. If we were to meet all of them - and the Brazilian attitude has so far been somewhat intransigent - we would end up with a very one sided agreement. Clearly therefore the advantages which United Kingdom/Brazil trade would derive from a Double Taxation Agreement need to be carefully weighed against the other consequences of accepting the Brazilian proposals.

13. The advantages to British investors and traders of a Double Taxation Agreement - and similarly the disadvantages of not havin

12

a Double Taxation Agreement - are sometimes exaggerated. Under our unilateral relief provisions we give credit for direct taxes paid overseas whether or not there is a Double Taxation Agreement in existence with the country concerned. In general the conclusion of a Double Taxation Agreement with a particular country will not lead to any reduction in the United Kingdom investor's United Kingdom tax bill: this would normally only happen if the Double Taxation Agreement contained matching credit provisions. Moreover Double Taxation Agreements by no means always result in a reduction in a United Kingdom investor's total tax bill. In the case of Brazil a United Kingdom investor's total tax bill will be reduced only if we accept the Brazilian proposals regarding credit for Brazilian tax given up under the Agreement. Moreover this reduction in tax will affect only profits remitted to the United Kingdom which in the circumstances prevailing in Brazil may prove to be a small proportion. Apart from this the only cash benefit to United Kingdom investors from a Double Taxation Agreement would arise from whatever matching credit provisions for pioneer reliefs we agreed to include - and these again would only affect the tax on remittances. In fact the main commercial benefits of a Double Taxation Agreement are probably intangible: Double Taxation Agreements regularise the fiscal relations between countries and usually provide guarantees against discrimination on grounds of nationality. Particularly in the case of developing countries they often introduce an element of certainty into an otherwise vague and confusing fiscal situation.

14. We would prefer however not to make firm recommendations about the Brazilian proposals at this stage. Representatives of the Inland Revenue and the Treasury have been studying our policy on Double Taxation relief and will shortly be reporting to the Paymaster General. If the Chancellor agrees we will make a further submission on the question of a Double Taxation Agreement with Brazil after Ministers have had an opportunity to study that report. Meanwhile we enclose a suggested draft reply to Mr Shore.

MRS C B HUBBARD
Private Secretary
Inland Revenue



From the Secretary of State

The Rt Hon Denis Healey MBE MP
Chancellor of the Exchequer

CH/EXCHEQUER		215-7877
REC.	23 JAN 1975	
ACTION	PS/IR Copies sent Full 23	
COMES	15/PMG	
10	15/MST	
Sir D Wars		
22 January 1975		

Mr Clegg

Mr F Jones

Mr Ham

Mr Turnbull

Dear Denis,

flag B

You wrote to me on 6 January about the negotiations for a double taxation convention with Brazil.

I am grateful for your assurance that you will bear in mind the points made in my letter of 12 December, and my wish to be consulted before any final decision is taken on contentious issues which might adversely affect our commercial relations with this important market.

I do of course appreciate that we already given credit unilaterally for Brazilian tax paid on income flowing from Brazil - though it is worth adding that for a number of reasons the relief so available may not extend to the whole of the Brazilian tax paid.

But the heart of the current negotiating problems concerns the relief to be given on tax spared by the Brazilian authorities. Here I find it difficult to understand the distinction being drawn between tax spared under Brazilian legislation to encourage economic development, and tax given up under the convention itself. It seems to me that the difference is a matter of technique, not substance - especially if our competitors do not draw this distinction.

As far as legislative powers are concerned, the frequency of Finance Bills in current circumstances suggests that there should be no undue delay if any doubtful points of policy can be settled.

As the Brazilian Finance Minister is visiting the UK in March, I am sure it would be helpful if substantive progress could be made on the convention.

I am copying, as before, to Jim Callaghan.

Yours sincerely
Peter Shore

PETER SHORE

MR HOPKINS

1. You asked for a note on the cost of the United Kingdom's giving credit for the tax which other countries might give up under double taxation agreements on dividends, interest and royalties flowing to the United Kingdom. The Brazilians have of course recently made it clear that only if we agree to give credit for part or all of the tax which they might give up under an agreement will they reduce their tax on this income. They regard a double taxation agreement primarily as a means of encouraging investment in Brazil and they do not see why they should agree to any reduction in their tax which would benefit the overseas Revenue and not the investor himself. The relevant papers are T1169/242/74 and PS 9006/74 (the Chancellor's correspondence with Peter Shore): I attach a copy of the latter.

2. I have considered fourteen countries (including Brazil) which either have asked or might in the future ask the United Kingdom to give such credit as part of a double taxation agreement. I obtained the net totals of direct dividends, interest and royalties from the Department of Trade (the latest year for which they are available is 1972) for all the countries I selected except Morocco, the Philippines, South Korea and Tunisia (for which records are not separately kept).

3. The figures in the Table 1 for the ten countries for which Department of Trade figures were available (based on a maximum acceptable tax credit rate of 15%) show inter alia that

(a) the overall cost to the United Kingdom would be of the order of £9m.

(b) Brazil and India have the largest amount of UK investment;

(c) the highest rates of dividend withholding tax are in Iran (10-60%), Singapore (40%) and Sri Lanka (39%);

(d) the net flows of interest are negligible and the highest rates of withholding tax on interest are in Argentina (38%), Bangladesh (60%), India (73%), Iran (15-60%), Pakistan (60%), Singapore (40%) and Sri Lanka (71%);

(e) withholding rates for royalties are high in Argentina (54%), Bangladesh (60%), India (52%) and Sri Lanka (71%).

4. Table 2 shows the current rates of withholding tax for the four remaining countries.

5. The figures are in general small and of course in any event must be balanced against the currency inflow to the United Kingdom which is presumably a corollary to our giving this credit. On the other hand the flows may be greater in the future and certainly are greater in the cases of developed countries with which we trade: further, there are the important arguments of principle which are described in our notes to the Chancellor in replying to Peter Shore.

6. We do of course already give this amount of relief unilaterally, except in the case of Pakistan and Singapore with which we have double taxation agreements.

Pwf

P W FAWCETT
3 March 1975

CONFIDENTIAL

NOTE OF MEETING WITH MR LORD ON 20 MAY

I had a general discussion with Mr Lord about the Brazilian Double Taxation Agreement problem.

The figures now provided by the Department of Industry demonstrate the importance of the flows from Brazil. I pointed out that the only one of the countries in the table of comparison which has an Agreement in force with Brazil is Japan. In relation to the other competitors it cannot therefore be maintained that UK companies are doing worse than foreign competitors because they lack the benefit of a double taxation agreement.

I explained why we could not meet the Brazilian demands under the present law, and indicated that if we did give way to Brazil we would have to do the same at considerable cost to other developing countries. It was not simply a question of former colonies but of significant areas, the Philippines, probably South Korea and other eastern countries, and any other Latin American country with which we might negotiate. Of the Commonwealth countries it was possible that Nigeria would want similar treatment when the time came to renegotiate.

I undertook to set out comments and our views in a letter. Mr Lord said that his Minister might well wish to pursue the matter with the Chancellor.

AHS

AHS

22 May 1975



PS 9006/74

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

23 June 1975

A Lord Esq CB
Department of Industry
Industrial Planning Division
Millbank Tower
Millbank
SW1P 4QU

Dear Alan,

DOUBLE TAXATION : BRAZIL

When we had a discussion on 20 May I undertook to set out our views in writing and I am sorry that they did not reach you earlier.

In case there is any misunderstanding I should first explain that we allow unilaterally full credit for taxes paid on profits earned in Brazil by our residents against the United Kingdom tax charged on those profits. The effect of this provision of the tax law is that United Kingdom residents operating in Brazil are at a disadvantage compared with competitors from countries which have an agreement with Brazil only in relation to "tax sparing". We do not allow unilateral credit for tax which is spared by another country as an incentive to development. The commonest form is the "tax holiday" allowed in the early years of an enterprise which sets up an approved activity in a developing country. Under our enabling powers we can as part of an agreement with another country allow tax credit for tax which is not in fact paid in the other country because of a relief given with a view to promoting "industrial, commercial, scientific, educational or other development" in that country.

The main but not the only impediment to concluding an agreement with Brazil is their insistence on going further than this. In their view matching credit should be given in any case where they reduce their rate of tax under an agreement; for example if the withholding tax on dividends were 40% and we and they undertook under an agreement to reduce the rate to

15% they would require us to allow matching credit to United Kingdom residents for the 25% tax foregone. We would then have reduced our own take from the basic rate to 15% and also have provided credit to our resident recipient for the Brazilian tax given up on income flowing to this country. This is not so much an extension of matching credit as a new concept; our provision of matching credit relief was intended to ensure that the benefits given to desirable industrial and commercial development in a developing country were not frustrated by our recovering the tax given up by the other country, so that the United Kingdom Government benefitted from the relief, the United Kingdom investor was no better and no worse off, and the Exchequer of the developing country suffered to no purpose. Brazil would argue that the same principle applies if tax is given up or the rate reduced under an agreement, but normally both sides make concessions in order to arrive at an agreement and the quid pro quo for a reduction in take by one side is a reduction by the other. If a satisfactory agreement is concluded both sides will benefit and it cannot be said that any element in the package or indeed the package as a whole is frustrated as pioneer reliefs could be frustrated in the absence of matching credit in the country of residence of the recipient of income. We are not convinced by the Brazilian contention, and in general it does not commend itself to countries like ourselves which relieve double taxation by allowing credit; it can readily be accepted by countries like France and Germany which use the exemption method of giving relief for overseas trading income. But whatever the merits of allowing matching credit as the Brazilians wish, we are advised that there is no power to do so under our enabling legislation so that we would need amending legislation in a Finance Bill in order to meet their case. There is however no question of breaking off negotiations, which have been conducted in a cordial atmosphere, and there are other points requiring resolution on which we are continuing to work.

We discussed the significance of the figures provided by your Department which demonstrate the importance of the flows from Brazil. We have of course recognised the economic importance of Brazil and are disappointed that it has not been possible so far to arrive at an agreement. The absence of an agreement can not fully explain our unfavourable performance compared with the other countries listed in Table III attached to your letter of 12 May, because our understanding is that only the Japanese agreement is actually in force. It is also interesting that the proportion of remitted profits over total profits is high in the case of Brazil (40.9%

compared with a world figure of 32.9%) in spite of the alleged disincentive effect of the withholding tax.

If we were to accept the Brazilian terms on matching credit we would have to do the same, and at considerable cost, for other developing countries. The point has been mentioned, and other countries are aware of the Brazilian attitude and are waiting for results. The countries we have in mind are mostly like Brazil of economic significance - the Phillippines, probably South Korca and other Eastern countries, and any other Latin American country which decides to negotiate. We could also expect similar claims from Nigeria when our Nigerian agreement was re-negotiated, and we might be asked to re-open concluded agreements for example with Indonesia and Malaysia. These are the considerations which have to be weighed against the potential effects of having an agreement with Brazil.

There have been allegations that British companies cannot compete in Brazil because they must increase their prices to compensate for the absence of an agreement. Some of these allegations I am sure arise from misunderstandings and possibly ignorance about unilateral relief. It could be however that some companies are significantly affected by the absence of matching credit, and it would be useful to see specific examples. If the Department of Industry is aware of any, it would be useful to have particulars, and perhaps companies which think that they are affected could be encouraged to get in touch with us.

Yours sincerely,

Nam.

MRS A H SMALLWOOD

Mr Willett
IC/1

Reference CRE 37906

cc: Mr Bryant OPG
Mr Titchener ESP

DOUBLE TAXATION: BRAZIL

Your minute of 8 July refers.

Three examples of UK firms who feel they are disadvantaged by the lack of a Double Taxation Agreement (DTA) with Brazil have recently come to our attention. The firms are:-

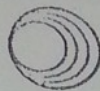
- a) Davy Powergas Ltd - I attach a copy of a letter from the firm stating their belief that French and German companies enjoy a competitive advantage over UK companies as a result of their DTAs, and stressing that a UK/Brazil DTA would lead to a dramatic improvement in their foreign earnings from Brazil. Davy Powergas are very active in Brazil, competing for a number of projects particularly in the petro-chemical sector. The firm therefore speak with some considerable experience on this subject.
- b) English China Clay - are considering some direct investment in Brazil for the production of china clay. An important consideration for the firm is the level of profits they will be able to remit to the UK. They have expressed the hope that the proposed Memorandum of Understanding (MOU) between the UK and Brazil, due to be signed this October, might lead to a speedy conclusion of a DTA.
- c) Humphreys & Glasgow - have advised the Consulate-General in Rio (and the Secretary-General of the Brazilian Ministry of Industry & Commerce has advised the Embassy in Brasilia) that the rate of withholding tax which H&G would have to pay had tipped the balance of a close competition for a major petrochemical contract (worth US\$106 million) in Bahia last year. (See also the attached record of their recent discussions with our Commercial Post in Rio).

L. Davies
M. J. Treble

21st August, 1975.

J.A. Nutt Esq.,
SPP Group Limited,
Oxford Road,
Reading,
BERKSHIRE.

RG3 1JD



BOOKER
McCONNELL
LIMITED

Bucklersbury House (Reg. Off)
83 Cannon Street, London EC4N 8EJ

Telephone: 01-248 8051

Telex: 888169

Cables: Considerer London EC4

CRO (London) Reg. No: 65519

Dear John,

Brazil

Thank you for sending me a copy of Francis Walker's letter in connection with a possible double tax agreement between the UK and Brazil.

When income is remitted to the UK from a country like Brazil, which has no double tax agreement with this country, relief for overseas tax suffered on that income is usually available against the UK tax chargeable on that income. Double tax agreements normally provide additional benefits by restricting the rates of with-holding taxes that may be levied on the remittance of dividends, interest, royalties, management fees, etc. between residents of the two countries party to the agreement. This not only reduces the likelihood of having unrelieved overseas tax but it can in certain circumstances also have the effect in a somewhat roundabout way, of actually increasing in the UK a company's available claims for group relief and advance corporation tax set-off.

Double tax agreements are often very helpful in situations when operations are carried on through overseas branches. Now that BATS has an office in Rio de Janeiro, this is another reason why Bookers would welcome a full double tax agreement between the UK and Brazil.

Perhaps I might add that the UK Inland Revenue's claim that "there is very little evidence in the UK of companies wanting such an agreement" seems a little dubious to me. One of the main advantages of changing the UK corporation tax system in April 1973 was to put the UK in a much stronger bargaining position when negotiating double tax agreements. It also had the effect of virtually ensuring that all the overseas countries which had double tax agreements with the UK at that time would want to re-negotiate them. This task of re-negotiating existing double tax agreements is, I suspect, the main reason why the UK Revenue is very slow in negotiating a completely new agreement with Brazil.

I hope these comments will be helpful to you in framing a reply to Francis Walker's letter.

Kind regards,

Yours sincerely,

[Handwritten signature]



Mr Gray
Mr Wheatley
AMS

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

Telephone Direct Line 01-215 3564
Switchboard 01-215 7877

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

22 October 1975

25/4/78

Dear Nan

*I put this file
away, with cross-ref - B.L.
to later pps AMS 2/11.*

DOUBLE TAXATION: BRAZIL

1 On his move from this Department Alan Lord has asked me to reply to your letter of 23 June and to apologise for the length of time that has elapsed. We have, in the meantime, been endeavouring to pull together details of a number of specific cases where the absence of an agreement has been regarded by companies as relevant to the level of their activities in Brazil. As we expected, it has proved difficult, even on this timescale, to identify very many hard cases (although we hope to let you have further evidence from industry shortly), but the few items attached, some of which you are no doubt aware of already, do illustrate I think that UK companies regard this as a matter of some importance.

2 At the risk of labouring a point that I know has already been made in correspondence and discussion, I would like to stress again that our interest in this matter is simply to ensure that UK companies wishing to undertake activities in Brazil are not put at a continuing competitive disadvantage as against companies resident in other countries which either have a different approach to double taxation or have been able to negotiate agreements with Brazil on favourable terms. You have written separately to me on the wider question of your general review of double taxation and I will not duplicate my reply to that letter (which will follow shortly) by spelling out in detail here why we regard outward investment as important to the UK e.g. through assistance to exports. This is however particularly relevant in the case of Brazil, where the stringency of import controls makes direct involvement in the local industry vitally important if our export market in Brazil is to be maintained and expanded. It is then against this background that we view the disadvantage at which UK companies currently operate in Brazil.

3 We do of course accept that the availability of unilateral relief goes a substantial way towards preventing double taxation and that one of the main advantages that would follow from an agreement with Brazil would be the ability to grant matching relief for tax spared under their incentives for development.

But there are other ways in which the conclusion of an agreement would be of benefit. Some of these are intangible but important - the establishment of a framework relating to such questions as treatment of overseas branches, guarantee of non-discrimination etc. One of the tangible benefits is however to my mind equally important - the reduction of rates of withholding taxes on dividend and royalties.

4 Although in theory unilateral relief should take care of this, it is easy to envisage cases where, particularly with the reduced tax base of UK companies now that we have both first year allowances and relief for stock appreciation, the full amount of overseas tax suffered is not available for relief because of an insufficiency of UK mainstream corporation tax. The relevance of the ACT provisions in these circumstances is well known to you. In such cases any reduction in the rate of Brazilian withholding tax would be a direct benefit to the UK company with no effect whatever on the UK Exchequer. It is also worth bearing in mind in this respect the effect of the Brazilian limitation on the remittance of profits. This limitation to 12 per cent of the registered capital in Brazil is applied by reference to the net amount of dividend remitted after deduction of withholding tax. If a company wishes to maximise the return to the UK from its investment in Brazil, by remitting the full 12 per cent, the withholding tax effectively becomes a charge that has to be met out of the profits remaining for reinvestment in Brazil, thus restricting the natural growth that would otherwise take place in our investment there without any cost to the balance of payments.

5 On the other side of the argument we do of course fully understand the implications that would be involved, for our double taxation negotiations with other countries, if we conceded the Brazilian proposals for matching relief for reduction in withholding taxes, but we wonder whether most of the countries likely to be influenced would in any case be prepared to conclude an agreement with us that was satisfactory in this respect, regardless of the outcome of the Brazilian negotiations. In the final analysis any difference in our two Departments' views on this matter depends on our respective judgments of the relative weights to be attached to the two conflicting objectives - maintaining intact our present policy on double taxation or avoiding the disadvantage that this may entail for UK companies operating in an important and rapidly expanding market.

6 I referred above to the general review that you are now undertaking of double taxation and will be replying fully in the next few days to your letter. As the question of matching reliefs is obviously one aspect of this review, it would I think be sensible if the Brazilian problem were taken into account in this wider ranging discussion rather than pursued at this stage as a separate issue between us. It may of course be necessary later on,



if the general review is prolonged, to suggest that this aspect be pursued separately again as we do regard a successful conclusion to the Brazilian negotiations as a matter of some urgency, particularly as it appears that any reduction in withholding taxes resulting from the agreement would be deferred for a further three years. I hope however that some progress on all these points may prove possible in the near future.

Yours sincerely
Anne Mueller

ANNE MUELLER