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THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

5 May 1976

PRIVATE SECRETARY TO THE MINISTER OF STATE

TAX TREATY WITH BRAZIL

Background

1. A team will be leaving for Brazil in about two weeks to continue negotiations for a comprehensive tax treaty. This will be the fourth round of talks with Brazil since they re-commenced in 1972 after earlier discussions, in the 1960's, had resulted in only a limited agreement confined to shipping and air transport profits. The talks are at a crucial stage and will culminate either in a draft treaty being initialled or the recognition by both sides that at the present time there exists insufficient common ground for agreement to be reached. The purpose of this submission therefore is to bring the issues involved to the notice of Ministers and to seek their approval to the line we proposed to take at the talks.

Importance of the talks

2. As the Prime Minister remarked in replying to a Parliamentary Question as recently as 31 March, Brazil is

cc Principal Private Secretary
PS/Chief Secretary
PS/Financial Secretary
Sir Douglas Wass
Mr Lord
Mr Couzens
Mr Lovell
Mr Houghton
Mr Turnbull
Lord Kaldor

Sir Norman Price
Mr Dalton
Mrs Smallwood (origin)
Mr Moorcroft (2)
Mr Boyd (2)
Mr Boyles
Mr Brooman
Mr Pollard

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our largest trading partner in Latin America. Nevertheless it is apparent from statistics made available to us by the Department of Industry that the United Kingdom has slipped from being the largest investor in Brazil in 1972 to sixth place in 1974, the comparative shares in the total of foreign investment in Brazil being as follows: United States of America 36 per cent, (£1,188), West Germany 11 per cent, Japan 8 Per cent, Switzerland 8 per cent, Canada 7 per cent and the United Kingdom 6 per cent (£349). Moreover the indications are that the United Kingdom has declined from being the fourth largest exporter to Brazil in 1972 to ninth place in 1975 and that since 1968 our visible trade balance has moved from a net surplus of £m7 to a net deficit of over £m50. Against this background it is hardly surprising that business interests in the United Kingdom have pointed to the absence of a tax treaty as a possible contributory factor to the decline in our position in the Brazilian market.

Unilateral relief

3. There can be little doubt that tax treaties are a means of stimulating trade and investment between the treaty partner countries. Apart from reducing or eliminating withholding taxes on income flowing between the two countries OECD type tax treaties provide clear and equitable rules for the treatment of income which is subject to double taxation and - particularly important in the case of developing countries - they introduce an element of certainty into an otherwise vague, confusing and risky fiscal situation. They guarantee protection against discriminatory taxation and provide for consultation between experts in the respective Revenue Departments rather than through the necessarily more cumbersome diplomatic machinery. On the other hand their importance is sometimes exaggerated. The main consequence for a United Kingdom taxpayer of the absence of a tax treaty is that he continues to be liable to the full rate of the foreign country's withholding tax on dividends, interest and royalties. But his total tax bill is not necessarily higher than under a treaty because of the United Kingdom system of giving credit unilaterally for foreign tax paid - that is to

say, even in the absence of a treaty. Compared with exemption or reduction of foreign tax, his "cash flow" is affected because he first pays the foreign tax and only later is given credit for it against his United Kingdom tax bill. Yet at the end of the day he would normally be no worse off than if he had paid a reduced amount of foreign tax and this is not always understood by those United Kingdom business interests who complain that the absence of a tax treaty with Brazil is putting them at a disadvantage compared with their competitors from treaty countries. What cannot be denied however is that United Kingdom residents who operated in Brazil are at a financial disadvantage compared with their competitors from countries who have been prepared to grant what Brazil has demanded in the way of matching credit.

Matching credit

4. We have offered to give credit for Brazilian tax given up ("spared") under special incentive provisions in Brazil's domestic law designed to encourage economic development there ("Pioneer relief"). If we did not match the tax spared - by giving credit for it against United Kingdom tax as if it had been paid - the effect of the Brazilian incentive provisions would be frustrated; although the United Kingdom resident would be paying less Brazilian tax he would be paying a correspondingly increased amount of United Kingdom tax because there would be less Brazilian tax to set off against it. But this is as far as we can go under existing statutory powers. We have not been able to accede to the Brazilian demand that credit should be given for Brazilian tax given up, across the board, by reductions of their withholding taxes under the tax treaty itself. This is the main reason - though not the only one - for the present impasse in the negotiations but if Clause 43(2) of the current Finance Bill becomes law we will have the power to grant matching credit in the way the Brazilians want and thus one of the main obstacles to reaching agreement would have gone. The next round of talks will thus be proceeding on the assumption that "across the board" matching credit could be given as part of a comprehensive

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agreement though it would of course have to be made clear to the Brazilians that any agreement to give it was conditional on the substance of Clause 43(2) becoming law.

Other obstacles to agreement

5. Matching credit has not been the only obstacle to agreement. There are several features of the Brazilian tax code which are considered objectionable by OECD member countries but which the Brazilians insist on incorporating in their tax treaties. The most important of these undesirable features are:

- a. the disallowance as a deduction in computing taxable profits of royalties paid by a Brazilian subsidiary company to its foreign (United Kingdom) parent;
- b. the extension of the definition of royalties to include management fees so that withholding tax is levied on the gross amount of the fees instead of on the net amount of income after allowing a deduction for expenses incurred in earning the fees;
- c. the taxation of virtually all capital gains arising from the disposal in Brazil of foreign-owned assets (including shares). This is completely at variance with the generally accepted international practice of giving the sole right to tax gains from movable property to the country of residence of the taxpayer unless they are connected with a permanent establishment in the country where the disposal takes place;
- d. the excess remittance tax which is imposed at progressive rates ranging from 40 per cent to 60 per cent on the amounts by which the profits distributed to non-residents exceed a prescribed amount.

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6. These features of their code - and various others which are not quite so important - are treated by the Brazilians as non-negotiable and the talks with the Brazilians have therefore tended to take the form of their continually reciting their demands without their being willing to consider any kind of compromise. They are prepared to reduce their domestic rates of withholding tax on the outward flow of dividends, interest and royalties and to incorporate in the treaty some OECD model type articles, the most important of which relate to non-discrimination and exchange of information. Further than this they will not go and we know from discussions with other OECD countries that the Brazilians have taken precisely the same line with them.

Brazil's Agreements with other countries

7. If the developed countries had presented a united front, Brazil - and the South American Andean Pact countries which follow her lead - would probably have had to modify her inflexible approach to international tax agreements. In the event, Japan and Sweden started the rot in 1968 by agreeing to terms which were at variance with OECD principles. Brazil then progressively increased her demands until by 1971 Germany, after seven years of negotiation, was presented with terms similar in all essential respects to those Brazil is now offering us. The Germans accepted them all and France followed suit. The latest information we have is that Brazil has now succeeded in re-negotiating its treaty with Japan on the German model.

Views of other Departments and the CBI

8. The general view of interested Departments - Industry, Trade and the Foreign and Commonwealth Office - tends to be that "any tax treaty is better than no treaty" and that we should be prepared to accept the Brazilian terms if we are satisfied that we cannot get better ones. This view is supported by the non-fiscal voices of the CBI but although the CBI Taxation Committee have had a special meeting about

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the matter they have been unable to give us a clear cut view. We have, on a confidential basis, kept them fully informed about the considerations involved in having a treaty with Brazil on her terms but the response we have had seems to be based on the quite unfounded assumption that the Brazilians would be prepared to give the United Kingdom more favourable terms than they have given to other countries. They are firm, for example, in not wanting us to give way on the royalties point (Paragraph 5(a) above) but at the same time they say they would welcome the prospects of a reduction in Brazilian withholding taxes without facing up to the fact that we cannot get such a reduction unless we go along with the Brazilians on royalties. Insofar as the CBI can be said to be speaking with one voice their attitude seems to be - as stated in a letter dated 12 January 1976 - that "as other countries are entering into tax relief arrangements with Brazil, failure to reach an agreement could leave the United Kingdom in an isolated position. There remains a considerable pressure from our membership for the successful conclusion of a treaty with Brazil on the best possible terms." The fact of the matter is that the CBI's Tax Committee, as a Committee of tax experts, recognises that if we give way to the Brazilians on so important a matter as the tax treatment of royalties it would be difficult for us to resist attempts by other developing countries with whom we have, or are negotiating, treaties to treat royalties in the same fashion; but some members of the Committee find themselves bound to support the "treaty at any price" line because of the importance to their particular companies of the very generous pioneer reliefs given by Brazil to foreign investors and which their companies are not benefiting from in the absence of a treaty. Other members have made it clear that in their view we should not conclude a treaty on terms which would set a bad example to other developing countries and would be costly for the United Kingdom.

Objections to the Brazilian terms

9. We look on "across the board" matching credit relief for tax given up under the treaty as a major concession which needs to be balanced by equally substantial concessions by the Brazilians, particularly with regard to the matters referred to in paragraph 5 above, if the terms of the treaty are to be in balance. The Brazilians, on the other hand, see the grant of "across the board" matching credit as a sine qua non for continuing the negotiations. They do not have treaties with countries which are not prepared to grant matching credit on their terms and they are not prepared to offer us anything better than the German package which gives "treaty approval" to the various features of Brazilian domestic law which we consider undesirable.

10. Brazil's "German package" has been accepted by various OECD member countries because they take the view that they cannot afford to stand on principle with so important a developing country as Brazil and the unrivalled opportunities that it offers for investment. Canada is the latest country to succumb. The odd ones out are now the Americans, the Dutch and ourselves. We three countries are the only ones holding out for better terms on OECD Model lines. Our view, which is shared by the Americans and the Dutch, has been that it is of little use trying to "educate" developing countries - at the United Nations Expert Group on tax treaties and elsewhere - about acceptable international fiscal standards if, when it comes to the crunch, we are prepared to sacrifice principle in order to secure an agreement. On the other hand we have more at stake than the Dutch in getting an agreement with Brazil and it could perhaps be said that the Americans can afford, more than we, to moralise. The plain fact is that if we do not accept the German package - and nothing much better will be on offer - it is British investors who will be the sufferers, not the Brazilians who can turn to other countries for the investment they need.

11. There is however the important practical consideration - touched on in paragraph 8 above - that the United Kingdom has more treaties with developing countries than any other developed country and in the last few months we have been successful, though with difficulty, in negotiating "normal" treaties with some developing countries which even only a year or two ago were not interested in a treaty with us on "normal" terms. If we were to agree to special terms for Brazil it is very likely that we would come under pressure from these countries to do for them what we have shown ourselves ready to do for Brazil and the pressure would be difficult to resist.

Cost

12. The cost of a treaty on the lines of the Brazil/Germany treaty would be of the order of £m4 a year, which would increase if the flow of remittances to the U.K. from Brazil were to increase.

Line to take

13. The arguments involved in deciding whether to agree to the Brazilian terms or to break off negotiations for the foreseeable future are starkly opposed and it is not easy - perhaps not possible - to establish where the balance of advantage to the U.K. lies. If negotiations are broken off we cannot expect a resumption for some years, and British investment in South America will continue to operate at a lower return after tax than foreign competitors: the share of British investment in Brazil will presumably go on falling and arguably, British exports will follow suit. On the other hand, if we line ourselves up with Germany, France and the other countries who have accepted the Brazilian terms we run the risk of upsetting the balance of our treaties with other important developing countries - for example, Indonesia, Malaysia and Korea - who accepted our terms with reluctance and would probably ask us to revise our treaties with them and to give "across the board" matching credit to them also for tax "spared" under a treaty without any off-setting concessions from their side. Our general negotiating stance would be weakened, because it will be clear that if we, want an agreement enough, we will agree to almost any terms.

14. If Ministers think that we should in substance accept Brazil's terms, we would of course strive at the May talks to get some improvement in the terms so far offered. We shall also try to get a most favoured nation clause so that if, in the future, Brazil offered better terms to any other country they would be offered to us also. (The only country likely to be able to extract better terms from the Brazilians is the United States of America - because of the supreme importance of American investment to Brazil). There may also be some scope - as a matter of drafting - for making the "German package" more acceptable presentationally: for

example it would be better, cosmetically, for there to be no capital gains article in the treaty (thus allowing the Brazilians to apply their domestic law) rather than incorporate into the treaty a capital gains article which offended OECD model principles. In addition, we would not offer a dividends article which provided for the payment of tax credits to Brazilian investors, though this would be only window-dressing as there is virtually no Brazilian investment in the United Kingdom and the Brazilians want the treaty to stimulate British investment in Brazil, not the other way round.

15. At the end of the day however the choice is likely to be between accepting what is, in substance, the "German package" or giving up the idea of having a comprehensive agreement with Brazil. The Department of Trade have consistently stressed the importance of an agreement with Brazil and the Secretary of State (then Mr Shore) wrote to the Chancellor about it on 12 December 1974 and 22 January 1975. Copies of the letters are attached; Clause 43(1) of the current Finance Bill would provide the legislative authority for matching credit for tax spared under a treaty with Brazil.

16. Conclusion

It is of course clear that in tax terms alone Brazil's "German package" is unacceptable and would be damaging. On the other hand, we would reluctantly accept that if Department of Trade's views about the benefits to UK industry flowing from increasing investment in Brazil were substantiated, the arguments would at least be evenly balanced. However, the assertions about the benefits to the UK - as opposed to individual companies - of investment in Brazil are ^{improven} ~~improving~~ ^{we also}; regard it as significant that individual companies with important or potential interests in Brazil have expressed the view privately that we should not give in. Our recommendation is, therefore, that we should be authorised to tell Brazil that, while we would -

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subject to parliamentary approval of the Finance Bill proposals - be able to meet their matching credit demands, this could only be as part of an agreement providing for significant amelioration of aspects of their tax code that run clearly contrary to OECD principles; and if they are not interested, so be it 170. Before reaching a decision to this effect Treasury Ministers would no doubt wish to mention the matter again to the Secretary of State for Trade: it is at least possible that Mr Dell will not entirely share the views of his predecessor on this matter. A draft letter for this purpose will follow immediately. In view of the urgency of the matter, we will be warning DT officials that the matter may shortly be raised with their Minister in the sense proposed.

A WILKINSON
Private Secretary
Inland Revenue

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cc Chairman
Mr Dalton
Mrs Smallwood
Mr Moorcraft (H)
Mr Boyd (L)
Mr Boyles
Mr Brooman
Mr Bush.

cc Principal Private Secretary
PS/Chief Secretary
PS/Financial Secretary
Sir Douglas Wass
Mr Lord
Mr Couzens
Mr Lovell
Mr Houghton
Mr Turnbull
Lord Kaldor

PRIVATE SECRETARY TO INLAND REVENUE.

TAX TREATY WITH BRAZIL

The Minister of State has seen your minute of 5 May and Mr Lord's of 6 May. He has commented:

"I agree with Revenue's conclusions that we should go no further than to offer matching credit unless the Brazilians are prepared to offer a substantial amelioration of the obstacles listed in paragraph 5 of Revenue's minute.

It seems to me that we could live with the feature mentioned in paragraph 5(c) (capital gains tax) but the other obstacles no doubt considerably restrict the flow of income from Brazil to this country.

I, of course, agree that we should inform the Secretary of State for Trade of the line which we propose to take. We should point out that we are meeting Mr Shore's main demand which was to grant matching credit."

wh

M L WILLIAMS

6 May 1976

TAX TREATY WITH BRAZIL

Brief for the Chancellor

Background

History

1. We have a limited tax treaty with Brazil providing relief against double taxation of shipping and air transport profits. This has been in force since 1968 and followed earlier unsuccessful attempts to reach agreement on terms for a comprehensive tax treaty. Negotiations about a comprehensive treaty were resumed in March 1972 and since then there have been two further rounds of talks - in November 1973 and in October 1974. There is to be a further round of talks commencing on 25 May in Brasilia.

Talks being resumed next month

2. The purpose of the May talks is to finalise - at official level - a draft treaty to be submitted to the respective Governments for approval. But while this is the expressed intention there are doubts about a successful outcome to the talks because of the differences of view that still remain between the two countries on a number of matters of principle.

Differences between the two sides

3. One of the main differences between the two sides is the Brazilian insistence that in return for reductions under the treaty in their rates of withholding tax on dividends, royalties

interest flowing to the United Kingdom we should not only - as is usual in tax treaties - make corresponding reductions in any withholding tax chargeable under United Kingdom tax rules but also give tax credit relief for the Brazilian tax given up ("spared"). In other words the Brazilians want us to give credit to United Kingdom residents investing in Brazil not merely for any Brazilian tax paid but for Brazilian tax given up under the treaty (~~"Matching Credit"~~). We have offered, under existing statutory powers (S.497(3) of the Taxes Act), to meet the Brazilian demand, so far as we could, by giving credit for Brazilian tax "spared" under special incentive provisions in Brazil's domestic law designed to encourage economic development there - for we recognise that unless the Brazilian tax incentives are "matched" by the United Kingdom in this way the effect of those incentives would be frustrated. (The Brazilian tax payable would be reduced by the incentives but the United Kingdom investor would be paying more United Kingdom tax because there would be less Brazilian tax to set off against it.) The Brazilians want us to go further than this and give credit for tax spared by the Brazilians not merely under their domestic incentive legislation ("selective matching credit") but under the terms of the treaty itself ("across the board matching credit" - not restricted to particular reliefs granted to particular

industries). We will have the power to do this if Clause 43(2) in the 1976 Finance Bill becomes law but we would of course be seeking a quid pro quo for the Brazilians in connection with some of the matters referred to in paragraph 4, below.

4. Even if we reach agreement on "matching credit" there would remain the problem that the Brazilians have so far treated as non-negotiable certain provisions in their tax code which other countries with similar provisions are normally prepared to give up or modify under a tax treaty. The most important of these provisions is the prohibition against the deduction in computing taxable profits of royalties paid by a Brazilian subsidiary to its foreign (UK) Parent. Other important stumbling blocks to agreement are the "excess remittances tax" which is levied at progressive rates from 40 to 60 per cent on the amount by which profits distributed to non-residents exceeds 12 per cent of capital and the taxation of capital gains - from both immovable and movable property (including shares) - arising in Brazil. There are also differences of views between the two sides on other less important matters.

Other Brazilian tax treaties

5. The best treaty terms were secured by Japan but their treaty was signed in 1968. More recently, Germany and France both had extreme

difficulty in reaching agreement (the German treaty took 7 years to negotiate) and eventually both these countries gave Brazil virtually all she wanted. On the other hand, the USA, the Netherlands and the United Kingdom have so far held firm in resisting the more objectionable of the Brazilian demands but with the result that ~~no~~ ^{not} agreement has been reached.

Prospects

6. We are under pressure from trade and business interests - supported to some extent by the Department of Trade and the FCO - to line ourselves up with the Germans and the French, great stress being laid on the intangible benefits that a treaty with Brazil would bring - for example, the provision of clear and equitable rules for the treatment of income which is subject to double taxation and the protection of United Kingdom investors against discriminatory taxation. The difficulty is that we have over 70 tax treaties, many of them with developing countries, and if for Brazil we abandon the principle of the OECD model agreement - which is really what Brazil is asking us to do - it would be difficult to resist accepting similarly unsatisfactory terms in negotiations with other developing countries. A detailed submission to Ministers about these difficulties will be made within the next few days, before the United Kingdom negotiating team leaves for Brazil.

7. In view of the proximity of the next negotiating round and the present rather delicate state of play the Chancellor may not wish to say much more than that he recognises the importance of an early and successful outcome to the current tax treaty talks to the prospects of increasing trade with, and encouraging British investment in, Brazil - our largest trading partner in Latin America. There can be no disguising the fact that there are differences in principle which have still to be resolved but it is hoped that enough common ground will be found in the May discussions *on which* to build a mutually satisfactory agreement.

PS/MINISTER OF STATE

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cc Chairman
Mr Dalton
Mrs Smallwood
Mr Motzcraft
Mr Boydell
Mr Boydell
cc Principal Private Secretary
PS/Chief Secretary
PS/Financial Secretary
Sir Douglas Wass
Mr Couzens
Mr Lovell
Mr Houghton
Mr Turnbull
Lord Kaldor
PS/Inland Revenue ✓
Mr Broom
Mr Bush

TAX TREATY WITH BRAZIL

May I raise one small point on the final paragraph of the Minister of State's comment which was recorded in your minute of yesterday.

2 I hope that we are going to consult the Secretary of State for Trade about the line to be taken by our negotiators in Brazil and not merely inform him of what we have decided. As the Minister of State observes, we are prepared to meet Mr Shore's earlier request that we should concede matching credit to the Brazilians, but that may be no consolation to the Secretary of State if we lose an agreement by holding out on other points. For my part, I think that the Brazilians are being very greedy; but I also think that we ought to try to bring the Department of Trade round to that view also before we effectively give up the prospect of a treaty which might have an important bearing on our overseas commercial relations. More generally, it is increasingly our practice to consult Departments about the industrial and commercial implications of taxation proposals, even in a budgetary context; this has been widely welcomed and it would not be easy to explain why we had taken a different line on this particular occasion.

ALAN LORD
7 May 1976

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Edmund Dell MP
Secretary of State for Trade
Department of Trade
1 Victoria Street
London SW1

May 1976

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TAX TREATY WITH BRAZIL

There was correspondence some time ago between Denis Healey and Peter Shore concerning the negotiations with Brazil about a double taxation treaty, culminating in Denis' letter of 7 February 1975. We now have to settle our negotiating position, as a matter of some urgency, since an Inland Revenue team will be leaving for Brazil in about 2 weeks to continue the negotiations.

We expect that the Brazilians will refuse to modify under the Agreement certain features of their tax law which are detrimental to United Kingdom interests as well as being contrary to internationally accepted tax principles. If we agree on those terms a significant amount of tax will be lost on this one treaty alone, to be followed by a larger amount as the more powerful of the developing countries ask for similar treatment. The only justification for agreeing would be the overriding importance, in the interest of United Kingdom trade and investment, of having a tax treaty with Brazil.

Since we allow unilateral credit for foreign taxes, the main consequence for a United Kingdom company of having a treaty with Brazil is that 'pioneer relief' would be available to match incentive reliefs provided by Brazil for investment to promote development there. Not all United Kingdom investors in Brazil qualify for these reliefs, but they are generous and therefore important to those who do. On this point the impact of a treaty must differ between one company and another.

We are also seeking in Clause 43(2) of the current Finance Bill to extend our powers to grant 'matching credit'. You will know that in his letter of 25 January 1975 to the Chancellor, Peter Shore noted that the need to grant such reliefs was at the heart of the current negotiating problems.

If Clause 43(2) becomes law we will have the power to grant matching credit for reductions in withholding taxes on dividends made under the treaty, which would be a benefit for companies generally. It will mean that if the Brazilians reduced their withholding tax from the normal 25 per cent to 15 per cent we could give credit for the full 25 per cent and not only for the 15 per cent actually paid. Apart from these financial benefits and the advantage of having sound rules covering matters like the taxation of branch profits, there are intangible benefits from a treaty including protection against fiscal discrimination. Clearly it is desirable for our investors in a foreign country to have these advantages, but in the absence of a treaty there is no question of them suffering the major burden of bearing unrelieved double taxation, because our unilateral relief provides for credit for overseas taxes actually paid. The fact that we allow unilateral relief must therefore reduce the commercial importance of a double taxation agreement in financial terms.

Against the advantages must be set the very real disadvantages of certain features of the Brazilian Law, which as I have remarked, they are unlikely to be willing to modify as part of a treaty package, even though we may be able to meet them on the matching credit point. The most important of these features are:-

- a. the disallowance as a deduction in computing taxable profits of royalties paid by a Brazilian subsidiary company to its foreign (United Kingdom) parent;
- b. the extension of the definition of royalties to include management fees. Withholding taxes are consequently levied on the gross amount of the fees instead of on the net amount of income after allowing a deduction for expenses incurred in earning them;
- c. the taxation of virtually all capital gains arising from the disposal in Brazil of foreign-owned assets (including shares). This is completely at variance with the generally accepted international practice of giving the sole right to tax gains from movable property to the country of residence of the taxpayer unless they are connected with a permanent establishment (ie a branch) in the country where the disposal takes place;

- d. the excess remittance tax which is imposed at progressive rates ranging from 40 per cent to 60 per cent on the amounts by which the profits distributed to non-residents exceed a prescribed amount. This tax is in addition to the normal withholding tax of 25 per cent which, subject to matching credit, may be reduced under an agreement to 15 per cent.

It may well have been assumed by some of those companies which made representations to us about the need to secure a Double Taxation Agreement with Brazil that if there were an agreement it would remove these undesirable features for United Kingdom companies. Until recently we had hoped that if we could offer matching credit for reductions in withholding taxes on dividends, interest and royalties, the Brazilians would be prepared to modify their code under the treaty so as to provide for taxation on a normal and internationally acceptable pattern. In 1968 Japan and Sweden concluded agreements which were not fully orthodox and in 1971 Germany had to accept something much less favourable than Japan, on the lines of what we have so far been offered, and France followed Germany. We were however told a few weeks ago that Brazil has renegotiated its agreement with Japan on the German model, so that it is now virtually certain that we can expect to do no better. America which is the largest investor in Brazil, has spent a lot of time in negotiation and refused to accept the Brazilian terms. The Dutch have also declined, and both these countries take the view that there is little point in trying to persuade developing countries, in the United Nations and elsewhere, to adopt acceptable international fiscal standards if, in practice, we abandon our principles in order to secure an agreement.

In negotiating any treaty, we naturally expect concessions by us to be matched by reciprocal benefits. If the Brazilians offer nothing, the cost of meeting their demands will be significant. It is estimated that full matching credit would cost something like £4 million a year which could increase if the flow of remittances to the United Kingdom from Brazil were to increase. The Brazilian terms are also damaging to the balance of payments on revenue account. The tax on excess remittances must either discourage companies from remitting profits to United Kingdom parents or reduce the net amount remitted if they make substantial distributions and suffer the tax.

Similarly, to accept the Brazilian terms may upset the balance of treaties with other important developing countries, like Indonesia, Malaysia and Korea, which accepted our normal terms with reluctance and could be expected to ask us to revise our treaties with them on the Brazilian model. In that case it would not merely be a question of allowing

matching credit, which could be a useful bargaining counter in securing concessions; we might also have to acquiesce in undesirable tax practices, as with Brazil. The lesson would have been learned that if sufficient pressure were brought to bear on the United Kingdom we would be prepared to conclude agreements which not only gave us less than a fair tax take but left it open to the other country to tax United Kingdom companies on an unfair and unreal basis. Acceptance of the Brazilian package would be resented by the Americans, who have already expressed concern about the effect on their negotiating position of our pioneer relief.

The CBI Taxation Committee which we consulted in confidence, and whose members include representatives of companies which would benefit from pioneer relief for Brazilians investment incentives, formally endorsed the desirability of a treaty with Brazil but a number of influential members were opposed to our concluding a treaty which allowed Brazilian malpractices to continue. One multinational came to see us to express concern about the likely consequences of setting such an undesirable pattern for future agreements with developing countries.

I therefore regard the arguments against including a treaty with Brazil that did not include some significant concessions on their part in relation to the matter outlined in Paragraph 4 above as strong; and I have it in mind that the Inland Revenue negotiators' remit should be in these terms. However, I realise that some may argue that the commercial case for concluding a treaty might be so strong as to outweigh the tax and direct balance of payments consideration (and the views of some major industrial concerns). This is something that you will wish to consider and let me have your views.

I am copying this letter to Tony Crosland and Eric Varley.

DENZIL DAVIES

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I am copying this letter to Tony Crosland and Eric Varley.

DENZIL DAVIES

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OTTAWA, Ontario.
K1A 0G5.

13 May 1976.

Mr. Barry Pollard,
Assistant Secretary,
International Tax Policy Division,
Inland Revenue,
Somerset House,
London WC2R 1LB, U.K.

Dear Barry:

I apologize for the delay in writing to you about the negotiations with Brazil. I must confess that the delay is attributable to a somewhat peculiar cause: I am unable to find the text of the Denmark-Brazil Double Taxation Convention recently initialled by Dr. Gjetting which we had in our possession during our negotiations with Brazil. The only plausible explanation is that the text has been left at the Canadian Embassy in Brazil. I hope that this will not cause too great an inconvenience to you.

On the other hand, I have promised to give you a quick list of the problems that we have encountered with the Brazilians.

1. The main problem, from our point of view, concerns the tax sparing provision. Canada has always granted tax sparing on the basis of a list of specific legislation covered and only in respect of taxes spared below the rate provided for in the treaty. The Brazilians want to have a "blanket provision" which reads as follows:

"For the purposes of applying the provisions of paragraph 2 (foreign tax credit in Canada) in respect of income which may be taxed in Brazil in accordance with Article X, paragraph 2 (other than the dividend to which the provisions of paragraph 3 of this article apply) and 5(b), Article XI, paragraph 2 in Article XII, paragraph 2(b), Brazilian tax shall always be considered as having been paid at a rate of 20% of the gross amount of the income paid in Brazil."

13 May 1976.

I might mention that the rate of withholding tax provided for in Article X, paragraph 2 for dividends is 15% and the rate of special tax on branch profits provided for by Article X, paragraph 5(b) is also 15%. On the other hand, the withholding tax on interest is fixed at 15% while paragraph 2(b) of Article XII provides for a rate of 15% on all royalties other than royalties arising from the use of, or the right to use, trade marks. In the case of royalties, the limitations do not apply to royalties paid to a resident of Canada which holds directly or indirectly at least 50% of the voting power of the company paying such royalties.

2. A rather substantial difficulty has arisen in connection with the non-deductibility in Brazil of royalties paid by a company resident of Brazil to a resident of Canada which holds at least 50% of the voting capital of the company.
3. The definition of royalties has also given rise to an additional problem since the Brazilians have asked that the expression "for information concerning industrial, commercial or scientific experience" be extended to include "income derived from the rendering of technical assistance and technical services."
4. A rather unexpected difficulty has arisen in connection with the drafting of the foreign tax credit provision on the Canadian side. As you know, we have always followed the wording similar to the one adopted by the United Kingdom and which refers to the domestic provisions of our law. The Brazilians have indicated that this is unacceptable to them and that the foreign tax credit provision must be drafted in an entirely neutral way, that is to say, without any reference to domestic legislation.
5. The taxation of capital gains has also given rise to a difficulty since the Brazilians do not want to restrict in any way whatsoever their right to tax capital gains. The text finally agreed to is similar to the one found in other tax treaties concluded by Brazil and it simply provides that each Contracting State can tax capital gains in accordance with its domestic legislation.
6. A difficulty has arisen in light of the Brazilian wish to include a provision reading as follows:

"It is understood that the commissions paid by a resident of Brazil to a bank or a financial institution in connection with services rendered by such bank or financial institution are considered to be interest and subject to the provisions of paragraph 2 of Article XI."

13 May 1976

7. We are also somewhat puzzled by the firm intention of Brazil to include a provision along the following lines in Article X dealing with dividends:

"The tax rate limitations provided for in paragraphs 2 and 5(b) shall not apply to dividends or profits paid or remitted before the expiration of the fourth calendar year following the year in which the Convention entered into force."

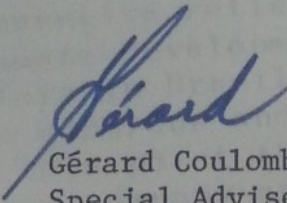
8. An additional problem concerns the treatment of independent personal services. The Brazilians have insisted on a provision reading as follows:

"Income derived by a resident of a Contracting State in respect of professional services or other independent activities of a similar nature shall be taxable only in that State, unless the payment of such activities and services is borne by a permanent establishment situated in the other Contracting State or a company resident therein. In such a case, the income may be taxed in that other State but the tax so charged shall not exceed 25% of the gross amount of the income."

As you can imagine, we are not particularly enamoured of a provision which allows the Brazilians to tax Canadian professionals in respect of work performed in Canada for Brazilian residents.

Most of the problems or issues which I have listed above are still open. We have reached a general understanding on a number of problems but there are still matters of drafting outstanding on each of them. I hope that this information will be somewhat useful in the course of your negotiations with the Brazilians and I would look forward to being kept informed of the result of your visit. Finally, I might mention that I would appreciate it if you would treat the information contained in this letter as confidential.

Warmest personal regards,


Gérard Coulombe,
Special Adviser,
International Taxation.

*S. : Best regards
to Jan G.*

Income Flows to the UK£'000

	1973 Outward Investment		1973 Royalties	
	Dividends	Interest	Net Flow to the UK	(Returns Received)*
Argentina	2369	6	794	
Bangladesh	-	-	..	
Brazil	16,210	80	448	
India	10,010	185	2,657	
Iran	167	38	349	
Pakistan	749	-	805	
Singapore	2747	158	174	
Sri Lanka	449	35	32	
Turkey	351	-	817	
Venezuela	587	-	227	

* Not Grouped up for non-respondents.

.. = Confidential

Oil companies are not included.

NOTES ON DRAFT DTA UNITED KINGDOM/BRAZIL

Prologue

Agreed

Article 1 - Personal Scope

Agreed

Article 2 - Taxes Covered

Brazil want to exclude from the DTA

- a. Excess Remittance Tax
- b. Tax on Activities of minor importance

Article 3 - General Definitions

Agreed

Article 4 - Fiscal Domicile

Tentatively agreed, see notes of talks and Article 27

Article 5 - Permanent Establishment

Agreed

Article 6 - Income from immovable property

Agreed

Article 7 - Business Profits

see notes of talks re exchange of letters, tentatively agreed.

Article 8 - Shipping and Air Transport

Agreed

Article 9 - Associated Enterprises

Agreed

Article 10 - Dividends

The Brazilians insist that in return for any reduction under a DTA in the rate of their withholding tax, which would take effect only after 3 years, on dividends, interest and royalties flowing to the United Kingdom we should give credit against United Kingdom tax for all or part of the Brazilian tax given up as well as for the reduced Brazilian tax paid at the following rates.

Dividends - 25%
Interest - 20%
Royalties - 25%

where received by a United Kingdom resident controlling more than 50 per cent of the working capital in the company paying the royalties.

20% in other cases

If the United Kingdom does not give credit for tax given up the Brazilians have suggested that the DTA should limit the withholding tax to the rate currently in force in both countries (25% in Brazil).

Article 11 - Interest

see above

Article 12 - Royalties

see above

Article 13 - Capital Gains

Brazil want the right to tax all capital gains (including those made by a United Kingdom parent company on the disposal of its shares in a Brazilian subsidiary) except those relating to ships and aircraft operating in international traffic.

Article 14 - Independent Personal Services

Brazil do not accept the concept of a fixed base and want to retain the right to tax if the payment is borne by a company or a permanent establishment in Brazil.

Article 15 - Dependent Personal Services

Agreed

Article 16 - Director's Fees

Agreed

Article 17 - Artists and Athlets

Agreed

Article 18 - Pensions and Annuities

Agreed

Article 19 - Government Payments

Reworded by Brazilians. If this wording is not acceptable by United Kingdom, then Brazilians will accept the original. The original is in the agreed portion of the Brazilian draft. The reworded Article is included in the United Kingdom draft.

Article 20 - Teachers and Researchers
Agreed

Article 21 - Students
Agreed

Article 22 - Income not expressly mentioned
Tentatively agreed, see notes of talks

Article 23 - Elimination of Double Taxation
Matching Credit provisions are still in dispute

Article 24 - Non-discrimination
Agreed

Article 25 - Mutual agreement procedure
Agreed

Article 26 - Exchange of information
Agreed

Article 27 - Diplomatic and consular officials
Agreed

Article 28 - Methods of Application
Agreed

Article 29 - Territorial extension
Agreed

Article 30 - Entry in force
Provisionally agreed

Article 31 - Termination
Agreed

Copy

*M. Simmons
Pl. see that
M. Pollard gets there
on arrival
in Brasilia
24/5*

CONSULTOR (E)
R. COLEMAN
MR. SIMMONS

ch.
COMMERCIAL REGISTRY

CONFIDENTIAL

GR 150

DESKBY 241400Z

CYPHER/CAT A

FM F C O 241140Z

CONFIDENTIAL

DESKBY 241400Z

TO IMMEDIATE BRASILIA TELNO 189 OF 24 MAY 1976.

PLEASE PASS FOLLOWING TO POLLARD, INLAND REVENUE FROM
MRS SMALLWOOD.

BEGINS.

THE MINISTER WANTS AN OPPORTUNITY FOR FURTHER CONSULTATIONS
BEFORE ARRIVING AT A FINAL DECISION. YOUR INSTRUCTIONS ARE THEREFORE
TO REFRAIN FROM AGREEING TO THE UNACCEPTABLE FEATURES OF BRAZILIAN
LAW WHICH THEY WISH TO ENSHRINE IN THE TREATY, BUT TO AVOID A
BREAKDOWN IN THE TALKS. IT IS SUGGESTED THAT THIS MAY
BE EASIER GIVEN THE FACT THAT OUR NEW MATCHING CREDIT PROPOSAL
HAS NOT YET BEEN APPROVED BY PARLIAMENT.

YOU MAY IN THE PROCESS GATHER WHETHER THE BRAZILIANS ARE
STILL TOTALLY UNYIELDING ON EVERY ITEM IN THEIR PACKAGE, AND
WHETHER ANYTHING COSMETIC COULD BE DONE TO PRESENT THE TREATY
IN MORE ACCEPTABLE TERMS THAN THOSE WE DISCUSSED LAST WEEK.
BUT THE IMPORTANT OBJECTIVE IS TO KEEP THE TALKS EXPLORATORY AND
KEEP THE DOOR OPEN FOR A FURTHER ROUND.

CROSLAND.

NNNN.

SEBT AT 1210+Z/24 HH
RECD AT 1210Z/24 TJS

00 FCO
GRS 650

CYPHER CAT A

FM BRASILIA 26:2005Z

CONFIDENTIAL

OUT

CONFIDENTIAL

Copy for Inland
Revenue Team

TO IMMEDIATE FCO TELNO 227 OF 26:05:1976.

PLEASE PASS FOLLOWING TO MRS A.H. SMALLWOOD, BOARD OF INLAND REVENUE, SOMERSET HOUSE, FROM POLLARD.

BRAZIL TAX TREATY.

1. DISCUSSIONS CONDUCTED IN A CANDID ATMOSPHERE WITH NO TRACE OF THE "INITIAL OR GET OUT" APPROACH SO EVIDENT WHEN THE TALKS WERE ARRANGED IN NEW YORK IN DECEMBER. DORNELLES WELCOMED THE SUGGESTED APPROACH OF GOING THROUGH EVERY ARTICLE TO ISOLATE POINTS OF DISAGREEMENT AND NOTE EACH SIDE'S RESPECTIVE POSITIONS WITH A VIEW TO FURTHER THOUGHT BEING GIVEN TO POSSIBLE SOLUTIONS BEFORE THE NEXT ROUND. IN THE EVENT, HOWEVER, THE BRAZILIANS MERELY RE-ITERATED THEIR DEMANDS AND SHOWED NO SIGN OF FLEXIBILITY ON ANY OF THE MAJOR MATTERS. INDEED ON SOME MINOR MATTERS THEIR POSITION HAS HARDENED. OUR POSITION REGARDING "ACROSS THE BOARD MATCHING CREDIT" WAS EXPLAINED AND IT WAS AGREED THAT ANOTHER ROUND SHOULD TAKE PLACE IN LONDON IN SEPTEMBER AFTER THE FATE OF CLAUSE 43(2) FINANCE BILL 1976 WAS KNOWN.

2. THE FOLLOWING MAJOR ITEMS ON WHICH THERE IS A DIVERGENCE OF VIEW BETWEEN THE TWO SIDES ARE STATED TO BE NON-NEGOTIABLE BY THE BRAZILIANS FOR "POLITICAL REASONS". DORNELLES FRANKLY ADMITTED THAT THE TREATMENT OF ROYALTIES WAS UNSOUND TAX PRACTICE BUT MADE IT CLEAR THAT HIS HANDS ARE TIED. THIS REFLECTS THE VIEWS OF THE COUNSELLOR (ECONOMIC) HERE THAT IF THERE IS TO BE ANY REAL BREAKTHROUGH ON ROYALTIES IT WILL HAVE TO BE AT MINISTERIAL LEVEL. THE MINISTER OF PLANNING WILL BE VISITING LONDON IN JUNE AND THIS IS SEEN HERE AS PERHAPS PROVIDING AN OPPORTUNITY TO MAKE PROGRESS AT THE POLITICAL LEVEL.

NON-NEGOTIABLE ITEMS.

- (A) EXCESS REMITTANCES TAX TO BE EXCLUDED FROM SCOPE OF THE TREATY.
- (B) MANAGEMENT FEES TO BE TREATED AS ROYALTIES.
- (C) NO DEDUCTION FOR ROYALTIES IN COMPUTING TAXABLE PROFITS.
- (D) INDEPENDENT PERSONAL SERVICES TO BE TAXED IN BRAZIL IF PAID FROM A BRAZILIAN SOURCE EVEN IF SERVICES PERFORMED IN THE U.K.

3. OIL

BRAZIL UNHAPPY ABOUT ACCEPTING A PROVISION WHICH WOULD DENY TAX CREDIT RELIEF UNDER THE TREATY TO U.K. OIL COMPANIES PARTICIPATING WITH PETROBAS. HE WOULD HAVE TO CLEAR THIS WITH MINISTERS.

4. TAX CREDITS.

BRAZIL APPARENTLY NOT CONCERNED ABOUT DENIAL OF TAX CREDITS TO PORTFOLIO INVESTORS BUT WANT TAX CREDIT ON AMERICAN LINES FOR THEIR HALF A DOZEN OR SO DIRECT INVESTORS (EXCLAMATION MARK).

5. MOST FAVOURED NATION TREATMENT.

AS A MATTER OF GOVERNMENT POLICY BRAZIL REFUSES TO INCORPORATE IN THE TREATY AN MFN CLAUSE BUT MIGHT BE WILLING TO SEND A "LETTER OF ASSURANCE" IN RESPECT MFN TREATMENT FOR ROYALTIES.

RELIEF UNDER THE TREATY TO U.K. OIL COMPANIES PARTICIPATING WITH PETROBRAS. HE WOULD HAVE TO CLEAR THIS WITH MINISTERS.

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6. COSMETICS.

BRAZILIANS ARE CONTENT FOR US TO RE-DRAFT IN ANY WAY WHICH WILL IMPROVE THE PACKAGE PRESENTATIONALLY.

7. BACKGROUND INFORMATION.

DORNELLES' NO 2 (NOQUEIRA) AT A DINNER GIVEN FOR US LAST NIGHT BY THE MINISTRY OF FINANCE TOLD ME THAT THEY ARE EXTREMELY ANXIOUS TO GET A TREATY WITH THE U.K. BECAUSE THEIR CHANCES OF GETTING ONE WITH THE U.S.A., SWITZERLAND OR THE NETHERLANDS ARE RANKED AS NIL. SWITZERLAND IS NOW SECOND LARGEST INVESTOR AND WILL NOT EVEN DISCUSS A TREATY ON "GERMAN PACKAGE" LINES. THE U.S.A. HAVE AN ANNUAL MEETING WITH THE BRAZILIANS FOR WINDOW DRESSING PURPOSES ONLY. THE NETHERLANDS MERELY WRITE ONCE A YEAR TO ENQUIRE WHETHER THERE HAS BEEN ANY CHANGE IN BRAZIL'S POLICY. NOQUEIRA ALSO TOLD ME THAT THERE IS LIKELY TO BE A CHANGE WITHIN THE NEXT FEW MONTHS IN TAX TREATMENT OF ROYALTIES UNDER BRAZILIAN DOMESTIC LAW BUT WHEN THIS WAS DISCREETLY RAISED AT THE TALKS DORNELLES SAID THERE WAS NO SUCH POSSIBILITY AT PRESENT.

8. BRITISH CHAMBER OF COMMERCE.

ARRANGEMENTS HAVE BEEN MADE FOR US TO MEET MEMBERS ON FRIDAY IN RIO BUT WE WILL OF COURSE BE ABLE TO DO LITTLE MORE THAN EXPLAIN TO THEM UNILATERAL TAX CREDIT RELIEF AND TO TAKE NOTE OF THEIR REMARKS.

9. FOLLOWING PRESS NOTICE MAY NOW BE ISSUED:

DOUBLE TAXATION: BRAZIL.

DISCUSSIONS AT OFFICIAL LEVEL WERE RESUMED IN BRASILIA DURING THE WEEK BEGINNING 24 MAY ABOUT A COMPREHENSIVE DOUBLE TAXATION CONVENTION BETWEEN THE UNITED KINGDOM AND THE FEDERATIVE REPUBLIC OF BRAZIL. FURTHER DISCUSSIONS WILL TAKE PLACE IN LONDON LATER THIS YEAR.

10. U.K. TEAM WILL BE ARRIVING HEATHROW ON FLIGHT TP 480 AT 13.25 HOURS ON SUNDAY 30 MAY. GRATEFUL IF WIVES COULD BE NOTIFIED.

BEVAN

NNNN

SENT AT 26:2154Z MVP

RECD AT 26:2154Z

PH

Discussions in Brazil 28 May 1976

Meeting in Rio with B H Davies, representative of Davy-Powergas

Present B H Davies

B P Pollard Assistant Secretary

I P Gunn Principal

J A Pinder HEO(A)

Mr Davies was in Brazil for the final negotiations for a contract to build a factory to produce fertilisers. The main suppliers under the contract are a French subsidiary of Davy International but services and supervision of the design work were provided by the UK company. The total amount involved is about £16m.

Davy Powergas had priced its contract so that it would bear the withholding tax, and had only just discovered that the tax paid would not be eligible for unilateral relief in the UK. Mr Pollard explained the position regarding unilateral relief on gross fees. Davies said his company had heard the bad news from Somerset House, and were planning to fight the decision. In addition they would consider transferring the base of the whole operation to France, to take advantage of the France/Brazil DTA. There was the alternative that the services could be supplied from associated Davy companies in West Germany or USA.

Mr Pollard asked that the company quickly wrote to him, setting out full details of the case. He would consider if it were possible to give relief from the tax on the profit element (which Davies said was likely to be between 5 per cent and 10 per cent).

Discussions in Brazil (Rio) 28 May 1976

Present Mr Hookway, of Rendall, Palmer and Tritton, Consulting
 Engineers
 B Pollard, Assistant Secretary
 I P Gunn, Principal
 J A Pinder, HEO(A)

Hookway's meeting with us had been arranged by Mr Munro, British Consulate General in Rio, and Hookway understood that we had asked to see him, which was not the case.

Rendall, Palmer and Tritton conduct their operations in Brazil through a Brazilian company which is 51 per cent Brazilian owned, 49 per cent British. The company has to pay 25 per cent withholding tax on gross fees paid to the UK, which had seriously damaged its competitiveness with, say, the Japanese. This situation was different from a few years ago, when UK salaries had been lower, and we could undercut the Japanese. We were still competitive with the USA and Canada. The firm are not in competition with the Germans on their work, which is port and harbour development. They were trying to expand into oil platforms, and hydro-electric schemes, sometimes in partnership with an American company, Cleveland Bridge.

The main difficulty is the withholding tax, which affects profitability. There were no other tax-related problems as far as he knew. The company faces difficulty in other fields, caused mainly by the extreme nationalist feeling in Brazil, which limited imports. Most heavy equipment is manufactured in Brazil, with imports confined to "the clever stuff".

NOTE OF DINNER GIVEN BY THE BRITISH CONSULATE GENERAL, AND THE
BRITISH CHAMBER OF COMMERCE, RIO DE JANEIRO
FRIDAY 28 May 1976

Present

B Pollard Assistant Secretary
I P Gunn Principal
J A Pinder HEO(A)
A Munro Consul-General
I Murray Acting Consul (commercial)
F C Tate Cia Expresso Mercantil
S A Fitzpatrick Cia International de Seguros
L C Derrick-Jehu London Assurance Co
G Kennedy N M Rothschild
A Machodr Souza Cruz
N E Burke Wilkinson Fiat Luz
J W Schofield " "

Mr Pollard gave the background to our DTA's, and pointing^{ed} to the world wide network we had - 75 in all, including 10 initialled in the last year. We were not blinkered tax men, and were conscious of our responsibility to industry. There were major difficulties in the case of Brazil, of which the question of tax given up under a treaty was one. It would not have escaped their notice that a clause is now in the Finance Bill which, if passed, would give us powers to give this. Munro said that under a DTA Brazilian^a withholding tax rates would be 15 per cent. Those people with new investments in Brazil tended to be more badly affected at the moment than the older established companies. The discussion became general and specific points raised were:

1. Unilateral Relief. Kennedy of Rothschilds said that there was great ignorance about unilateral relief, and companies needed to be educated. The most important problem is that there is no set-off against ACT, and many companies do not therefore get full credit.

2. Withholding tax. The Insurance representatives complained that withholding taxes are charged on balance sheet figures, whether remitted or not.

3. Tax Incentive Schemes. Brazil operates various types of tax incentive schemes, some consisting of funds into which companies paid money, which was used for specific projects. Sometimes assets accrued to the companies in this way. If money was not paid into these funds, it had to be paid over to the Revenue authorities. A complaint was that unilateral relief was not given for these payments, although to all intents and purposes they are tax. A suggestion was made that UK tax be deferred when money paid into incentive scheme funds until the company concerned regained control of it.

4. Capital Gains. Machodr of Souza Cruz, in a general discussion on CGT, said that when a UK parent sold its shares in a Brazilian subsidiary, tax was chargeable in Brazil. However, if the profit was reinvested, there was no tax.

5. Independent Personal Services. Our impression was that if money was paid from a Brazilian source to an independent consultant in the UK, withholding tax was charged. Machodr said that this is what Decree Law 401 Article 11 of 1969 said, but in fact there had since been several legal decisions which reversed this. He pointed out, however, that in Brazil judicial decisions have no binding precedent value, although they are normally followed in practice. He promised to send details to Munro. The effect is that no w.t is charged except where the services are performed in Brazil, where the tax is charged on the proportion of the fee relating to part of the job performed in Brazil.

6. Interest on Bank Loans. Richards said that the lower rate of w.t charged to German and French banks was not significant, as so many loans were routed via London. In any case, there is not much of a competitive situation here. A DTA would make interest rates more attractive, but there was no real problem.

The general feel of the meeting was that the few Chamber of Commerce people who turned up were not particularly indignant about the tax situation. There are problems particularly with Royalties and fees for

Technical Services, but the only really vociferous demand for an agreement came from Munro, who asked leading questions continually, and usually unsuccessfully. Many of the problems which were raised concerned Brazilian domestic matters, which would not be affected by a DTA, eg the Brazilian rules on inflation accounting.

The atmosphere was very cordial, and there was no trace at all of recriminations, just a general desire to help.

Some of those at the meeting appeared to think that a DTA would be in the terms of our usual DTA's, as illustrated by the attached report prepared by the Sao Paulo Chamber of Commerce, and possibly many of the demands for a DTA stem from this.

1976
TUESDAY 25 MAY AND WEDNESDAY 26 MAY / NEGOTIATIONS AT MINISTERIO DE
FAZENDA BRASILIA

Present:

UNITED KINGDOM

Mr B Pollard Asst Secretary
Mr I P Gunn Principal
Mr J A Pinder HEO(A)

BRAZIL

Sr F O N Dorrelles Pres, Int,
Tax Studies Commission
Sr J D Diniz, Vice Pres, Int,
Tax Studies Commission
Sr D B Nogueira, Vice Pres, Int,
Tax Studies Commission
Sr Pieta, Tax Studies
Commission
Sr Franca dos Arjos
Tax Studies Commission
Sr M Vieira
(Foreign Ministry)

The Brazilians said that foreign investment in Brazil totalled \$7500m and the United Kingdom share was \$500m. A DTA between our two countries was therefore very important, and Brazil hoped to be able to reach agreement with us shortly. Since the last meeting in 1974, Brazil had signed 10 DTA's.

Brazil has three main objectives in her DTA's.

1. To enable the Brazilian Government to create tax incentives for foreign investment, and to stop them being cancelled by foreign tax demands.
2. To increase the flow of foreign investment to Brazil.
3. To assure foreign investors that they would not be taxed onerously.

All Brazil's DTA's were made with these terms in view.

In reply, the United Kingdom said that the gap between the two countries points of view was very wide, and the length of time since the last talks was indicative of this. Since October 1974 the United Kingdom had initialled about 15 agreements, mainly with developing countries.

To get an agreement with Brazil it was clearly necessary for the United Kingdom Revenue to have power to give "across the board" matching credit for tax given up under the treaty itself, whereas at present we can only give 'matching credit' for tax spared under Brazilian law for development purposes. The 1976 Finance Bill now before Parliament contains a Clause, which if approved, would enable

us to give matching credit on our 'across the board' basis, but if the clause becomes law, the view will be taken that this is a major concession^{any} prospective treaty partner and Parliament would examine the terms of the proposed treaty to see whether suitable concessions had been made by the other country.

The present round of talks provided an opportunity to establish how we stand on other outstanding points, so that if extended matching credit powers are given to us we can come to an early decision on whether or not we could have a treaty.

The United Kingdom felt that at these talks we should concentrate on the differences between the two sides and suggests that this should be done Article by Article. The United Kingdom also pointed out that there might be presentational advantages in re drafting some provisions without affecting their substance. For example, the United Kingdom does not usually incorporate a Protocol in a treaty itself and a Miscellaneous Rules article on similar lines might be preferable.

After these talks, there should be another, final, round at which it could be decided whether an agreement could be initialled or whether the differences were unlikely to be resolved in the near future. On the United Kingdom side of the table, there would be no prevarication. At this stage in the negotiations, we should be quite clear where each side stood.

- Article 1 Personal Scope
Article 2 Taxes Covered

Agreed

1. The United Kingdom said that if Brazil insisted on excluding the excess remittance tax, and the tax on activities of minor importance, this would not by itself prevent us initialling. Brazil confirmed that these taxes could not be included in the treaty.

2. Brazil would like a paper to show why PRT was not to be included in the DTA. It was explained that PRT only applied to North Sea Oil, and was unlikely to be relevant in the context of a treaty with Brazil. Brazil accepted this, but again requested a paper to satisfy Ministers.

3. It was agreed to delete "(including surtax)".

This was agreed subject to Foreign Office approval (where necessary) on both sides.

Agreed.

Paragraph (4) to be deleted. Otherwise agreed.

Agreed

It was agreed to delete, " , whether in the State or elsewhere" which Brazil thought would call attention to the position, but to have an exchange of letters specifying what expenses were deductible to formalise the situation.

Agreed.

Agreed.

1. The United Kingdom explained that the imputation system would be retained, which meant that much of the United Kingdom draft was unnecessary. The United Kingdom could now accept the Brazilian form of draft.

2. The United Kingdom explained the imputation system to the Brazilians and suggested that Brazil might not be interested in the tax credit, as it would encourage investment by Brazilians in the United Kingdom. Brazil agreed.

*No. The exclusion of
PRT was directly*

*related to the exclusion
of oil corp. from Art.*

23.

- Article 3 General
Definitions

- Article 4 Fiscal Domicile

- Article 5 Permanent
Establishment

- Article 6 Income from
Immovable Property

- Article 7 Business Profits

- Article 8 Shipping and Air
Transport

- Article 9 Associated
Enterprises

- Article 10 Dividends

3. The Brazilians want a withholding rate of 15 per cent with a matching credit of 25 per cent. They refused to give "most favoured nation" treatment to the UK to have an exchange of letters promising mfn treatment because, as a matter of policy, the new Government which took office in 1974, will not allow this. They insisted that it was not Brazil's intention to give better terms to any other country, but refused to exclude the possibility.

4. Paragraph (2). The United Kingdom queried the necessity for the last sentence, but as it was OECD Brazil insisted it be kept in.

5. Paragraph (6). It was agreed to delete "foreseen" and substitute "mentioned" in the first line.

6. On the second day of the talks, Brazil mentioned the income flows between the United Kingdom and Brazil. These were:

Interest: Brazil to United Kingdom \$302m United Kingdom to Brazil \$1m.
Technical Assistance Payments: Brazil to United Kingdom \$100m United Kingdom to Brazil \$1m. As Brazil lost so much under the treaty by giving up tax, she wanted some compensation. There are one or two Brazilian enterprises with United Kingdom subsidiaries eg Bank of Brazil, and Eurobras. As we had given the tax credit to direct investors in the United Kingdom/United States of America agreement, Brazil wanted similar treatment for these enterprises. The United Kingdom said this request came completely out of the blue, and would be noted, but our initial reaction was that at a minimum we would want a 5 per cent withholding rate as in our US Treaty, which also provided reciprocal exemption for interest and royalties.

Article 11 Interest

1. Brazil proposed a 15 per cent withholding rate, with tax sparing at 20 per cent. United Kingdom agreed, subject to legislative changes.

2. On looking at the proposed draft prepared by Brazil, the United Kingdom asked whether Brazil was now withdrawing the offer of a differential rate of 10 per cent for long term loans. Brazil said that this was not being given now, but after the United Kingdom pointed out the importance of a lower rate as far as banks were concerned, Brazil tentatively agreed to keep the original Brazilian draft with its differential rate of 10 per cent but it would be necessary to consult Ministers on this.

3. Paragraph (8). The United Kingdom explained that this was an anti-avoidance provision, and suggested rewording to make it wider. It was agreed to delete in line 3 "having regard to the debt-claim for which it is paid" and insert in line 4 after "exceeds", "for whatever reason".

4. The UK suggested the inclusion of a limitation to the definition of interest, to exclude interest treated as a distribution. It was agreed to include a provision to this effect in a Miscellaneous Rules Article.

Article 12 Royalties

1. The UK pointed out that the withholding tax rate in the new Japan/Brazil Protocol was 12½ per cent, but Brazil replied that this was a concession. The original Japan/Brazil DTA, signed in 1972, had a rate of 10 per cent. Brazil wanted to terminate the agreement, but Japan wanted a Protocol. The 12½ per cent rate was not a reduction from 15 per cent but an increase from 10 per cent. This was the only exception - no other country had lower than 15 per cent. A political decision had been taken that no rate lower than 15 per cent was to be given.

2. Brazil said that two versions of the Royalties Article were available, one with a withholding rate of 25 per cent and the other with a split rate of 25 per cent and 15 per cent with matching credit. We preferred the latter.

3. The Brazilians said that since the change of government on 15 March 1974, it had been policy that payments for technical assistance should be treated as dividends, as well as royalties. For this reason a paragraph deferring the reduction of tax for 3 years was included, to ensure consistency with the Dividend Article where there was also a deferral.

4. Paragraph (6). It was agreed to redraft to widen the scope of this provision. In line 3, delete "having regard to the use, right or information for which they are paid", and insert after "exceeds" , "for whatever reason".

5. Paragraph (7). Agreed to delete "foreseen", replace by "mentioned".

Article 13 Capital Gains

The United Kingdom said that for presentational reasons, as we were agreeing to Brazil's demands, we would prefer to delete the Article altogether. Brazil preferred to keep it, for clarity, and readily agreed to a suggestion that the USA/UK style Article be adopted.

Article 14 Independent Personal Services

The Brazilians explained their source principle. A United Kingdom individual working independently in Brazil will not be taxed there if his remuneration comes from outside Brazil: the source is in the country where the income is paid. But if a Brazilian company pays him, Brazil will tax even if the activity is exercised outside Brazil. The Brazilians said that there was no possibility of a compromise on this Article which would have to follow their draft. They refused to have a cash limit ensuring that only substantial sums would be taxed.

Article 15 Dependent Personal Services

Agreed.

Article 16 Directors Fees

Agreed.

Article 17 Artistes and Athletes

It was agreed to adopt the UK/Egypt draft, with "enterprise" deleted, and replaced by "non-profit making organisation".

Article 18 Pensions and Annuities

1. Paragraph (1). It was agreed to have a limit of £3000.

Article 19 Governmental Payments

2. Paragraph (1). In line (1), it was agreed to delete "paragraphs (1) and (2) of".

Brazil's revised draft Article was agreed, with the deletion in (2) a, line 1 of the words "or out of funds created by" to meet our problem with Northern Ireland. Brazil needs paragraph (4) to catch pensions paid under her social security schemes, and we agreed to keep this.

Article 20 Teachers and Researchers

1. It was agreed to delete "and Researchers" from the title.

2. It was agreed to adopt paragraph (1) of the UK/USA agreement, and have nothing else.

Article 21 Students

Agreed, with cash limit raised to £750.

Article 22 Income not Expressly Mentioned

The UK suggested (a) the country of residence should have the sole taxing rights, or (b) omitting the Article completely. Brazil could accept neither alternative, and it was agreed by the UK, with reluctance, that we would accept the Brazilian draft.

Article 23 Elimination of Double Taxation

1. Pollard said that there was a difficulty here because we did not know what the provision giving us power to give matching credit would eventually say. We must, therefore, leave parts of this Article until later.

2. Dorrelles wanted matching credit also to be given to the UK branch of the Bank of Brazil which lends money to a company in Brazil and receives interest. Without this it would be in a worse position than a UK bank. Pollard pointed out that S 502 prohibits the giving of relief to non-residents, and so even unilateral relief was not due. (This discussion came before the request for the Tax Credit for direct investors which appeared to replace this demand.)

3. The Brazilians handed over a redraft of Article 23. In paragraph (2) they could not agree to a provision which said "subject to the provisions of UK law" because it was against the wishes of Congress. Dorrelles was willing to examine the wording but could not accept a reference to UK law.

4. Paragraph (3)(a). The United Kingdom asked if the Brazilians would give "underlying relief" and explained the concept. Brazil said that they would give exemption to Brazilian direct investors in the UK, and would write in a 10 per cent test.

5. Paragraph (4) of the revised Brazilian draft was agreed.

6. Paragraph (5). Dorrelles apologised for the bad drafting of this paragraph. It was intended to catch the case where bonus shares were issued when profits were incorporated into capital. The UK accepted this in principle.

7. The UK wished to incorporate a provision excluding oil companies from the Article, so that they would have to rely on Unilateral Relief provisions. The Brazilians said they would have to think about this, but wished the UK to remember that Brazil was not yet an oil producer and this sort of provision was not really necessary. The UK emphasised that this was policy. Brazil said that there were to be changes in Brazilian law relating to oil companies, as they were starting to have participation agreements. Brazil wished to attract foreign capital to produce oil.

Article 24	Non-discrimination	Agreed.
Article 25	Mutual Agreement Procedures	Agreed.
Article 26	Exchange of Information	Agreed.
Article 27	Diplomatic and Consular Officials	Agreed to add paragraph (2) from UK/ Egypt draft.
Article 28	Methods of Application	Agreed to delete.
Article 29	Territorial Extension	Agreed to delete.
Article 30	Entry into Force	Agreed. Because of constitutional difficulties, Brazil did not want dates mentioned. The agreement could not be retrospective.

Article 31 Termination

Protocol

It was agreed to extend the minimum lifetime of The Treaty to 4 years, at the UK request, as some reductions did not occur for 3 years.

Pollard suggested that this be deleted, and a Miscellaneous Rules Article brought in, immediately before "Entry into Force". This was agreed.

Miscellaneous Rules

1. Dorrelles handed over a draft.
2. Paragraph (a). The Brazilians want this to ensure that the UK will continue to give, if Brazil reduces its tax rates, credit by reference to the actual income, rather than net income plus tax sparing. Pollard agreed to this.
3. Paragraph (b). Agreed that this should be deleted and replaced by paragraph (2) of the Brazilian draft protocol. The word "company" should be deleted, and replaced by "person" as there are certain bodies in Brazil which are not companies.
4. Paragraph (c) is intended to counter avoidance of tax on interest by the device of paying an artificially high commission or service fee. Agreed.
5. Paragraph (d) includes management fees etc, within the definition of royalties, to eliminate doubts. The UK explained that the difficulty here was the question of expenses. The profit element in Management Fees is very small. In addition, the UK were in difficulty because we could not give relief on a tax on gross receipts. He suggested that a Management Fees Article be included on the lines of that in the Protocol with Kenya, (without mentioning names) which contained a limit on the amount of claimable expenses. Dorrelles said this would make no difference, because expenses still would not be deductible. There was no prospect of this being changed - it was out of the control of the Minister of Finance. All paragraph (d) did was allow the Minister of Finance to reduce the withholding tax on these fees from 25 per cent to 15 per cent. Dorrelles accepted the UK argument and he himself felt the legislation was wrong, but at the moment there was no prospect of it being altered. The official view was that parent and subsidiary are in reality one company, and there should be no payments between them for technical assistance. In addition, there was the difficulty of establishing the true amount that should be paid. Mr Pollard said that we had hoped to devise a Royalties article which put the onus on the company to establish the market value, but there was no point in this if the question of deductibility was non-negotiable.

6. Dorrelles finally agreed, after pressure to attempt to obtain most favoured nation treatment on Royalties, and to send a letter of assurance on this.

7. Paragraph (e). It became clear, after the UK asked for clarification, that an individual or partnership could not set up in business in Brazil without a licence. This would not be granted unless the individual became resident. This paragraph is to clarify the situation eg where a firm of lawyers carries out work, the firm can be taxed under the IPS Article. The United Kingdom asked whether an individual could ever have a permanent establishment in Brazil, and would therefore, in the absence of a permanent establishment, always be taxed on his gross receipts. Dorrelles said that in fact most non-resident individuals operating in Brazil worked through Brazilian companies.

It was agreed to delete "civil company".

Other Matters

1. Dorrelles prefers to visit London in the week after the IFA meeting in September.

2. Dorrelles had no objection to a press notice being issued, but did not want details released.

3. We undertook to send Brazil a new draft before the next meeting, reworded for cosmetic reasons if necessary. This draft will incorporate the matching credit facilities, and will form the basis for the next round of talks.

4. We are to send Dorrelles information concerning PRT.

MRS SMALLWOOD

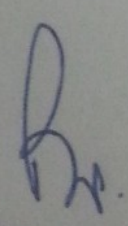
BRAZIL TAX TREATY

1. On the same day (24 May) that we arrived in Brazilia we had a long discussion with the Counsellor (Economics) - Mr Bevan - about the difficulties we had encountered in our negotiations with the Brazilians and he was aware of the contents of your telegram which had arrived shortly before we did. Mr Bevan was standing in for the Ambassador (on leave). nt,
2. Bevan has been in Brazil only a few months but he had obviously given a lot of thought to the tax treaty question and I was very impressed with his grasp of what was involved. It was in fact a pleasure to discuss things with a man who was prepared to look at the issues objectively. After our detailed discussion he said that he was content to leave things entirely in our hands as he could see that we had not lost sight of the non-fiscal arguments in favour of a treaty. He then apologised to us for not giving us earlier notice of an "ordeal" to come. This was to be a dinner - laid on by the Rio Consulate - at which we were going to have to sing for our supper in front of a hostile audience - tax consultants and business people who thought that the Inland Revenue was letting them down because of its failure to conclude a treaty. I told him that, in fact, we welcomed the opportunity of meeting these people and exchanging views. This lack of fuss and "taking it in our stride" approach clearly impressed Bevan who I think had expected us to try to avoid a confrontation of this sort which Bevan himself was obviously not very keen about. ;
3. After our discussion with the Brazilians we had no sooner arrived in Rio than we were whisked to the Consulate to meet Mr Munro the Consul General there. We were thereupon subjected to a harangue by Munro - lasting about three hours - about the vital need for a comprehensive tax treaty with Brazil. He seems to have been working himself up for some weeks in anticipation of our visit and I felt it best to let him get it off his chest. He fancies himself as a tax expert but I am afraid that his diatribe - for that is what his arguments amounted to - and his inadequate appreciation of the fiscal considerations involved served only to contrast his performance very unfavourably with that of Bevan in Brazilia. Munro has, to my mind, become positively paranoiac about the whole question of a tax treaty with Brazil and has got past the stage, if he was ever there, of being able to consider objectively the arguments against accepting the Brazilians' terms. I am quite convinced that Munro sees his role as being to stir things up amongst the British business community so as to make "those Inland Revenue people" see sense. Judging from his performance with us I shudder to think what sort of stuff he is pushing through to London and if there are leakages about the line the UK has been taking in the talks with the Brazilians, I don't think we would need to look much further than Munro to find the source. His naivety is illustrated by his wanting to t e

publish an account of the proceedings at the dinner in a professional journal and I had to tell him quite firmly that I would not attend the dinner if this was to happen. It may be significant that Bevan had not sent him a copy of the telegram which I sent to you about the outcome of the talks.

4. The dinner was given at the Rio de Janeiro Country Club by the British Consulate General and the British Chamber of Commerce though I am sure that the driving force behind the arrangements was the former and not the latter. Twenty five people had been invited but only seven turned up - so this did not give much support to Munro's assertion that there is a burning interest about a tax treaty amongst the business community. Those that did turn up were top people in their companies and they were very impressive. They gave me a very fair hearing and although I could not of course tell them anything about the talks I did what I could to make them understand the sort of obstacles we were facing. I also gave them a full account of our unilateral relief provisions and the matching credit rules and Clause 43(2) of the 1976 Finance Bill. The impression all three of us got from this valuable meeting - about which Andrew Pinder is preparing a detailed note - was that the business community in Brazil were doing very well indeed and a tax treaty would be a bonus rather than a matter of life or death to them. The sort of treaty they are expecting is OECD type and they would not be at all impressed with one which served only to confirm the undesirable features of Brazilian law in return for a reduction in Brazilian withholding taxes from 25 per cent to 15 per cent. They would be even less impressed if they knew that even this benefit was to be deferred for three years and that the guaranteed life of the treaty - as proposed by the Brazilians - was also three years: thus if the Brazilians were to change their policy about encouraging foreign investment they would not be inhibited by the treaty.

5. The dinner did not go quite as Munro had expected. Frankly, I think we made a hit with those half dozen top British business people in Brazil and Munro came away from the meeting rather subdued. I have a feeling that we will be hearing rather less of the "treaty at any price" line within the next few weeks and if we can - as I think we can - work something out for the consultants who cannot get unilateral relief for Brazilian withholding tax on their gross fees my feeling is that the only pressure for a treaty will come from those who stand to gain from matching credit. And, as to them, no hard evidence has been produced that British industry (or Swiss, American, Dutch or Canadian) has suffered in competition with the Germans, the French and the Japanese.


B POLLARD
4 June 1976

CONFIDENTIAL



INLAND REVENUE

Somerset House, London WC2R 1LB

Telephone 01-438 6601

From: Mrs. A.H. Smallwood

M J Treble Esq
Department of Trade
1 Victoria Street
LONDON SW1

11 June 1976

Dear Mr Treble,

BRAZIL: DOUBLE TAXATION

You have seen the telegram of 26 May in which Mr Pollard reported the outcome of the double taxation talks in Brasilia.

I have now seen a note of the discussions and I do not think that it adds substantially to what is contained in the telegram. I have also however had a note of a meeting with representatives of the British Chamber of Commerce in Rio, with whom our team had dinner after the end of the talks in Brasilia. Twenty-five people had been invited but only seven attended, which may suggest that the interest in a tax treaty has its limitations. Those who attended were the senior people from their companies, the companies represented being:

International de Seguros
The London Assurance
N M Rothschild
Souze Cruz
Wilkinson Fiat Lux
Expresso Mercantil

Our team formed the clear impression that the business community was expecting a standard double taxation agreement of the OECD type and would not be at all impressed with one which confirmed the undesirable features of Brazilian law in return for a reduction in Brazilian withholding taxes from 25% to 15%. The normal rules of confidentiality made it impossible to give a report on the talks or any details of the propositions which had been discussed but it was made clear first that there was provision in the current Finance Bill to extend the matching credit rules and that even if matching credit were allowed there were still serious difficulties with Brazil which went beyond the purely technical. They could

not be told that the main benefit of the treaty, the reduction of withholding taxes to 15%, is to be deferred under the Brazilian proposals of three years and that the guaranteed life of the treaty would also be three years. On this basis if the Brazilians were to change their policy about encouraging foreign investment they would not be inhibited by the agreement.

There is a problem about the treatment of consultants' fees about which we may be able to do something within the existing unilateral relief provisions. If that can be done the main benefit of a treaty, apart from an ultimate reduction in withholding taxes, will be to those who would gain from the matching credit for investment incentives.

The dinner was laid on by our Consulate in Rio and the reactions of those present may have come as something of a surprise to our Consul General who displayed a missionary zeal for a double taxation agreement, delivering a two hour sermon on the subject to our team on their arrival in Rio. Doubtless he had been in touch with contacts from whom his point of view is derived, but the evidence of the meeting in Rio would point clearly to the conclusion that their views are not those of the whole British community there.

Yours sincerely

Anne Smallwood

Confederation of British Industry



21 Tothill Street
London SW1H 9LP
Telephone 01-930 6711
Telex 21332
Telegrams
Cobustry London SW1

14 June 1976

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

Dear Mrs Smallwood,

I have pleasure in enclosing a copy of a CBI Paper on double taxation which is being sent to the British Overseas Trade Advisory Council at the request of that body. I understand that the Revenue have also submitted a Paper.

The Working Party on Double Taxation referred to in the Paper is the new group which I mentioned at a CBI/BNC of ICC meeting with yourselves some months ago. The group is intended to look at double taxation in the wide context of trade and investment and is expected to meet for the first time shortly. If I may, I will keep you in touch with progress.

Yours sincerely,

Paul Moran

Paul E Moran
Taxation Department

Director-General:
Campbell Adamson
Secretary:
E M Felgate

copy sent to Mr Treble.
DTJ.

Confederation of British Industry

21 Tothill Street London SW1H 9LP Telephone 01-930 6711 Telex 21332



E.389.76

11 June 1976

TO THE BRITISH OVERSEAS TRADE ADVISORY COUNCIL

SOME CURRENT PROBLEMS IN THE NEGOTIATION OF DOUBLE TAXATION CONVENTIONS :

COMMENTS FROM THE CONFEDERATION OF BRITISH INDUSTRY

1. The CBI regard the question of the negotiation of Double Taxation Conventions with overseas countries as of considerable importance in ensuring the equitable taxation treatment of an overseas investment and of remittances from the overseas investments of British industry. While double taxation is far from being the only consideration which enters into the calculations of a firm when contemplating or maintaining an overseas investment it is frequently a significant one for our members.
2. The CBI Taxation Committee, therefore, keeps in very close touch with developments in the negotiation and operation of Double Taxation Conventions and, from time to time, makes recommendations to Government to promote and protect the taxation position of the overseas investments of British industry. The CBI are particularly grateful to the Board of Inland Revenue for the opportunity for regular exchanges of views on these matters.

The value of Double Taxation Conventions

3. Where no Double Taxation Convention is in existence or where a Convention is silent on a particular aspect of relief, the United Kingdom Revenue give 'unilateral' relief by way of credit for overseas taxes suffered where these taxes are of a similar nature to the United Kingdom taxes which would normally be covered by a Convention. In general, the United Kingdom operates the system of 'unilateral' relief in a generous way.
4. However, the satisfactory negotiation of a Double Taxation Convention can have substantial value. It would, for instance, usually result in a substantial reduction in the rate of withholding tax imposed by the 'source' country*. Three of the basic advantages for British

* The country in which the income arises.

industry arising from a Convention are:

- (i) the adoption of a fair definition of a 'permanent establishment' which not only limits the rights of the 'source' country to tax industrial and commercial profits, but limits the capacity of the 'source' country to tax other kinds of income deemed to be connected therewith.
 - (ii) protection against discrimination by the 'source' country against foreign enterprises.
 - (iii) the establishment of mutual agreement procedures.
5. For 'new' investment a Convention is particularly important where tax reliefs e.g. a 5 year tax 'holiday' are offered by the overseas government as part of a development programme aimed at attracting new investment. Without a Convention, no 'tax-sparing' relief is available in the United Kingdom in respect of the tax which would have been payable if investment reliefs were not available. This aspect is explained more fully below.
6. Although the negotiation of Double Taxation Conventions has proceeded comparatively smoothly for many years a number of developments have, in recent years, led to substantial difficulties. These difficulties have largely arisen as a result of negotiations for Double Taxation Conventions between developed and developing countries. Such negotiations have given rise to a tendency among developing countries to require, for instance, a larger share of the tax revenue arising from foreign investments than would be normal for a developed country to claim.

Developments in the international tax sphere

7. Members of the Advisory Council may be aware of the course of international legal developments since the war with regard to double taxation. In particular, the London and Mexico Conventions and the subsequent OECD Model Convention, the latter governing generally, the basis of double taxation agreements between developed countries. CBI have normally supported the main lines of the OECD Model in making representations on individual tax treaties considering that the Model, in general, ensures fair and equitable treatment both to investors and to the Governments concerned.
8. In a number of respects the OECD Model has, however, not been regarded as satisfactory by developing countries and since 1968, a United Nations Group of Experts has had a series of meetings in Geneva in response to a resolution of the United Nations Economic and Social Council. The aim of these meetings has been to find acceptable ground for both developed and developing countries in the negotiation of Double Tax Conventions.
9. Among the wide range of subjects which have been discussed by the Group of Experts are the rights of a 'source' country to tax dividends, interest and royalties remitted overseas, the deductibility of expenses, the taxation of shipping profits and the credits given by developing countries in respect of tax incentives.

10. In fact the meetings of the Group of Experts have so far been noted more for the diversity of views expressed than for agreement on the major issues and there has been a trend towards regional economic groupings of developing countries devising their own solutions. The most notable are perhaps the Andean Group Conventions. Similar trends have been noticeable in other theatres of international law and countries such as Brazil have emerged as leaders of the developing world in this respect.
11. Thus, an increasing number of developing countries have, in negotiating unilateral Conventions with developed countries, made demands which reflect their own views of the rights of taxation of a 'source' country. The demands of some developing countries cover only a few points while others make demands over a more extensive field. Such demands have caused substantial difficulty in the negotiation of new Double Taxation Conventions with such countries, compliance with the demands frequently being detrimental to the Treasuries of developed countries, to the private investor, or to both.
12. Unless agreement can be reached on a new Model Convention for tax treaties between developed and developing countries which will be acceptable to all parties, the trend towards regional and unilateral requests for special treatment on certain points is likely to increase.
13. In general, Her Majesty's Government have resisted the claims of developing countries in the taxation field but the problems for the United Kingdom have been accentuated by the fact that no concerted front of resistance seems to have been put up by many of our major commercial rivals. This is reflected in the negotiation of Double Taxation Conventions with Brazil, a country with which the United Kingdom is currently in negotiation. Conventions with Brazil have already been concluded by the following fully developed countries, (but not, it will be noted, by the United States of America*); Belgium (1972), Denmark (1974), Finland (1972), France (1974), Japan (1967), Norway (1967), Sweden (1965 and 1975) and the Federal Republic of Germany (1976)**. The terms of these Conventions reflect a number of special features to fit in with the Brazilian tax system and acceptance of these features by the developed countries concerned may have been conditioned by the investment potential in Brazil. Apart from the case of Brazil, there has to date, been comparatively little evidence, how-

* The United States legislature has resisted 'tax-sparing relief' (apart from anything else) as a matter of policy. There have been recent signs, however, that this attitude may be undergoing a change.

** It is, in any case, rather easier for some of the developing countries requirements to be accommodated under an 'exemption' system as operated by e.g. France than under a 'credit' system as operated by the United Kingdom. Basically an 'exemption' system exempts income from overseas from liability to tax in the recipient country while a 'credit' system allows tax suffered overseas to be credited against the final tax liability of the recipient. The relative merits of the two systems are controversial; both have advantages and disadvantages. Both 'exemption' and 'credit' countries are represented in the list of countries which have concluded a Convention with Brazil.

ever, of any general move towards the acceptance of developing countries requirements.

14. In cases where other countries have concluded a Convention and the United Kingdom has not done so, investors from this country may be at a competitive disadvantage vis-a-vis many of our main competitors and investment from this country may be reduced. Nevertheless, there may still be reasons for resistance.

The views of British industry

15. No concerted industrial view of the desirability or otherwise of negotiating Double Tax Conventions on the terms asked for by developing countries can at present be given. In every case the CBI would prefer a Convention on the general lines of the OECD Model. There is, however, some current diversity of view on the line to follow where a Convention on OECD lines is not possible.
16. While it is probably true to say that, where a developing country is undergoing a rapid industrial development and conditions for profitable investment are particularly good, many firms might consider some concessions permissible (especially in circumstances where commercial rivals have already negotiated Conventions and prospective United Kingdom investors ^{insisted} may be at a disadvantage), the risk of these concessions once made being ^{insisted} upon by other developing countries, including perhaps those who have already negotiated satisfactory Conventions with the United Kingdom, must be taken into account. In such circumstances it is possible that established United Kingdom overseas investment might be prejudiced over a wide field.
17. This represents a particularly difficult problem for the United Kingdom which has a large amount of 'old' established investment e.g. in former Colonial territories, the position of which must be protected. Not all of our main commercial rivals have to bear such considerations in mind to the same extent. Nevertheless, it is arguable that, once developed countries other than the United Kingdom have made concessions to a developing country, the risk of such concessions being demanded by other developing countries already exists and it might be thought unlikely that the United Kingdom would be immune from such demands simply because she has stood out against them elsewhere.
18. While it is clear that not all developing countries make the same demands and that a number of important developing countries are prepared to negotiate mutually beneficial Conventions with developed countries without adopting an extreme position (Indonesia is an example of a major developing country which has recently concluded such a Convention with the United Kingdom), there are a substantial number of developing countries who are unlikely to take a moderate line, particularly in South America, and the result may be no Convention at all with these countries.
19. On a number of aspects, the interests of the United Kingdom Revenue and of investors are generally in line. With regard to some aspects, however, reluctance to agree to developing countries terms may be conditioned largely by the national budgetary loss which would be

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involved. So far as these aspects are concerned, there would seem to be a case for the United Kingdom Revenue to be prepared to make concessions which are advantageous to investors and which are unlikely to be very significant in total budgetary terms.

20. CBI have called for a number of alleviations of the position in respect of taxation for firms with overseas income. Those included in our 1976 Budget Representations are noted in the Annex to this paper. The question of foreign tax relief to promote development where no Double Taxation Convention is in operation is particularly relevant in the present context and this is explained in more detail in the following Section.

TAX-SPARING

21. 'Tax-Sparing' relief for new investment can be among the important advantages which can be gained by British investors from the successful negotiation of Double Taxation Conventions with developing countries. This form of relief is given by the United Kingdom Revenue in respect of tax 'spared' by a developing country as a result of a programme* to encourage new investment in the country concerned e.g. a tax 'holiday' for the first five years of operation. Such incentives in the developing country are generally referred to as pioneer relief. Where 'tax-sparing' relief provisions are covered by a Convention a credit is available in the United Kingdom in respect of the tax which would have been due but for the relief under the developmental programme. A common example is that in which a United Kingdom parent company receives a dividend from its overseas subsidiary enjoying such a tax 'holiday'. Relief for the foreign tax foregone is given against the United Kingdom tax on the dividend, but only where specified in a Double Taxation Convention. There are no provisions for 'tax-sparing' relief to be given where no Convention is in existence. In such circumstances a United Kingdom firm investing in a developing country would be liable to United Kingdom tax in full with no credit available. The effectiveness of developmental relief would, therefore, be largely negated.
22. While there is some dispute as to the general efficacy of pioneer relief provisions as a means of promoting development in the overseas country (e.g. it has been argued that such incentives as 100% first year depreciation may be superior in that they assist both 'new' and 'old' investment, domestic and from overseas sources), pioneer relief incentives are frequently attractive for United Kingdom firms contemplating new investments. CBI have pressed on a number of occasions

* Section 497 of the Taxes Act, 1970 covers exemptions under foreign law granted with a view to promoting industrial, commercial, scientific, educational or other development in a territory outside the United Kingdom when specific provisions have been made in a Convention. Clause 43(2) of the Finance Bill 1976 extends relief to other circumstances where expressly provided for in a Convention. The extension is welcome but still requires a Convention to be in existence before such relief can be allowed.

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for the present United Kingdom provisions for 'tax-sparing' relief to be relaxed and have called in our Budget Representations and on other occasions, for 'unilateral' relief to be given by the United Kingdom even when no Convention is in operation. Such 'unilateral' relief would be particularly important in promoting 'new' United Kingdom investment in expanding developing countries where it has not been possible to negotiate a satisfactory Convention.

CBI Working Party on Double Taxation

23. As will be apparent from the above comments, a simple answer to these problems is unlikely to be found. Largely as a result of the difficulties the CBI Overseas Committee and Taxation Committee have set up a joint Working Party with the purpose of identifying the main problems of double taxation in the context of international trade and investment and to make appropriate recommendations to the Committees.
24. It is expected that the Working Party, which will shortly commence its activities, will also look at a number of other points relating to double taxation including the question of gaps in the geographical coverage of United Kingdom Double Taxation Conventions and it is hoped that the results of its deliberations will be helpful to Her Majesty's Government in clarifying the views of British industry on a complex and important subject.

ever, of any general move towards the acceptance of developing countries requirements.

14. In cases where other countries have concluded a Convention and the United Kingdom has not done so, investors from this country may be at a competitive disadvantage vis-a-vis many of our main competitors and investment from this country may be reduced. Nevertheless, there may still be reasons for resistance.

The views of British industry

15. No concerted industrial view of the desirability or otherwise of negotiating Double Tax Conventions on the terms asked for by developing countries can at present be given. In every case the CBI would prefer a Convention on the general lines of the OECD Model. There is, however, some current diversity of view on the line to follow where a Convention on OECD lines is not possible.
16. While it is probably true to say that, where a developing country is undergoing a rapid industrial development and conditions for profitable investment are particularly good, many firms might consider some concessions permissible (especially in circumstances where commercial rivals have already negotiated Conventions and prospective United Kingdom investors may be at a disadvantage), the risk of these concessions once made being ^{insisted} upon by other developing countries, including perhaps those who have already negotiated satisfactory Conventions with the United Kingdom, must be taken into account. In such circumstances it is possible that established United Kingdom overseas investment might be prejudiced over a wide field.
17. This represents a particularly difficult problem for the United Kingdom which has a large amount of 'old' established investment e.g. in former Colonial territories, the position of which must be protected. Not all of our main commercial rivals have to bear such considerations in mind to the same extent. Nevertheless, it is arguable that, once developed countries other than the United Kingdom have made concessions to a developing country, the risk of such concessions being demanded by other developing countries already exists and it might be thought unlikely that the United Kingdom would be immune from such demands simply because she has stood out against them elsewhere.
18. While it is clear that not all developing countries make the same demands and that a number of important developing countries are prepared to negotiate mutually beneficial Conventions with developed countries without adopting an extreme position (Indonesia is an example of a major developing country which has recently concluded such a Convention with the United Kingdom), there are a substantial number of developing countries who are unlikely to take a moderate line, particularly in South America, and the result may be no Convention at all with these countries.
19. On a number of aspects, the interests of the United Kingdom Revenue and of investors are generally in line. With regard to some aspects, however, reluctance to agree to developing countries terms may be conditioned largely by the national budgetary loss which would be

Mr Pollard
B. Green
Binder

SECRETARY OF STATE FOR TRADE OFFICE MINUTE NO: 736

NOTE OF A MEETING HELD IN ROOM 802 ON MONDAY 24 MAY 1976 AT 9.15 AM.

Those present:

Secretary of State	Minister of State - Treasury
Miss Mueller - IC	Mr Lord
Mr Treble - CRE2	Miss Smallwood
Mr Hewes - IC	Mr Dolton

The meeting had been called to discuss the line to be adopted during the negotiations with Brazil about a double taxation agreement as expressed in Mr Davies's letter of 11 May to the Secretary of State.

The Secretary of State said that as he understood the situation, the UK would be placed in an uncompetitive position in the Brazilian market if it did not conclude a double taxation agreement. Other countries had concluded agreements with the exception of Holland and the US. The Secretary of State asked why in view of the fact that other countries had conceded an agreement with Brazil, why the UK should not do likewise. There was the possibility of damaging the UK's exports in what was a rapidly expanding market. Mr Dolton commented that there was a world wide network of DTAs and to concede bad terms in this instance would be to give sanctity to a number of undesirable taxation measures. The UK had made a stand and succeeded as regards other agreements, for example India. It was short sighted to consider only the large trade prospects and not to bear in mind the considerable repercussions of concluding an agreement on such terms. Mr Davies suggested that there was a need to quantify the precise benefit to the UK economy. The Secretary of State asked what would the position be if we failed to conclude an agreement on the terms suggested. It was pointed out that this would probably mean that negotiations will be broken off for a considerable period of time and represent a crisis in the UK's trading relationship with Brazil. It was felt it would not simply be a deferment. Mr Davies said that he was concerned about the tax restrictions in the agreement, in particular management expenses, royalties and remittances. All these were similar in some respects to exchange control regulations. The Secretary of State agreed that certain aspects of the agreement would be damaging but that the UK would be at a major disadvantage with its competitors in the market who were willing to negotiate agreements. It was pointed out that the tax measures which were not considered acceptable, were enshrined in Brazilian law. It was not considered that there would be any change likely in the Brazilian attitude towards the agreement and the recent case was quoted whereby Japan had stood out against certain aspects of an agreement and had been obliged in the end to conclude.

The Secretary of State said that he was intrigued by the negative response of the CBI Taxation Committee to a Double Taxation Agreement. It was pointed out that this would be the expected view from a Taxation Committee, not the view of the respective regional trade committee.

On the question of pioneer relief, the Secretary of State considered that this really only applied to the development areas of Brazil and not San Paulo. Any tax concessions made for development reasons in Brazil would be in designated areas and not the capital. Investors who had a main interest in San Paulo would not be affected by pioneer relief. Companies only interested in development areas would be

adversely affected and lose incentives offered if there were no agreement. Mr Davies commented that he thought the existence of a double taxation agreement was marginal. Miss Mueller pointed out the three main benefits which would result from an agreement namely pioneer relief, withholding tax and the general stability a double taxation agreement would give to investors. The Secretary of State commented that a specific gain was the withholding tax. He suggested that he would like to have discussions with representatives of companies who were investing in Brazil and seek their views on the advisability of an agreement. In particular firms such as ICI, Unilever and BAT could be consulted. In the interim the Inland Revenue official in Brazil should be instructed to avoid breaking off negotiations completely. The line to be adopted could be that the UK were unable to go firm on an agreement until the Finance Bill had been approved and become law.

CDP

F D EVANS
PS/SOS(T)
Rm 812 V/S
Ext 5525

26 May 1976

Copies to: Those present
PS/PUSS(T)
PS/Secretary
Secretary - ECGD
Mr Preston
Mr Steele - Gen Div.
Mr Gill - ECGD



THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

23 June 1976

PRIVATE SECRETARY TO THE MINISTER OF STATE

BRAZIL: DOUBLE TAXATION

1. Our negotiators were very successful in following the instructions sent to them after the meeting with the Secretary of State for Trade on 24 May.
2. The discussions were conducted in what they describe as a candid atmosphere with no trace of the hectoring attitude which was very marked last year. The Brazilians welcomed the suggested approach of going through every article of the Draft Agreement to isolate points of disagreement and to note the respective positions of each side with a view to further thought being given to possible solutions before the next round. In the event the Brazilians merely reiterated their demands and showed no sign of flexibility on any of the major matters. They noted our position on the proposals for additional matching credit in Clause 43(2) of the Finance Bill, and agreed that there should be another round of talks in London in September when the fate of the Clause would be known.
3. The Brazilians described the following major items on which there is a divergence of view between us as non-negotiable for "political reasons", and admitted that the treatment of royalties was unsound tax practice but made it clear that their hands were tied.

cc Principal Private Secretary	Sir William Pile
PS/Chief Secretary	Mr Dalton
PS/Financial Secretary	Mrs Smallwood (origin)
Sir Douglas Wass	Mr Moorcraft (2)
Mr Lord	Mr Boyd (2)
Mr Couzens	Mr Boyles
Mr Lovell	Mr Brooman
Mr Houghton	— Mr Pollard
Mr Turnbull	
Lord Kaldor	

4. The non-negotiable items continue to be the excess remittances tax which the Brazilians insist on excluding from the scope of the Agreement, management fees, which they treat as royalties, royalties, for which no deduction is given in computing taxable profits, and independent personal services which are taxed in Brazil if they are paid from a Brazilian source even if the services are performed in the United Kingdom.
5. There were two promising developments by way of background information. One of the Brazilian team told our negotiators that they were now very anxious to have a treaty with the United Kingdom because their chances of success with the United States Switzerland or the Netherlands were regarded as nil. The other was the reaction of members of the British Chamber of Commerce in Rio who met the United Kingdom team over dinner. Their general reaction was that they expected a Double Taxation Agreement to be on OECD lines and would be very disappointed if we were to conclude one on the unsatisfactory Brazilian terms.
6. A further report will be sent when the views of industry are clarified.

AW

A WILKINSON
Private Secretary
Inland Revenue

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A WILKINSON
Private Secretary
Inland Revenue

BOARD OF INLAND REVENUE

FINANCE BILL 1976
CLAUSE 43

CLAUSE 43: OTHER PROVISIONS RELATING TO DOUBLE
TAXATION

SUMMARY

1. This clause contains three separate provisions relating to double taxation:

subsection (1) would prevent a non-resident financial concern trading in the United Kingdom from claiming relief for losses created by treating certain interest and dividends as non-trading receipts;

subsection (2) would enable credit against United Kingdom tax to be given for foreign tax which is not in fact payable but which would have been payable had the income in question not been exempted or relieved from foreign tax under the terms of a double taxation convention between the United Kingdom and the country in question;

subsection (3) ^{would prevent} prevents the allowance of excessive relief for tax on the profits underlying dividends in certain cases.

NOTE ON SUBSECTION (1)

Effect of the subsection

2. This provision would prevent a non-resident financial concern trading in the United Kingdom from claiming relief - by set-off against profits arising on or after 15 April 1976 - for losses created by treating certain interest and dividends as non-trading receipts. The interest and dividends in point are those which, although they are in fact trading receipts, may fall to be treated as exempt from United Kingdom tax under the terms of a tax treaty.

Background

3. This provision is needed because of a difficulty recently encountered in connection with Article XV (see Appendix A) of the tax treaty with the United States. There is no such Article in any of our other tax treaties but a similar difficulty could possibly arise in some of them as regards the dividends Article. Thus, both as a matter of presentation and precaution, the provision has been drafted to meet the general problem of artificial losses

BOARD OF INLAND REVENUE

~~the United Kingdom~~ - as non-trading receipts so as to create losses capable (under Section 117 of the Taxes Act) of being relieved against income or profits of the concern arising on or after 15 April 1976. The subsection is drawn widely enough to cut out claims (under Section 312) for the relief of losses on pension business in the United Kingdom by overseas life assurance companies.

NOTE ON SUBSECTION (2)

Effect of the subsection

18. This provision - an amendment to Section 497(3) of the Taxes Act - would enable credit against United Kingdom tax to be given for foreign tax which is not in fact payable but which would have been payable had the income in question not been exempted or relieved from foreign tax under the terms of a double taxation convention between the United Kingdom and the country in question.

Present scope of Section 497(3)

19. The concept of granting relief in respect of tax given up by a foreign country is not new. Section 497(3) already provides for such relief to be given but the subsection applies only where the tax has been given up with a view to promoting industrial, commercial, scientific, educational or other development in the foreign country. The United Kingdom "matches", as it were - by giving relief for it as if it had in fact been paid - the tax which the foreign country has given up (or "spared").

20. A fuller explanation of "matching credit" relief for foreign tax "spared" and the circumstances in which it can be granted is given at Appendix D.

Why further matching credit provisions are needed

21. There are some important developing countries with whom we have not yet been able to conclude tax treaties, mainly because what we can offer them in the way of matching credit (under Section 497(3)) is not as good as they can get from other developed countries. In the case of Brazil, for example, we have offered, under the Section 497(3) umbrella, to give credit for Brazilian tax spared under special incentive

BOARD OF INLAND REVENUE

provisions in Brazil's domestic law designed to encourage economic development there. The Brazilians want us to go further than this: they want us to give credit for Brazilian tax given up under the tax treaty itself. This is to say, in return for any reduction they make under the treaty in their rate of withholding tax on dividends, interest and royalties flowing to the United Kingdom, the Brazilians want us not only to make corresponding reductions in any withholding tax which we would impose under our domestic law - as is usual in tax treaties - but also to give credit against United Kingdom tax for all or part of the Brazilian tax so given up (in addition, of course, to our giving credit for the reduced Brazilian tax actually paid under the agreement). This is something - "across the board" matching credit for tax spared, not under incentives legislation but under the treaty itself - which our existing powers under Section 497(3) do not enable us to give.

Extension of Section 497(3)

22. Our experience with Brazil in connection with matching credit is not unique. Most developing countries ask us in the normal course of negotiations to grant matching credit for tax spared under the treaty itself. The difference is that while other countries have accepted the position - albeit, reluctantly - when we have explained that we have no statutory power to match "across the board" reliefs Brazil is prepared to break off negotiations unless they get from us what they have managed to get from France, Germany and Japan. It may have been easier for these countries to meet the Brazilians on this, either because they use the exemption method for trading income (France and Germany) so that the scale of the concession was less than it would be for us, or because they have a smaller treaty network (Japan) and so have a smaller stake than ours. But whatever the reasons, these countries have set a precedent for tax treaties between Brazil and developed countries and if there is to be any possibility of making progress with Brazil (and the South American countries generally) it is clear that powers are needed to enable "across the board" matching credit relief to be given for tax given up under a treaty.

BOARD OF INLAND REVENUE

23. This provision would provide these powers. Whether it was appropriate for them to be invoked in any particular case would be a decision which - as with the present enabling powers under Section 497(3) - could only be taken having regard to whether or not the country in question was a developing country and also whether the general balance of concessions given under the treaty, both to and by the United Kingdom, made the treaty an acceptable package as a whole.

Possible criticisms

24. These are likely to fall under two main heads - first, that the provision goes too far and, second, that it does not go far enough. There might also be criticism about the discretionary nature of the relief.

That the provision goes too far

25. Criticism on these lines would be against using tax treaties as a means of granting aid to foreign countries. But granting matching credit relief is not on all fours with granting aid. While it is of course true that the cost of matching credit is borne by the United Kingdom Exchequer, tax treaties invariably provide for a cut in the developing country's tax-take from income arising in its territory and, in return, the developing country simply expects the United Kingdom not to frustrate - by refusing to grant matching credit - the incentive the foreign country is thereby attempting to provide for British investment there. Without the widening of the matching credit enabling provisions which this clause would achieve the ability of the United Kingdom to secure tax treaties with developing countries will be seriously impaired; we would continue to be out of line in this respect with most other major industrial countries.

That the provision does not go far enough

26. There may be criticism that although the proposed extension of Section 497(3) is needed, the subsection should be further amended to provide for matching credit for "pioneer" reliefs to be given not, as now, solely by way of tax treaties but, instead, unilaterally - that is to say, whether the United Kingdom has a tax treaty with the country in question or not. It is a line which has been taken by one body of opinion within the CBI.

BOARD OF INLAND REVENUE

27. The answer to this criticism is that it would be neither practicable nor desirable to grant matching credit relief outside the terms of a tax treaty. With developing countries it is not unusual for us to have difficulty in getting details of their new legislation, even where we have treaties with them containing the usual exchange of information and mutual assistance articles. With unilateral matching relief provisions the difficulties would be far more serious. A United Kingdom resident investing in a developing country would put in a claim to us for unilateral matching credit relief but it would very often be the case that neither he nor we could get sufficient details of the enactment concerned (often by Presidential decree, or suchlike) for us to be able to decide whether or not it qualified for relief.

28. There would also be a tax avoidance aspect. When we give matching credit relief under a treaty it is, of course, perfectly true that we do not make value judgments about the foreign legislation itself; we are simply concerned to ensure that it matches the terms of Section 497(3) as "pioneer relief". Nevertheless, this is a far cry from our abandoning the ability - in the context of tax treaties - to pick and choose those countries to whom we are prepared to give matching credit relief. If we had to give relief unilaterally we might be running the risk - however restrictively the enabling provisions were drafted - of being compelled to give the relief in respect of tax haven territory. So far as we are aware, no other country gives matching credit relief under its domestic unilateral relief provisions and this "lack of control" aspect may be one of the main reasons for this. There is the related risk that a developing country could frame its tax code so as to attract investment from developed countries at the expense of the revenue in those countries. If the final result were acceptable to the companies engaged in the investment it is hardly to be expected that they would object merely in order to protect the United Kingdom tax-take. Arrangements could be devised to suit both a developing country and United Kingdom investors there at the expense of the United Kingdom revenue; this has already happened in relation to Middle East oil taxation and it would be unfortunate to encourage any extension. It might be said that the poorer developing countries are in a different category from OPEC states and that we should be

INLAND REVENUE
HOUSE

BOARD OF INLAND REVENUE

prepared to encourage them, but unilateral pioneer relief would be an inefficient, unselective, and probably expensive way to do it.

29. A further disadvantage of unilateral matching credit is that matching credit is often the only concession we give under an agreement with a developing country which that country regards as substantial. Thus, if we were to give the relief unilaterally we would have deprived ourselves of an important bargaining counter in our treaty negotiations.

That the relief is discretionary

30. It may be suggested that there should be more certainty about the provision, in the sense that it should state specifically the circumstances in which the relief would be granted. This, however, would be to misunderstand the nature of the provision which is not concerned with reliefs granted by the treaty partner for any particular purpose but with reliefs granted "across the board". Admittedly, Section 497(3) does set out specific foreign reliefs - all connected with development - which the United Kingdom will match. But, by extending the scope of the foreign reliefs to be considered for matching credit to those given "across the board", discretion must obviously be retained to decide the extent, if any, that the United Kingdom would be prepared to match the reliefs; and a decision about this could be taken only in the context of the treaty negotiations as a whole. The discretion would not, of course, be that of the United Kingdom negotiating team but that of Parliament, to whom all tax treaties are submitted for approval.

Cost and Staffing

31. By its very nature the overall tax cost of the provision cannot be estimated because this would depend on the extent of matching credit granted under the treaty and what concessions had been made to the United Kingdom by the treaty partner. An estimate of the cost of any matching credit provision in a particular treaty would of course be made, so far as possible, when the terms of the treaty were brought before the House of Commons for consideration. The cost of the existing matching credit provisions is however small,

BOARD OF INLAND REVENUE

being of the order of £m5, and it is likely that costs of the proposed extension would be relatively modest.

32. There is of course the danger - indeed, the likelihood - that developing countries with whom we have already made treaties would ask for the wider matching credit provisions to be extended to them, particularly those countries who asked for such relief during the treaty negotiations and were turned down because we did not have the power to give it. But any country wanting to change the terms of its tax treaty with the United Kingdom in this way would have to be prepared to keep the balance of the treaty undisturbed by granting a concession, in return, to the United Kingdom.

33. There are no staffing implications.

DETAILS OF SUBSECTION (2)

34. As amended by this provision, Section 497(3) of the Taxes Act will be as follows:

"For the purposes of this section and, subject to Section 503(3) below, of the said Chapter II in its application to relief under this section, any amount of tax which would have been payable under the law of a territory outside the United Kingdom but for a relief to which this subsection applies given under the law of that territory shall be treated as having been payable; and references in this section and that Chapter to double taxation, to tax payable or chargeable, or to tax not chargeable directly or by deduction shall be construed accordingly.

This subsection applies

- (a) to any relief given with a view to promoting industrial, commercial, scientific, educational or other development in a territory outside the United Kingdom, being a relief with respect to which provision is made in the arrangements in question for double taxation relief; and

50

NOTE OF A MEETING WITH DAVY INTERNATIONAL AT SOMERSET HOUSE ON
THURSDAY 15 JULY, 1976 AT 2.30PM

Present

For Inland Revenue: Mr Gunn
Mr Robins
Mr Bene

For Department of
Industry:

Mr Hewes

For Davy International: Mr Carswell
Mr Cooke
Mr Smitton

1. Mr Gunn opened the discussion by pointing out that the Revenue were in negotiation with Brazil about a possible Double Taxation Agreement. Davy International's gross fees case was the sort of problem which the Revenue had very much in mind in the negotiations but at this stage confidentiality prevented any discussion of the terms of the negotiation. In reply to questions, Mr Gunn said that discussions with Brazil would probably be resumed later in the year but he could not forecast the outcome of the negotiations.
2. Since there was no DTA with Brazil at present it was necessary to fall back on unilateral relief for British companies taxed in Brazil. However, claims for unilateral relief might founder if the income taxed by Brazil had a UK source. Unilateral relief could only be given for foreign taxes which corresponded to UK taxes on income or profits, so while relief was available for Brazilian taxes on dividends, interest and royalties it was not available for taxes on gross fees. Such fees were merely receipts which entered into a computation of profit or loss. The statutory enabling powers did not allow relief for such relief. It was also questionable whether the Brazilian gross fee tax of 25% would leave any residual taxable profit for UK purposes to which a hypothetical unilateral relief could be applied.
3. Davy explained that their pricing policy was to decide on an acceptable profit on costs for a contract, after foreign and UK taxation. They mentioned a target profit of perhaps 10% - 20%. The Brazilian and UK tax treatment of their design fees had to be taken into account when Davy fixed the contract price, but with the present tax position it was impossible for Davy to make its target profit after all tax and charge on competitive price against international rivals.

Davy gave the following example which, under the present Brazilian and UK tax rules, resulted in an uncompetitive price:-

Cost	
Target profit after all tax	80
Income after all tax	10
	90

This could only be achieved by charging a high price as follows:-

Price	133
Brazilian gross fees tax 25%	33
Income after Brazilian tax	100
Taxable profit in UK	$(100-80) = 20$
UK tax at 50%	10
Income after all tax	$(100-10) = 90$

The argument was that with UK relief for the Brazilian tax, a lower-competitive-price could be charged by Davy with the same costs (80), target profit after all tax (10) and income after all tax (90), as follows:-

Price	120
Brazilian gross fee tax	30
Income after Brazilian tax	90
Taxable profit in UK	$(120-80) = 40$
British tax	20
less tax credit relief of	30
British tax payable	Nil
Income after all tax	90

The Revenue recognised that where the mark-up on costs was considerable, so that the Brazilian gross fees tax did not create a loss for Davy, tax credit relief would be of value to the company.

4. Davy added that their competitors, such as the Germans, Americans and Japanese, seemed able to get relief for their Brazilian tax and were thus able to undercut the British firm. Davy could not accept a loss or an abnormally low profit and would therefore not win the contracts. This would entail a loss of related exports of capital equipment which would be much more serious than the loss of the design contracts alone.

5. Davy went on to say that under the Germany/Brazil DTA Brazil would reduce its gross fees tax for German companies to 15% and give credit at a higher rate in some circumstances. The Americans took a global approach so that a 25% gross fees tax could be set against other foreign profits of an American company.

6. The Revenue said that even in the context of an agreement with Brazil, the question of credit for taxes on gross receipts (which would depend on the terms of the agreement) would be a difficult one to deal with because our enabling powers in S. 497, ITCA 1970, refer to relief for foreign taxes of a similar character to UK taxes. In the unilateral context, were the Revenue to relieve the Brazilian gross fees tax this could let in other foreign turnover taxes and it would be difficult to know where to draw the line. Hewes asked whether the Brazilian tax only applied to fees remitted outside Brazil, which might distinguish

it from other turnover taxes, but Davy explained that the gross fees tax was charged on all fees received by a non-resident company regardless of the money's destination so a "remittance" approach did not begin. Mr Robins cautioned that in any case if the fees were remitted it might be inferred that the services were performed outside Brazil, which again raised the problem of a foreign source of income for unilateral relief purposes.

7. With reference to Davys point that the Germans might get credit for Brazilian tax at a higher rate than they pay, the Revenue mentioned the provisions in the 1976 Finance Bill which would enable the UK to give credit for tax given up by the partner country under a double taxation agreement as distinct from tax spared under its domestic law. However, this was a point of general interest and not specifically related to Brazil and relief on these lines, if the provision is approved by Parliament, could be given only in the context of a balanced convention.

8. The Revenue apologised for being unable to say more at this meeting but hoped Davy would understand that the delicate stage of the Brazilian negotiations prevented this. Careful note had been taken of Davy's representations about credit relief and for the Brazilian tax on gross tax, however, and this would be kept very much in mind in the further negotiations with Brazil. At this stage it was not possible to say how design fees would be dealt with under a Convention, nor how the Revenue could try to alleviate any competitive disadvantage which Davy and other British firms might suffer. It would be necessary to reconsider the position in the light of developments in the Brazilian negotiations.

WPMG/PAF.

Mrs. A.H. Smallwood,
Board of Inland Revenue,
Somerset House,
LONDON.
W.C.1.

20th October 1975.

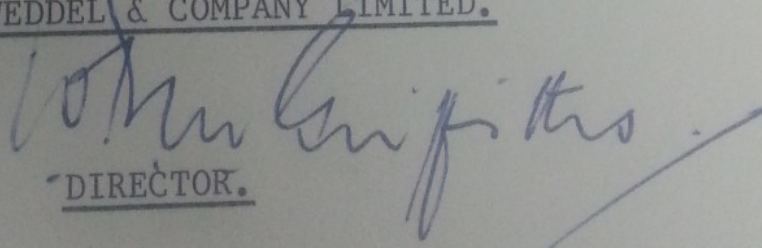
Dear Madam,

As I am sure you know, the British Chamber of Commerce in Sao Paulo are making representations to the Brazilian Government with a view to encouraging the negotiation of a double taxation agreement with the United Kingdom. Our fellow subsidiary company in Brazil S.A. Frigorifico Anglo, is joining with many other British interests in the country in supporting this effort.

Whilst in the absence of such an agreement, our organisation can already benefit from the generous provisions for unilateral relief in United Kingdom Statute, we feel that an agreement can only benefit residents of this country and thus play some part in helping to promote trade. One point here would be the mitigation of the burden of withholding taxes on the remittance of interest and dividends.

We are taking this opportunity of indicating our warm support for the moves which are being started in Brazil, and expressing our hope that the Revenue Authorities of this country would deal favourably with developments in the direction indicated. If you felt that discussion of the issues would be helpful, Mr. A.H. Wakeford our Tax Adviser would be pleased to call on you at your convenience.

Yours faithfully,
W. WEDDEL & COMPANY LIMITED.


DIRECTOR.

POLICY DIVISION

MRS SMALLWOOD

BRAZIL

1. I spoke to Mr Dornelles - while we were both in New York for the Expert Group meeting in the second week of December 1975 - about the possibility of having further tax treaty talks. I cannot say that he shewed any enthusiasm whatsoever for the idea. He indicated strongly that the pressure for a treaty was coming from the UK and not from Brazil although Brazil were of course very willing to sign a treaty with us if we were prepared to give them the same sort of concessions as the Germans have done.
2. He said that they had already offered us substantial concessions but when I enquired what he had in mind he replied that he did not have his papers with him. He could confidently say however that Brazil were not prepared to give the UK anything more than they had given to any other agreement country. It was now the UK's turn to think about giving concessions, particularly in the field of matching credit.
3. I said that I found what Dornelles had to say to be rather disappointing. He seemed still in effect to be inviting us to enter into a treaty which would do no more than confirm Brazilian internal law and provide aid to the Brazilian economy by way of generous matching credit provisions on a scale which our internal law did not enable us to offer. Nevertheless I was reluctant to break off talks completely if there was in fact some hope of the Brazilians modifying their demands. Dornelles responded by saying that he himself failed to understand why the UK were being so difficult about agreeing terms. Either they wanted a treaty or they didn't and if they did they knew the Brazilians' terms.
4. Dornelles was obviously reluctant to discuss matters in any more detail on this particular occasion and it was arranged that a UK team would visit Brazil in the last week in May for further talks. These would culminate either in an initialled agreement or an acceptance by both sides of the fact that until the policy of either country changed there would be no point in arranging further talks.

Rw.

B POLLARD
24 December 1975

POLICY DIVISION

Mrs Smallwood

Mr Pollard

Mr Gunn -

BRAZIL

At the CBI meeting this afternoon, Mr A G Davies may refer to comments about charges for services and use of intangible property made by Mr Dornelles at the recent UN conference.

In general the position of the developing countries is that since they are in many cases unable to satisfy themselves that a royalty charge is correct for the rights being transferred, they feel obliged to impose a high withholding tax on royalties to combat excessive charges which are in fact transfer of profits. On the subject of technical service fees, some members felt that if the parent were charging a royalty there should not be an additional charge. However, Dornelles said that his experience was that in practice there were usually two contracts, one providing for a royalty and the other providing for continuing technical assistance. In Brazil payments made by a subsidiary to a controlling parent in another country are not deductible for tax purposes. He went on to say that a developing country could not refuse a deduction for payments to obtain technology but ~~the~~ difficulties arose because the developing countries were unable to determine whether the services were really rendered and what the proper payment for the services should be. Reference was made to a study being conducted by ~~the~~ LAFTA about payments of royalties and remuneration for technical services by subsidiaries located in Latin-American countries to their parent companies located abroad. Since the developing countries lacked the administrative sophistication to apply the arm's length standard, Dornelles suggested that the burden of proof should be placed on the company. The payments of royalties and technical service fees should then initially be disallowed until such time as the subsidiary proved the appropriateness of the charge.

No firm conclusions were reached on this topic - which will be continued at the next meeting in 1977 - but the Secretariat were asked to collect useful information on the subject and make it available to the group. An example given of such information was the report of the 1975 IFA congress which gave a list of the minimum and the maximum royalty rates for various properties. Consideration would also be given to the use of safe haven ranges in the royalty area and the possible use of independent auditors to verify the reasonableness of the expenses. Finally the developed countries could possibly

provide more data on contracts and the charges which were being made.

J P B BRYCE
21 January 1976

Mr Houghton
HM Treasury

Confidential

STATE VISIT OF PRESIDENT GEISEL OF BRAZIL

This is the briefing about a double taxation convention with Brazil referred to in Sir Michael Palliser's letter of 5 April.

Background

1. A limited double taxation agreement with Brazil covering ~~only~~ shipping and air transport profits has been in force since 1968. It followed earlier unsuccessful attempts to conclude a comprehensive agreement.
2. Negotiations about a comprehensive agreement were resumed in March 1972. Exploratory talks in London were followed by formal negotiations ~~here~~ in November 1973 and by further talks in Brazil in October 1974. Arrangements have now been made for further talks in ~~Brazilia~~ during the last week in May this year.
3. The Brazilians have so far treated as non-negotiable certain aspects of their law to which British interests take serious exception. (For example, the excess remittances tax and the tax treatment of royalties.) It is unlikely that ~~our~~ Convention with Brazil would be regarded as acceptable to British investors if it failed to secure concessions from the Brazilians in these areas.
4. We are hopeful that a clause in the 1976 Finance Bill (to be published on 15 April) will, if it becomes law, enable better progress to be made. The clause would provide enabling powers for British investors to be granted tax credit relief for tax given up by Brazil under the terms of the treaty as if the tax given up had in fact been paid by the British investor ("matching credit for tax spared").

Line to take

Since the negotiations are at a critical stage the Minister may not wish to do more than express guarded optimism-on the following lines - about the outcome of the talks.

(1) ~~He knows that~~ Both negotiating teams, conscious of the importance of the proposed treaty as an aid to trade and economic co-operation between our two countries, have been making every effort to reach agreement at official level.

(2) There are still a number of problems which remain to be solved. These are not merely technical but include some points of principle.

(3) Discussions are being resumed in Brasilia on 24 May and the United Kingdom team will then be putting forward certain proposals which it is hoped will facilitate progress towards agreement.

Confederation of British Industry



21 Tothill Street London SW1H 9LP Telephone 01-930 6711 Telex 21332

E.326.75

STRICTLY CONFIDENTIAL

GENERAL NOTE OF A MEETING ON INTERNATIONAL TAX MATTERS HELD AT SOMERSET

HOUSE ON 6 AUGUST 1975

The CBI/ICC side were led by Mr Nortcliffe.

The Revenue side were led by Mrs Smallwood.

Mrs Smallwood said that the purpose of the meeting was to discuss the current state of negotiations concerning the proposed Anglo-Brazilian Treaty. The Revenue had shortly to make a submission to Ministers on the problems which had arisen in the course of the negotiations. If the Brazilians demands on tax-sparing relief were to be met a change in UK legislation would, of course, be required. But whatever attitude Ministers took on this point, there were a number of other unsatisfactory aspects which the Brazilians were insisting upon and which could have serious effects of the position of UK industry. She listed some of the main points emphasising the importance of maintaining absolute confidentiality if negotiations were not to be prejudiced*, and asked whether, in these circumstances, those members of the CBI/ICC Group present thought that a Treaty with Brazil would be worthwhile. In particular she emphasised the Revenue view that once concessions had been made to one country, others in South America and, indeed other developing countries, would quite probably expect the same concessions. She did not exclude the possibility that other developing countries might press for renegotiation of existing treaties or that even some developed countries would expect concessions.

After some discussion, the members of the CBI/ICC Group took the general view that a Treaty with Brazil on the lines proposed would not be worthwhile. The main objections concerned the treatment of royalties.

Mr Nortcliffe and Mr Crowe thought that many developing countries regard royalties as payments for fully written off technology or as disguised dividends. It was not necessarily Brazil as such that members were worried about but the danger of other countries expecting similar concessions. If this happened the results could be very damaging.

Mr Moran (CBI Staff) said that there was, nevertheless, a strong feeling among CBI membership that the Treaty should be concluded as soon as possible and it might well be that the majority of members would still in favour of conclusion even bearing in mind the Brazilians demands on

* The most important point concerned the treatment of royalties.

in Gufun
I told the CBI
yesterday
that this
could be
discussed in
strict confidence,
with the CBI
Taxation
Committee
which meets
on 15 Oct - I
promised a
short note,
summarising
the Brazilian
demands
without
comment
Att 1/10.

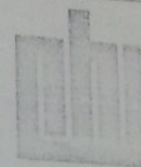
such points as royalties. He would consult further on this point and wondered whether it would be possible for the matter to be discussed in CBI Council or for the Revenue to undertake to publicise the full implications of the difficulties which arose in negotiating tax treaties with developing countries.

Mrs Smallwood said that it was essential that confidentiality should be maintained and could not agree to the details being revealed to CBI Council. She thought that those who favoured tax-sparing relief at the cost of other things did so largely from ignorance of the implications. She did not, however, think that the Revenue could undertake to publicise problems of negotiations with developing countries as it would be apparent that those referred to a particular Treaty in the course of negotiation. Any submission to Ministers would contain something on the lines of 'not all of industry would support a Treaty on this basis' and would certainly not suggest that a formal CBI view was being expressed.

It was agreed that this would be satisfactory and Mr Crowe said that the CBI attitude should be to educate membership as to the real implications for UK industry if concessions on the lines of those asked for by the Brazilians were allowed.

176 Gunn

Confederation of British Industry



21 Tothill Street
London SW1H 9LP
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Telegrams
Cobustry London SW1

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

26 September 1975

Dear Mrs. Smallwood,

TAX TREATY NEGOTIATIONS : BRAZIL

You will recall that, at the special meeting of the joint CBI/ICC Group which you called on 6 August 1975 to discuss the progress of negotiations on the Anglo-Brazilian Treaty, the members of that Group were generally of the opinion that a Treaty on the basis proposed by the Brazilians would not be desirable but that, on behalf of the CBI staff, I expressed reservations as to whether that would be the view of the majority of CBI membership.

I have now had the opportunity to consult my superiors on this question and I would wish to confirm that there can be little doubt that a very strong body of opinion among our membership would be in favour of the conclusion of a Treaty with Brazil even on the terms which the Brazilians are insisting on.

The general attitude of the CBI must, therefore, remain that we urge Her Majesty's Government to conclude a Double Taxation Treaty with Brazil at the earliest possible moment on the best terms which it is possible to obtain.

As we discussed at the meeting, we are in some difficulty in that, for reasons of confidentiality, we are not able to directly inform members as to the full implications which might arise from acceptance of the Brazilian terms.

We agreed that it would be undesirable for matters subject to a national security classification to be put to our full Council as we would be unable to guarantee that confidentiality would be maintained by so large a body.

However, it would be most helpful to us if we were able to conduct a fully informed discussion in a much smaller forum, the CBI Taxation Committee. The members of this Committee are generally tax experts

Continued...

Director-General
Campbell Annan

and include Mr Davies, Mr Crowe, Mr Esam, Mr Evans and Mr Nortcliffe who are also members of the CBI/ICC Group. The meetings of the Taxation Committee are conducted in absolute privacy and we firmly believe that confidentiality can be maintained. The next meeting of the Taxation Committee will be on 15 October 1975 and this would present an excellent opportunity for discussion of the Brazilian issue.

While we fully realise the difficulties you are faced with in considering how widely the details of the negotiations can be revealed, we do hope that you will be able to meet this request as we are most anxious to ensure that there is an opportunity for both sides of the case to be discussed.

Yours sincerely,

Paul E. Moran

Paul E Moran
Taxation Department

Confederation of British Industry



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

12 January 1976

Dear Mrs Smallwood

ANGLO BRAZILIAN TREATY NEGOTIATIONS

The CBI Taxation Committee discussed the question of the Brazilian Double Taxation Agreement at its recent meeting and, as promised, I am writing to report the outcome of the discussion.

The Committee was in general agreement that a Treaty provision endorsing disallowance of inter-company payments such as royalties, technical service fees etc. should be resisted since the tacit acceptance of such a principle on the part of the United Kingdom might have repercussions on other agreements with developing countries.

On another matter the Committee felt that there should be some flexibility on the part of the Brazilians with regard to the 12% remittance ceiling based on registered capital. Although Brazil gives generous tax reliefs on unremitted profits which often help to improve the registered capital base, retention of the present remittance limitation would render a dividend withholding tax reduction largely ineffective to a successful United Kingdom investor since the limitation is concerned with after tax income. The reduction of the dividend withholding tax rate by Brazil would have only limited effect as an incentive if additional remittance funds are to be subject to penal rates of remittance tax.

Nevertheless, a reduction in the rate of withholding tax would be seen as the most important feature of a Treaty and, if the Brazilians prove to be intractable on the remittance limit, the Committee took the view that it would be wise to accept this one concession however limited its present value might be.

While the Committee is well aware of the difficult position in which the Inland Revenue is placed, it believes that every effort should be made to continue negotiations for a Treaty, if necessary even in a limited form. As other countries are entering into tax relief arrangements with Brazil, failure to reach an agreement could leave the United Kingdom in an isolated position. I think

Director-General:
Campbell Adamson
Secretary:
E M Felgate

*This point
covered in
discuss 27/1*

I should also restate that there still remains a considerable pressure from our membership for the successful conclusion of a Treaty with Brazil on the best possible terms.

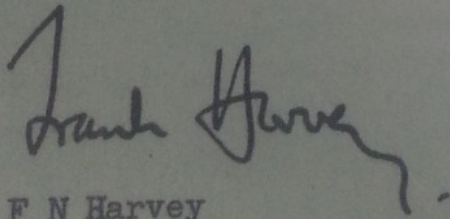
If, however, it should not prove possible to reach a satisfactory conclusion to the negotiations at the moment, it is felt that the best alternative would be to ensure that adequate unilateral relief is available to investors by appropriate amendments of United Kingdom legislation. Such amendments to legislation should be made to ensure that tax credit is available for pioneer reliefs given in Brazil to promote development. Credit should also be allowed for Brazilian taxes on intragroup payments to United Kingdom companies which have been disallowed locally.

Indeed, the Committee took the view that such unilateral relief should be available irrespective of the outcome of any Treaty negotiations. As you may be aware, the extension of pioneer relief provisions on a unilateral basis has been raised as a CBI Budget Representation on more than one occasion.

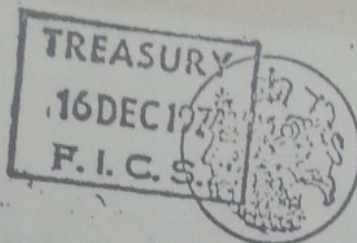
The Committee also considered that unilateral matching credit relief should be available against the tax foregone as a result of reduced rates of withholding tax if these are accepted by the UK authorities as part of an investment incentive programme. Such arrangements seem to be becoming wide-spread and we would be happy to discuss this development with the Inland Revenue.

You will be aware of developing countries' strong objections where the benefits of tax concessions to foreign investors designed to promote development, merely go to augment the revenue of the foreign government. It is imperative that United Kingdom Government Ministers should be fully aware of the difficulties inherent in a situation where the tax benefits given by a developing country are not allowed to be retained by the investor and, in particular, the competitive handicap under which United Kingdom industry labours in situations where the benefits can be retained by our competitors by not by our own firms.

Yours sincerely

A handwritten signature in dark ink, appearing to read 'Frank Harvey', with a stylized flourish at the end.

F N Harvey



01 215 7877

CH/EXCHEQUER	REC. 13 DEC 1974
PS/IR	
PS/MT	
PS/MST	
M. Wars	

12 December 1974

✓
HCS

From the Secretary of State

The Rt. Hon Denis Healey M.B.E., M.P.
Chancellor of the Exchequer

M. Carey
M. F. Jones
M. Ham
M. Turnbull

Dear Sir,

When I visited Brazil a few months ago, I saw the Minister of Finance, and expressed my interest in reaching an early and satisfactory conclusion to the current negotiations for a double tax agreement. The Inland Revenue have since kept my staff au fait with progress, and I understand that an impasse has been reached, in that our present legislation may not provide powers wide enough to accommodate some of the terms which the Brazilians are seeking to have included in the Treaty. Questions of tax policy as well as powers are involved, and I understand the issues will be put to Treasury Ministers before negotiations are resumed.

2. I am writing therefore to place on record my strong commercial interest in concluding an agreement with Brazil. This is a rapidly expanding market, developing its secondary industries, and trade will increasingly depend on local investment. I attach some importance therefore to British investors getting the protection afforded by a double tax agreement, and to the incorporation in such an agreement of facilities which ensure, so far as practicable, that our investors are not placed at a disadvantage against competitors from other nations.

3. Obviously, I would not wish to stray into the details of such a complex subject as reciprocal taxation, but I hope I may be consulted if there is any danger of our 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.

4. I am sending a copy of this letter to Jim Callaghan

Yours sincerely
Peter Shore

PETER SHORE

128

TREASURY
14 JAN 1975
PS/Paymaster General
Minister of State
Sir. Douglas Wagg
Mr. Airey
Mr. F. Jones ✓
Mr. Ham
Mr. Turnbull

6 January, 1975

You wrote to me on 12th December about your interest in the early conclusion of a satisfactory double taxation convention with Brazil.

I appreciate the importance which you attach to such a convention which would, I agree, encourage trade between the two countries and provide protection for our people investing in Brazil.

The main difficulty is the Brazilian insistence that, in return for any reduction under a convention in their rate of withholding tax on dividends, interest and royalties flowing to the United Kingdom, we should give credit against United Kingdom tax for all or part of the Brazilian tax given up, as well as for the Brazilian tax actually paid. The Inland Revenue have statutory powers to give credit for Brazilian tax "spared" under special incentive laws designed to encourage economic development there - and they have agreed in principle to do this - but they cannot under existing legislation, give credit for Brazilian tax given up under the convention itself. Any extension of the Inland Revenue's existing enabling powers would require legislation in a Finance Bill and would raise an important issue of policy. I can assure you that I shall bear in mind the points you have made, and I have noted your wish to be consulted before any final decision is taken.

I should make it clear that under the existing statutory rules credit is given unilaterally against United Kingdom tax on income flowing from Brazil for the Brazilian tax paid on that same income. Thus as a general rule, double taxation is relieved although there is no double taxation convention.

I am sending a copy of this letter to Jim Callaghan.

DENIS HEALEY

The Rt. Hon. Peter Shore, MP.

2. Mr. Callaghan.

cc. Mrs. Beaven

F(E)



From the Secretary of State

REC.	23 JAN 1975
CLASS.	PS/IR
10	PS/IR
	PS/MS
	Sir D. Ward
22 January 1975	

The Rt Hon Denis Healey MBE MP
Chancellor of the Exchequer

Mr. Callaghan
Mr. F. Jones
Mr. Ham
Mr. Turnbull

Dear Sir,

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. Airey
Mr. F. Jones
Mr. Ham
Mr. Turnbull

PS/Inland Revenue

7 February, 1975

You wrote to me on 22nd January in reply to my letter of 6th January about negotiations for a double taxation convention with Brazil.

I am afraid that the difficulties for us in the Brazilian proposals are rather more serious than you suggest. The distinction between relief for tax spared under Brazilian domestic legislation to encourage economic development there and relief for tax given up by Brazil under a double taxation convention is not simply a matter of technique. We have for some years now had legislation which enables us to help developing countries to stimulate the growth of certain industries by "matching" the special tax reliefs which they give to United Kingdom investors in those industries with a credit for the tax spared against the investors' United Kingdom tax liabilities. But this selective matching credit - restricted to particular reliefs granted to particular industries for limited periods - is different from what the Brazilians are demanding: they want us to provide certain reliefs across the board, not to match reliefs which they give under their domestic law in taxing industrial or commercial profits, but to match reductions in withholding tax which they would offer to United Kingdom taxpayers under a double taxation agreement. It would mean in effect our giving an inducement to outward investment in Brazil compared with investment elsewhere, including the United Kingdom itself. This would involve change in tax policy which would have not only revenue consequences but also implications for the balance of payments and the appropriate level of overseas, as opposed to domestic, investment. The effects might not be significant if they were confined to our relations with Brazil but a precedent would have been set for other developing countries and the Brazilian agreement might well become the model for all our agreements with those countries.

I appreciate your desire to see a double taxation convention concluded as soon as possible but - if only because we cannot meet

/ the Brazilians

The Rt. Hon. Peter Shore, MP.
Secretary of State for Foreign and Commonwealth Affairs,
Foreign and Commonwealth Office,

the Brazilians under existing law - it would be unrealistic to expect further outstanding progress to have been made by the time of the Brazilian Finance Minister's visit in March.

I am copying this to Jim Callaghan.

DENIS HEALEY

CONFIDENTIAL

(Rev) 1-5

PRIVATE SECRETARY TO THE MINISTER OF STATE

Tax Treaty with Brazil

Background

in about two weeks

1. A team will ~~shortly~~ be leaving for Brazil to continue negotiations for a comprehensive tax treaty. This will be the fourth round of talks with Brazil since they re-commenced in 1972 after earlier discussions, in the 1960's, had ~~succeeded in securing~~ ^{resulted in} only a limited agreement confined to shipping and air transport profits. The talks are at a crucial stage and will culminate either in a draft treaty being initialled or the recognition by both sides that at the present time there exists insufficient common ground for agreement to be reached. The purpose of this submission therefore is to bring the issues involved to the notice of Ministers and to seek their approval to the line we propose to take at the talks.

Importance of the talks

2. Brazil is our largest trading partner in Latin America. Nevertheless it is apparent from ~~Statistics~~ ^{Statistics} made available to us by the Department of Industry that the United Kingdom has slipped from being the largest investor in Brazil in 1972 to sixth place in 1974, the comparative shares in the total of foreign investment in Brazil being as follows: USA 36 per cent (£m1,188), West Germany 11 per cent, Japan 8 per cent, Switzerland 8 per cent, Canada 7 per cent and the UK 6 percent (£m349). Moreover the indications are

Mr. Simon

Ref.
29/4

Mr. Dalton

A/H
4/5

As the Prime Minister remarked in replying to a P.Q. as recently as 31st March,

that the United Kingdom has declined from being the fourth largest exporter to Brazil in 1972 to ninth place in 1975 and that since 1968 our visible trade balance has moved from a net surplus of £m7 to a net deficit of over £m50. Against this background it is hardly surprising that business interests in the United Kingdom have pointed to the absence of a tax treaty as a possible contributory factor to the decline in our position in the Brazilian market.

Mundatand relief

3. There can be little doubt that tax treaties are a means of stimulating trade and investment between the treaty partner countries. Apart from reducing or eliminating withholding taxes on income flowing between the two countries OECD type tax treaties provide clear and equitable rules for the treatment of income which is subject to double taxation and - particularly important in the case of developing countries - they introduce an element of certainty into an otherwise vague, confusing and risky fiscal situation. They ^{guarantee} ~~guantee~~ protection against discriminatory taxation and provide for consultation between experts in the respective Revenue Departments rather than through the necessarily more cumbersome diplomatic machinery. On the other hand their importance is sometimes exaggerated. The main consequence for a United Kingdom taxpayer of the absence of a tax treaty is that he continues to be liable to the full rate of the foreign country's withholding tax on dividends, interest and royalties. But his total tax bill is not

necessarily higher than under a treaty because of the United Kingdom system of giving credit unilaterally for foreign tax paid - that is to say, even in the absence of a treaty. Compared with exemption or reduction of foreign tax, his "cash flow" is affected because he first pays the foreign tax and only later is given credit for it against his United Kingdom tax bill. ~~It may also of course involve him in extra work in claiming relief.~~ Yet at the end of the day he would normally be no worse off than if he had paid a reduced amount of foreign tax and this is not always understood by those United Kingdom business interests who complain that the absence of a tax treaty with Brazil is putting them at a disadvantage compared with their competitors from treaty countries. What cannot be denied however is that United Kingdom residents who operate in Brazil are at a financial disadvantage compared with their competitors from countries who have been prepared to grant what Brazil has demanded in the way of matching credit.

Matching credit

4. We have offered to give credit for Brazilian tax given up ("spared") under special incentive provisions in Brazil's domestic law designed to encourage economic development there ("Pioneer relief"). If we did not match the tax spared - by giving credit for it against United Kingdom tax as if it had been paid - the effect of the Brazilian incentive provisions would be frustrated; although the United Kingdom resident would be paying less Brazilian tax he would be paying a

correspondingly increased amount of United Kingdom tax because there would be less Brazilian tax to set off against it. But this is as far as we can go under existing statutory powers. We have not been able to accede to the Brazilian demand that credit should be given for Brazilian tax given up, across the board, by reductions of their withholding taxes under the tax treaty itself. This is the main reason - though not the only one - for the present impasse ~~on our~~ ^{in the} negotiations but if Clause 43(2) of the current Finance Bill becomes law we will have the power to grant matching credit in the way the Brazilians want and thus one of the main obstacles to reaching agreement would have gone. The next round of talks will thus be proceeding on the assumption that "across the board" matching credit ^{could} ~~can~~ be given, though it ^{would} ~~will~~ of course have to be made clear to the Brazilians that any agreement to give it was conditional on the substance of Clause 43(2) becoming law.

as part of
a compromise
agreement

Other obstacles to agreement

5. Matching credit has not been the only ^{obstacle} ~~obstacle~~ to agreement. There are several features of the Brazilian tax code which are considered objectionable by OECD member countries but ^{which} the Brazilians insist on incorporating ~~them~~ in their tax treaties. The most important of these undesirable features are:

- a. the disallowance as a deduction in computing taxable profits of royalties paid by a Brazilian subsidiary company to its foreign (United Kingdom) parent;

- b. the extension of the definition of royalties to include management fees so that withholding tax is levied on the gross amount of the fees instead of on the net amount of income after allowing a deduction for expenses incurred in earning the fees;
- c. the taxation of virtually all capital gains arising from the disposal in Brazil of foreign-owned assets (including shares). This is completely at variance with the ^{generally} accepted international practice of giving the sole right to tax gains from movable property to the country of residence of the taxpayer unless they are connected with a permanent establishment in the country where the disposal takes place;
- d. the excess remittance tax which is imposed at progressive rates ranging from 40 per cent to 60 per cent on the amounts by which the profits distributed to non-residents exceed a prescribed amount.

X 6. ~~All~~ ^{features of their code} These ~~items~~ - and various others which are not quite ^{so} ~~as~~ important - are treated by the Brazilians as non-negotiable and the talks with the Brazilians have therefore tended to take the form of their continually reciting their demands without their being willing to consider any kind of compromise. They are prepared to reduce their domestic rates of withholding tax on the outward flow of dividends, interest and royalties and to incorporate in the treaty some OECD model type articles, the most important of which relate to

non-discrimination and exchange of information. Further than this they will not go and we know from discussions with other OECD countries that the Brazilians have taken precisely the same line with them.

Brazil's Agreements with other countries

7. If the developed countries had presented ~~her~~ with a united front, Brazil - and the ~~other~~ South American Andean Pact countries which follow her lead - would probably have had to modify ^{her} ~~their~~ inflexible approach to international tax agreements. In the event, Japan and Sweden started the rot in 1968 by agreeing to terms which were at variance with OECD principles. ~~and~~ Brazil then progressively increased her demands until by 1971 Germany, ~~after~~

Seven years of negotiation, was presented with terms similar in all essential respects to those Brazil is now offering us. The Germans accepted them all ~~and~~ France followed suit. ~~and the present position is that only the United States of America, the Netherlands and ourselves are holding out for better terms on OECD model lines.~~ The latest information we have is that Brazil has now succeeded in re-negotiating its treaty with Japan on the German model.

Views of other Departments and the CBI

8. The general view of interested Departments - Industry, Trade and the FCO - tends to be that "any tax treaty is better than no treaty" and that we should be prepared to accept the Brazilian terms if we are satisfied that we cannot get better ones. This view is supported by the ~~non-fiscal~~ ^{industrial} voices of the CBI but although the CBI Taxation Committee have had a special meeting about the

matter they have been unable to give us a clear cut view. We have, on a confidential basis, kept them fully informed about the considerations involved in having a treaty with Brazil on her terms but the response we have had seems to be based on the quite unfounded assumption that the Brazilians would be prepared to give the United Kingdom more favourable terms than they have given to other countries. They are firm, for example, in not wanting us to give way on the royalties point (Paragraph 5(a) above) but at the same time they say they would welcome the prospects of a reduction in Brazilian withholding taxes without facing up to the fact that we cannot get such a reduction unless we go along with the Brazilians on royalties. Insofar as the CBI can be said to be speaking with one voice their attitude seems to be - as stated in a letter dated 12 January 1976 - that "as other countries are entering into tax relief arrangements with Brazil, failure to reach an agreement could leave the United Kingdom in an isolated position. There remains a considerable pressure from our membership for the successful conclusion of a treaty with Brazil on the best possible terms." The fact of the matter is that the CBI's Tax Committee, as a Committee of tax experts, recognises that if we give way to the Brazilians on so important a matter as the tax treatment of royalties it would be difficult for us to resist attempts by other developing countries with whom we have, or are negotiating, treaties to treat royalties in the same fashion; ~~yet some individual members of~~
but some members of the

Committee find themselves bound to support the "treaty at any price" line because of the importance to their particular companies of the very generous pioneer reliefs given by Brazil to foreign investors and which their companies are not benefitting from in the absence of a treaty. Other members ~~would be happier if we did not~~ conclude a treaty on terms which would set a bad example to other developing countries and would be costly for the United Kingdom.

Objections to the Brazilian terms

9. We look on "across the board" matching credit relief for tax given up under the treaty ~~which might cost something of the order of £m5 a year overall but is likely to increase as dividend flows increase~~ as a major concession which needs to be balanced by equally substantial concessions by the Brazilians, particularly with regard to the matters referred to in paragraph 5 above, if the terms of the treaty are to be in balance. The Brazilians, on the other hand, see the grant of "across the board" matching credit as a sine qua non for continuing the negotiations. They do not have treaties with countries which are not prepared to grant matching credit on their terms and they are not prepared to offer us anything better than the German package which gives "treaty approval" to the various features of Brazilian domestic law which we consider undesirable.

10. Brazil's "German package" has been accepted by various OECD member countries because they take the view that they cannot afford to stand on principle with so important a developing country as Brazil and the

have made
it clear that
in their view
we should not

See para 12

it
unrivalled opportunities that it offers for investment. Canada is the latest country to succumb. The odd ones out are now the Americans, the Dutch and ourselves. We three countries are the only ones holding out for better terms on OECD Model lines. Our view, which is shared by the Americans and the Dutch, has been that it is of little use trying to "educate" developing countries - at the United Nations^{Nations} Expert Group on tax treaties and elsewhere - about acceptable international fiscal standards if, when it comes to the crunch, we are prepared to sacrifice principle in order to secure an agreement. On the other hand we have more at stake than the Dutch in getting an agreement with Brazil and it could perhaps be said that the Americans can afford, more than we, to moralise. The plain fact is that if we do not accept the German package - and nothing much better will be on offer - it is British investors who will be the sufferers, not the Brazilians who can turn to other countries for the investment they need. ~~The figures quoted in paragraph 2 above indicate that this is what they are already doing.~~

11. There is however the important practical consideration - touched on in paragraph 8 above - that the United Kingdom has more treaties with developing countries than any other developed country and in the last few months we have been successful, though with difficulty, in negotiating "normal" treaties with some

I think this
implies that
the reason for
the turning is
connected with this.
This may be - but
there is no evidence.

developing countries which even only a year or two ago were not interested in a treaty with us on "normal" terms. If we were to agree to special terms for Brazil it is very likely that we would come under pressure from these countries to do for them what we have shown ourselves ready to do for Brazil and the pressure would be difficult to resist.

Cost

12. The cost of a treaty on the lines of the Brazil/Germany treaty would be of the order of £m⁴⁴ a year, which would increase if the flow of remittances to the U.K. from Brazil were to increase.

Line to take argument

13. The ~~issues~~ involved in deciding whether to agree to the Brazilian terms or to break off negotiations for the foreseeable future are ~~finely~~ balanced. If negotiations are broken off we cannot expect a resumption for some years, and British investment in South American will continue to operate at a lower return after tax than foreign competitors. On the other hand, if we line ourselves up with Germany, France and the other countries who have accepted the Brazilian terms we run the risk of upsetting the balance of our treaties with other important developing countries - for example, Indonesia, Malaysia and Korea - who accepted our terms with reluctance and would probably ask us to revise our treaties with them and to give "across the board" matching credit

Bonnie's
12/12/19
15 min

perhaps not possible -
starkly opposed
and it is not
easy to establish
where the balance
of advantage to the U.K.
lies.

the share of
British investment
in Brazil will
presumably
~~continue~~ go
on falling and
arguably, British
exports will
follow suit.

But what if they do this 10
if we get anything more?

Board's
Cable Paper
12/2/51
15 min

developing countries which even only a year or two ago were not interested in a treaty with us on "normal" terms. If we were to agree to special terms for Brazil it is very likely that we would come under pressure from these countries to do for them what we have shown ourselves ready to do for Brazil and the pressure would be difficult to resist.

Cost

12. The cost of a treaty on the lines of the Brazil/Germany treaty would be of the order of £m⁴ a year, which would increase if the flow of remittances to the U.K. from Brazil were to increase.

Line to take argument

13. The ~~issues~~ involved in deciding whether to agree to the Brazilian terms or to break off negotiations for the foreseeable future are finely balanced. If negotiations are broken off we cannot expect a resumption for some years, and British investment in South American will continue to operate at a lower return after tax than foreign competitors. On the other hand, if we line ourselves up with Germany, France and the other countries who have accepted the Brazilian terms we run the risk of upsetting the balance of our treaties with other important developing countries - for example, Indonesia, Malaysia and Korea - who accepted our terms with reluctance and would probably ask us to revise our treaties with them and to give "across the board" matching credit

— perhaps not possible —
starkly opposed
and it is not
easy to establish
where the balance
of advantage to the U.K.
lies.

the share of
British investment
in Brazil will
presumably
~~continue~~ go
on falling and
arguably, British
exports will
follow suit.

But what they do this 10

if we got all the money?

without any off-sides
(missions from this side)
Concessions

to them also for tax "spared" under a treaty

Our general
negotiating stance
would be weak, but
because it will be
clear that if we
want an agreement
fast enough
we will
agree to almost
any terms.

If Ministers
decide that we
should in substance
accept the Brazilian's
terms, we would
of course

14. We will obviously strive at the May talks to get ~~at least~~ some improvement in the terms so far offered. We shall also try to get a most favoured nation clause so that if, in the future, Brazil offered better terms to any other country they would be offered to us also. (The only country likely to be able to extract better terms from the Brazilians is the United States of America - because of the supreme importance of American investment to Brazil). There may also be some scope - as a matter of drafting - for making the "German package" more acceptable presentationally: for example it would be better, cosmetically, for there to be no capital gains article in the treaty (thus allowing the Brazilians to apply their domestic law) rather than incorporate into the treaty a capital gains article which offended OECD model principles. In addition, we would not offer a dividends article which provided for the payment of tax credits to Brazilian investors, though this ^{be only} ~~again would serve only a~~ window-dressing purpose as there is virtually no Brazilian investment in the United Kingdom and the Brazilians want the treaty to stimulate British investment in Brazil, not the other way round.

15. At the end of the day however the choice is likely to be between accepting what is, in substance, the "German package" or giving up the idea of having a comprehensive agreement with Brazil. The Department

01 215 1877

one) of Trade have consistently stressed the importance of an agreement with Brazil and the Secretary of State wrote to the Chancellor about it on 12 December 1974 and 22 January 1975. Copies of the letters are attached; Clause 43(1) of the current Finance Bill would provide the legislative authority for matching credit for tax spared under a treaty with Brazil, but it has recently become clear that even with matching credit the Brazilians are insisting on other terms in their treaties which we find unacceptable (para 5 above). Accepting as we believe we must the Department of Trade assessment of the desirability of concluding an agreement, it would follow that the balance of advantage to the United Kingdom would lie in the direction of accepting Brazil's "German

16. Conclusion

It is of course clear that in tax terms alone Brazil's "German package" is unacceptable and would be damaging. On the other hand, we would reluctantly accept that if Department of Trade's views about the benefits to UK industry flowing from increasing investment in Brazil were substantiated, the arguments would at least be evenly balanced. However, ~~we remain sceptical about the assertions made about the benefits to the UK - as opposed to individual companies of investment in Brazil and we regard it as significant that individual companies with important or potential interests in Brazil have expressed the view privately that we should not give in.~~ Our recommendation is, therefore, that we should be authorised to tell Brazil that, while we would - subject to parliamentary approval of the Finance Bill proposals - be able to meet their matching credit demands, this could only be as part of an agreement providing for significant amelioration of ~~effects~~ of their tax code that run clearly contrary to OECD principles; and if they are not interested, so be it. Before reaching a decision to this effect Treasury Ministers would ~~presumably~~ wish to mention the matter again to the Secretary of State for Trade: it is at least possible that Mr Dell (who, while at the Treasury, was no enthusiast for double tax relief) will not entirely share the views of his predecessor in this matter. A draft letter for this purpose will follow immediately.

In view of the urgency of the matter, we will be warning DT officials that the matter may shortly be raised with their Minister in the sense proposed.

are unproven & indeed the whole question of ~~national investment~~ is one of economic and political dispute. We also

aspects

no doubt

170

Brazil and the pressure would be difficult to resist.

12. ^{Cost} The cost of a treaty on the lines of the Brazil/Germany treaty would be of the order of £m2 a year, which

12. The issues involved in deciding whether to agree to the Brazilian terms or to break off negotiations for the foreseeable future ^{are fairly balanced} is a difficult one to take. If

negotiations are broken off British investment in South America will ^{continue to operate at a lower return after tax than foreign competitors} be seriously affected. On the other hand,

if we line ourselves up with Germany, France and the other countries who have accepted the Brazilian terms we run the risk of upsetting the balance of our treaties with other important developing countries - for example, Indonesia, Malaysia and Korea - who accepted our terms with reluctance and ^{would probably} will ask us to give ^{revise our treaties with them and} ~~them too~~ "across the board" matching credit ^{to them also for tax spared} under the treaty.

13. We will obviously strive at the May talks to get at least some improvement in the terms so far offered. We shall also try to get a most favour^{ed} nation clause so that if, in the future, Brazil offered better terms to any other country they would be offered to us also.

(The only country likely to be able to extract better terms from the Brazilians is the United States of America - because of the supreme importance of American investment to Brazil). There may also be some scope - as a matter of drafting - for making the "German package" more acceptable presentationally: for example it would be better, cosmetically, for there to be no capital gains article in the treaty (thus allowing the Brazilians to apply their domestic law) rather than incorporate into the treaty a capital gains article which offended

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We cannot
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some years, and

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⁵
14. At the end of the day however we are likely to be ^{is likely to be between} faced with the choice of accepting what is, in substance, the "German package" or giving up the idea of having a comprehensive agreement with Brazil. Our view ~~is~~ that the balance of advantage to the United Kingdom would lie in the direction of accepting Brazil's "German package", unacceptable though it is in fact rather than in having no treaty ^{and} we therefore seek the Minister of State's approval to our doing so if that ~~package~~ is the best that is on offer.

*Faced with
this sort of
choice*

The Department of Trade have consistently stressed the importance of an agreement with Brazil and the Secretary of State wrote to the Chancellor about it on 12 Dec 1974 and 22 January 1975. Copies of the letters are attached; Clause 43(1) of the current Finance Bill would provide the legislative authority for matching credit for tax spared under ~~the~~ a treaty with Brazil, but it has recently become clear that even with matching credit the Brazilians are insisting on other terms in their treaties which we find unacceptable (para 5 above). Accepting as we believe we must the

PTO



Foreign and Commonwealth Office

London SW1A 2AH

21 May 1976

From The Minister of State

Dear Minister,

You wrote to Edmund Dell on 11 May about our negotiating position on a possible double taxation agreement with Brazil. We have since discussed the agreement informally.

The central question now seems to be whether the commercial advantages of a double taxation agreement outweigh the possible loss in tax and balance of payments terms. Brazil is not only a significant market for the UK at present but one that is rapidly expanding. Failure to conclude a double taxation agreement would place British firms at a competitive disadvantage, vis-a-vis German, French, Belgian and Japanese firms, and make it increasingly difficult for the UK to maintain its share of this important market, let alone increase it. This failure could also have a harmful effect on efforts to penetrate the Latin American market generally.

On the question of precedent, this has already been set by the conclusion of agreements between Brazil and the countries mentioned above. But I am aware that there are wider arguments which pull in different directions.

I should point out that a number of the companies most active in Brazil have pressed for the conclusion of a double taxation agreement. This was brought home to me personally when I visited Brazil last January.

We would therefore support giving a remit to the Inland Revenue team to conclude an agreement, in the final resort, on the lines of those already agreed by Germany, France, Belgium and Japan.

I am copying this letter to Edmund Dell and to Eric Varley.

Yours sincerely

Ted Fowlands
(approved by Mr Rowlands
and signed in his absence)

Denzil Davies, Esq., MP,
Minister of State,
HM Treasury,
Whitehall,
London, S.W.1.



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Mrs A H Smallwood
The Board Room
Inland Revenue
Somerset House
Strand
LONDON WC2R 1LB

Your reference - 1,074 - 4,600

Our reference

Date 21 May 1976

CONFIDENTIAL

Dear Mrs. Smallwood,

DOUBLE TAXATION: BRAZIL

We spoke yesterday morning about the treaty negotiations with Brazil and I promised to send you anything we could find on difficulties the Brazilians might be facing in attracting finance and investment.

The papers attached are as much as we have been able to collate within the time available and I am afraid that some of it is still rather impressionistic. It does suggest however that there might be grounds for hoping the Brazilians will be slightly less unyielding on this occasion and I trust that the information will be of some assistance in the negotiations.

If there are any points on which you think further details would be useful we shall of course be pleased to help if we can.

Yours sincerely

Bob Hewes

The following extracts indicate the difficulties Brazil may be facing in financing its balance of payments deficit.

US \$m	Average 1969-72	1973	1974	1975	1976
Trade balance	- 9	7	- 4,562	- 3,514	- 800F
Services balance	- 901	- 1,795	- 2,323	- 3,560	- 3,800F
Current account	- 910	- 1,788	- 6,885	- 7,074	- 4,600
Direct investment	199	940	845		
Medium/long capital	293	706	1,080		
Financial credits	1,107	2,094	3,717		
Other capital	375	377	194		
Increase in reserves	1,064	2,328	- 1,049		

F = Forecast

Brazil: Economic Prospects

*Jan-April 1976 \$ -1,108m on trade, alone although pull back is expected in later part of the year, the Min. of Finance forecast of \$ -800 is thought to be optimistic.

QUALITATIVE EVIDENCE

The emphasis given to the success of the Rio Airport loan (which was increased from \$ US 100m to \$ US 120m) by contrast with the poor reception given by foreign bankers to the \$ 300m Sao Paulo loan suggests Brazil's concern to maintain its image with foreign creditors.

On debt already contracted by September 1975, amortisation will be \$ 2.5bn - \$ 2.7bn pa to 1980 and interest payments will be increasing to the extent that Brazil borrows each year more than it repays.

For the year starting next September either the current account deficit will have to be pruned right back or the volume of long term capital in flows must increase. Whilst this is quite possible, the increased investment may not yield Brazil more foreign currency from exports or import substitution from some time. Also there are signs that the Euromarket, which has been a major source of funds, may not increase its annual funding to Brazil (see James Greane of Manufacturers Hanover Trust).

The question facing Brazil is whether it can bring the export/import substitution programmes on stream before the debt servicing burden becomes too heavy to carry.

The early 1970's saw an explosion in the availability of foreign currencies to countries like Brazil; this will not be seen again for some time. At least one can expect the flow of funds to remain at their present levels.

The traditional links with the US have produced a few serious disappointments and the Japanese have had second thoughts about several big projects in Brazil.

QUANTITATIVE EVIDENCE

End	Growth in gorss o/s debt				§ US bn		Sept 1975 F
	1968	1970	1971	1972	1973	1974	
	3	5	6	9	13	17	22
Reserves	0	1	2	4	6	5	4
Debt (net)	3	4	4	5	7	12	18
Interest payments							1.9

				Amount maturing	
Debt repayment:	September 1975	-	September 1976	£ 535m	
	"	1976	-	" 1977	£ 2,260m

Debt service: (repayments + interest)	
September 1976 - September 1977	£ 5,000m

Debt service: foreign inflows %	
Calendar 1975	51%
September/September 1976/7	72%

EcS1A
DoI
21 May 1976

Mrs. Smithson

MEMORANDUM ON TAX IMPLICATIONS AFFECTING
U.K. INVESTMENTS IN BRAZIL INCLUDING SUGGESTIONS FOR
DOUBLE TAXATION TREATY BETWEEN BRAZIL AND THE UNITED KINGDOM

I - U.K. TAX RELIEF ON DIVIDENDS RECEIVED FROM BRAZIL

a) Present situation

It is understood that U.K. companies are normally unable to take full credit for taxes paid in Brazil on dividends remitted to the U.K. and therefore relief should be provided for to incentivise U.K. equity investments in Brazil.

The effective rate in Brazil is calculated at 50%, as follows:

Profits	100
Profits tax: 30%	<u>30</u>
Net	70
Additional profits tax on distribution: 5%	<u>3.1/3</u>
Gross distributions	66.2/3
Withholding tax: 25%	<u>16.57</u>
Net dividend remitted	<u><u>50</u></u>

Note: The 5% distribution tax above does of course not apply to 'open companies' in Brazil.

The actual effective rate for the purpose of computing relief against U.K. tax would of course have to be calculated in each individual case based on the actual tax paid on the profits out of which the dividend distribution had been made, and could be more or less than the 50% shown above due to the following factors:

- (i) Reduction of effective rate by the application of corporate tax liability in regional and specific industry fiscal incentive investments;
- (ii) Reduction of the effective rate by the exclusion from taxable income of profits attributable to export sales of manufactured products;
- (iii) Increase in the effective rate due to the incidence of supplementary withholding taxes of from 40% to 60% on profit remittances exceeding 12% per year of registered foreign capital.

The rate of U.K. corporation tax is 52%. However, the tax payable by a U.K. company is made up of two separate components:

- (i) Advance corporation tax (ACT)
- (ii) Mainstream tax (MT)

ACT is a fixed percentage (33/67 for the forthcoming year) of any distribution made to the shareholders, and the amount of ACT paid on this basis is credited against the ultimate tax liability thereby reducing the balance of MT due.

Relief for foreign taxes paid on dividends received from abroad is granted only against the MT liability so that to the extent that profits are distributed to shareholders, the limit of U.K. tax against which Brazilian tax paid can be credited is reduced accordingly.

The minimum rate of MT is 20%, so the effective U.K. rate of tax on profits received from abroad could vary from 20% to 52%. However, as most U.K. companies will wish to maximize distributions to shareholders this rate will tend to be nearer 20% than 52%, so that the incidence of Brazilian tax would normally be in excess of the U.K. tax.

b) Suggestions for double tax treaty

(1) Reduction in Brazilian tax rate

As explained above, with no reduction of the Brazilian tax rate U.K. companies would be paying more tax on their income from Brazilian investments than on their domestic income, or on income from these countries which limit their tax rate to that prevailing in the U.K.

In order to incentivate U.K. equity investments in Brazil, the simplest mechanism for reducing the Brazilian tax is for the treaty to provide for a reduction in the normal non-residents withholding tax of 25%. In the treaties with Portugal, France and Belgium the Brazilian authorities have allowed a reduction to 15%. However, in the Japanese treaty a reduction to 10% was granted, depending on the voting rights. It is recommended that a reduction to 10% without this condition be applied in the case of a U.K. treaty.

If in order to qualify for reduction in withholding tax, there is a condition of a minimum participation in capital, it is suggested that this condition be expressed as "either minimum of 10% of the voting shares or 25% of the capital", and that relief should be obtained in the U.K. as if the full rate of withholding tax had been paid in Brazil.

(2) Tax sparing clause

For the Brazilian authorities to be willing to grant a reduction in the rate of withholding tax, it must be expected that they would request an equivalent concession from the U.K. authorities. In this context, it is suggested that a tax sparing clause be included whereby the U.K. subsidiary operating in Brazil could obtain full benefit locally for the various tax incentive programs, and at the same time would not be prejudiced when calculating the credit allowable against U.K. tax liability.

Under the present system reduction of Brazilian tax through fiscal incentives to a rate below the U.K. rate has the effect of increasing U.K. taxes payable. The tax sparing clause, it is suggested, should be similar to that included

In the Japanese treaty which allows for full tax credit for amounts of Brazilian tax liability applied in fiscal incentive investments, together with an additional paragraph providing that the reduction of Brazilian income tax obtained through the export of manufactured products, should be considered as having been normally taxed in Brazil for the purpose of determining the amount of Brazilian tax creditable in the U.K.

(3) Recognition by Brazilian authorities of effect on withholding tax on remittance limits

The supplementary withholding taxes on excess profit remittances (see (a) above) are payable on the amount of the profit remittance net of the normal 25% withholding tax. Consequently, any reduction of the 25% rate permitted by the treaty would have the effect of increasing the exposure to the supplementary taxes on remittances in excess of the annual 12% limitation.

It is suggested, therefore, that the Brazilian authorities allow a notional credit for the reduction in the normal withholding tax for the purpose of calculating the incidence of the supplementary taxes.

(4) Definition of creditable taxes

The taxes for which credit would be granted should be clearly defined in the treaty. The four taxes referred to above are:

- (i) The corporate profits tax of 30%
- (ii) The additional profits tax of 5% on distributed profits
- (iii) The non-residents withholding tax of 25%
- (iv) The supplementary withholding tax of from 40 to 60% on excess profit remittances

With regard to the suggested tax sparing clause this should also be defined as to consider as tax payments (a) the amounts of corporate tax liability applied in approved investment mentioning specifically the Northeastern (SUDENE) and Amazon (SUDAM) regional development areas, and the fishing, tourism and reforestation industries; and (b) the amount of reduction on tax liability obtained through the benefit attributable to the exportation of manufactured goods.

II - BRAZILIAN WITHHOLDING TAX ON LOAN INTEREST

The rate of withholding tax applicable to loan interest is the standard non-residents rate of 25%. We understand that this would be normally creditable against the lender's U.K. tax liability, although it may not be fully creditable if the effective U.K. rate of tax is less than 25%.

However, even if full credit is possible, U.K. financial institutions will be prejudiced in relation to those countries with treaties with Brazil which grant reductions in the withholding tax rate as follows:

- Japan: 10% subject to the condition that the lender is a recognized Japanese financial institution, or that the lender owns more than 25% of the voting capital of the Brazilian borrowing company, and that the loaned funds were originally borrowed from a Japanese financial institution.
- Belgium, France, Portugal and Finland: 15%.

However, in the cases of the Belgian and French treaties the rate is further reduced to 10% on loans for a maximum period of 7 years from entities with Governmental participation for the purpose of financing the purchase of capital equipment.

Note also that in the cases of the Japanese and Belgian treaties the credit for Brazilian tax paid will be granted to the lender at the rates of 25% and 20% respectively.

It is suggested, therefore, that a reduction in withholding tax be requested on interest on loans from the U.K. in line with the existing treaties as summarized above, with the possibility of an additional reduction as suggested for longer term loans, as in the case of the French and Belgian treaties. Although in these treaties this additional reduction is limited to certain public financing, it is suggested that for the U.K. this should be requested to be extended to U.K. financial institutions in general.

III - BRAZILIAN WITHHOLDING TAX ON ROYALTIES

^{present}
The ~~personal~~ rate of withholding tax of 25% on royalties and technical assistance fees is a disincentive for U.K. companies to supply technology to Brazilian companies.

In accordance with treaties between Brazil and other countries, the following reductions in withholding tax have been granted:

- Japan: 10%
- Norway, Sweden and Portugal: 15%
- Belgium, France and Finland: 10% on films and books etc., and 15% on all other royalties, except for the use of trade marks on which the 25% rate is retained.

Note, however, that the Japanese and Belgium treaties allow a tax credit in those countries for 25% and 20% respectively.

The present severe restrictions on the rates of royalties would be compensated to some extent by a reduction in the rate of withholding tax. It is therefore suggested that a reduction of withholding tax be requested for royalty payments for the use of U.K. technology on the lines of the existing agreements with other countries, and that any clause in the treaty to this effect should define clearly that the term 'royalty' includes payments for technical assistance in order to avoid any unfavourable interpretation by the tax authorities which has already occurred in the case of the Swedish treaty. In addition, in order to further incentivate the transfer of U.K. technology to Brazil it is suggested that relief should be obtainable in the U.K. as if the full rate of Brazilian withholding tax had been paid.

IV - DOING BUSINESS IN BRAZIL

Several U.K. companies sell directly to Brazilian customers and for the purpose of obtaining their sales maintain an employee in Brazil or operate their sales activity through a local subsidiary which would normally have a manufacturing or technical assistance operation in addition. Under the terms of all the existing tax treaties, these methods are considered as constituting a permanent establishment in Brazil and profits on such direct operations would therefore be taxable in Brazil.

However, the existing tax treaties also provide that if the permanent establishment in Brazil does not have power to close the sales contract on behalf of the foreign supplier, no Brazilian tax would be due on the direct operation. This escape-clause must be included in the U.K. treaty.

V - CAPITAL GAINS

Under existing laws, non-resident individuals and companies can be charged Brazilian tax on capital gains earned in Brazil. It is recommended that provision be made in the treaty for a credit for this tax to be allowed against any U.K. capital gain or corporation tax.

VI - PERSONAL INCOME

Provision should be made in the Treaty for full relief in either state for tax withheld on any personal income, which may be taxable in both countries.

UNITED KINGDOM/BRAZIL

NOTE OF TALKS IN BRASILIA 29-31 OCTOBER 1974

Brazil

Francisco Oswaldo Neves Dornelles	- President, International Tax Studies Commission
Jose Daniel Diniz	- Vice President, International Tax Studies Commission
Dirceu Borges Nogueira	- Central Bank of Brazil
Ariane Leme Walther	- Ministry of Finance, International Tax Studies Commission
Lygia Mendes Correa	- Executive Secretary, International Tax Studies Commission
Yedda Rego Macedo	- Acting Executive Secretary, International Tax Studies Commission

United Kingdom

D Hopkins
I P Gunn

Tuesday am

Snr Dornelles handed over summaries listing the articles on which agreement had already been reached and those which still required discussion.

AGREED ARTICLES

It was agreed that the summary was broadly correct, although one or two minor matters remained to be settled. Mr Hopkins said that the United Kingdom might wish to make minor editorial amendments at a later stage. The following specific points were made:-

Article 3 (General definitions)

The terms 'Brazil' and 'nationals' of Brazil are included provisionally subject to the comments of our F & CO.

Article 18 (pensions annuities)

Brazil agrees that the amounts shown in paragraph 1 should be expressed as '£2,000' and not 'US \$4,000'.

Article 19 (Governmental Payments)

The United Kingdom undertook to consider a revised draft handed over by Brazil which is similar to the revised OECD model article, with an additional paragraph 4. If it is not acceptable to the United Kingdom Brazil will accept the previous version.

UNITED KINGDOM/BRAZIL

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Article 30 (Entry into force)

Dates of entry into force will have to be provided.

ARTICLES STILL PENDING

Mr Hopkins explained the United Kingdom position regarding credit for tax spared under the agreement. This involved important points of principle about which we have to approach Ministers. We had hoped to have an answer by the summer of 1974, but owing to the pressures and uncertainties which followed the change of government in February we had not thought it appropriate to press the matter at that stage. We have now to let the dust settle following the October election and would be unable to let Brazil have a decision until next year. Whilst we have no desire to delay matters, we are subject to this important policy constraint and cannot predict the outcome of our approach to Ministers. For this reason, Mr Hopkins had welcomed Snr Dornelles' suggestion of informal talks as he felt that he owed him some explanation. Snr Dornelles replied that Brazilian policy over tax sparing had not changed. Brazil does not want the United Kingdom Treasury to benefit by any reduction in Brazilian tax rates: the benefit should go to the investor. It would be difficult to explain in Brazil that tax which she gave up would not pass to the private sector.

He explained that the rate of tax in Brazil on interest on certain types of new and existing loans had recently been reduced with effect from 22 October 1974 to 5 per cent for a limited period in order to attract capital, because the balance of payments situation had worsened considerably. Brazil uses the tax system as an instrument of policy. The reduced rate applies to loans from Bank to Bank or company to company, with the condition that the money loaned has to enter Brazil from abroad and to be registered with the Central Bank. The reduced rate will apply only as long as the shortage of capital continues, and the Minister can therefore increase the rate without notice at any time.

Snr Dornelles thought that most loans from the United Kingdom are from Bank to Bank and will be covered by the reduced rate. It will not apply to loans to purchase merchandise or equipment but Brazil could accept a 10 per cent rate in the Agreement for such loans granted for a period of at least 7 years on the lines of paragraph 2(a) of their initialled agreement with Germany.

Mr Hopkins said he would like at these talks to explore without commitment on either side the possibility of arriving at a compromise package deal without loss of principle; for example by omitting a particular article or articles. This would leave Brazil the unrestricted right to tax in those particular fields and other articles could then be more on OECD lines. He referred in this connection to the United Kingdom's draft Management Fees article. Snr Dornelles replied that only now are Brazilians learning how to interpret their conventions now in force. He was attracted by the Management Fees article, but feared that acceptance of it could give rise to suggestions that the article

deals with points not covered in Brazil's existing conventions and that Management Fees might not be taxable under those agreements. He believed that the problems dealt with by the Management Fees article would be covered by other articles, but if the United Kingdom considered that any particular situation is not clear, it could be clarified in the Protocol. Mr Hopkins did not think that our Management Fees article fills a gap not already covered, but it gives the recipient the right by election to be taxed on net income after expenses. In certain circumstances the whole of the benefit would accrue to the company and not to the United Kingdom Revenue.

Mr Hopkins pointed out that whether or not there is a reduction in the United Kingdom company's tax bill, there will be a cash flow advantage in a rate reduction, which is important in times of high interest rates. He emphasised that the United Kingdom had never given matching credit on the lines proposed by Brazil, though we would in the context of a satisfactory convention give matching credit for specific pioneer reliefs granted under Brazilian law. Brazil's proposals about the taxes covered by the convention, if accepted, would also involve concessions by the United Kingdom. This was one reason for exploring possible areas of compromise. It would be easier for us presentationally to be able to tell Ministers that in recognition of a major change on the part of the United Kingdom, Brazil would also be willing to make certain concessions but could go only so far, and no further.

Snr Dornelles replied that Brazil is to make great development efforts in the next 10 years and needs foreign capital. The United Kingdom is Brazil's 5th largest foreign investor, so Brazil looks to the United Kingdom for further capital. He then put forward two alternative proposals for resolving the difficulty of principle over tax sparing:-

1st alternative

Rather than look at specific development projects covering the North East and Amazon regions, the United Kingdom should take Brazil as a whole and grant tax sparing for a limited period of say 10 years, in return for a reduction in Brazilian withholding tax rates.

2nd alternative

There should be no reduction in tax rates, but a convention of guarantee by which each State undertakes not to increase its rates. Brazil would therefore keep its 25 per cent rate.

Brazil preferred the first alternative but could only grant a reduction in her rates if the United Kingdom gave compensating matching credit. If this was not possible, Brazil would accept the second alternative, as being preferable to no convention at all because of the intangible benefits and stabilising influences which a Convention would bring.

With regard to the second alternative, Mr Hopkins asked whether the proposal would go further and provide lower rates for certain types of income. Snr Dornelles replied that any rate reduction by Brazil would require a compensating tax sparing concession from the United Kingdom.

Mr Hopkins then outlined the United Kingdom's approach over the years to the question of relieving double taxation. We use the credit, and not the exemption method. We give credit for the partner country's reduced tax rates under the Convention and thus share the burden of relieving the double taxation. At the moment we give credit unilaterally as well under our Agreements and so in a sense we subsidise investment in Brazil at the expense of our companies investing in the United Kingdom's own development areas. This is politically a sensitive matter. He pointed out, however, that unilateral relief can be withdrawn at any time whereas we would have to honour an international treaty. The difference between giving credit for overseas tax and merely allowing a deduction for it could be quite considerable. Snr Dornelles did not doubt this, but said that he must look at the current situation. Under a Convention Brazil would be making concessions by reducing rates, which could be explained only in the light of concessions also made by the United Kingdom. Mr Hopkins said that a Convention would be a guarantee to the United Kingdom investor that overseas tax rates would not be increased and that his right to credit for the overseas tax would not be withdrawn. Snr Dornelles replied that Brazil could not reduce its tax rates only against a guarantee from the United Kingdom but he could accept a guarantee by one side against a guarantee by the other eg mutually to freeze the situation on the lines of his 2nd alternative.

Mr Hopkins said that because of the difference in the tax bases and our generous capital allowances there might be no United Kingdom tax against which Brazilian tax could be set off, so that any reduction in Brazilian tax would benefit only the investor. Then under our imputation system, foreign tax can be set off only against mainstream corporation tax, and not against ACT and that where only a limited part of the United Kingdom tax is available for credit, any reduction in the overseas tax bill might accrue directly to the company.

Snr Dornelles replied that whilst Brazil does not want the United Kingdom to lose tax, she cannot allow the United Kingdom to collect more tax as a result of a Convention. A tax sparing provision would guarantee that the benefit of a reduction in Brazilian rates would pass to the investor. Mr Hopkins agreed that across the board tax sparing would be a guarantee but said that if the United Kingdom company rate was reduced to around 40 per cent there would be scope for reduction of Brazilian withholding rates without a transfer of benefit to the United Kingdom Revenue. He asked whether it would be easier for Snr Dornelles to present an agreement with no provision for across the board matching credit if the United Kingdom did not give unilateral relief. Snr Dornelles replied that he would have to think about this.

In reply to a question from Mr Hopkins about the 1st alternative proposal, Snr Dornelles said that he thought that the Convention should remain in force slightly longer than the limited matching credit period. Mr Hopkins said that the proposal would be more acceptable if the matching credit period was fixed at 5 years without any guarantee of reconsideration of the Convention at the end of that period. Snr Dornelles replied that in these circumstances a tax sparing period of 5 years would be too short if afterwards credit is to be given only for Brazilian tax paid at the same rates.

At the conclusion of the talks, Snr Dornelles handed over a written statement setting out the alternative Brazilian proposals. .
... A copy is attached to these notes.

paragraph 2 of this Article was tentatively
agreed in October 1974.

Article 27

Diplomatic and consular officials

1. Nothing in this Convention shall affect the fiscal privileges of diplomatic or consular officials under the general rules of international law or under the provisions of special agreements.
2. Notwithstanding the provisions of Article 4, diplomats of a Contracting State who are covered by the Vienna Convention and who are serving in the other Contracting State shall not be considered residents of that other Contracting State.

encl. 7.

Tuesday pm

Article 18 (Pensions and annuities)

At the request of the United Kingdom, it was agreed to delete the words "after retirement" in paragraph 2(a).

Article 2 (Taxes covered)

Snr Dornelles explained that the excess remittances tax is computed by reference to an average of the total registered capital calculated at the time of distribution. The tax does not apply simply to the issue of bonus shares on a capitalisation of reserves.

The tax on activities of minor importance has not yet been applied and Snr Dornelles doubted whether it could be imposed without the authority of Congress. The tax would take the form of an additional 20 per cent charge of withholding tax only on distributed profits and dividends. Snr Dornelles said he had no authority to exclude this tax from the Convention; the position is not negotiable by law. He confirmed that the tax would be supplementary to the normal withholding tax on distributed profits. Later, he handed over a translation of the Decree dated 10 May 1966 imposing this tax.

The United Kingdom reserved its position on the exclusion of these two taxes from the Convention.

5 per cent tax on distributed profits

Snr Dornelles confirmed that this is an additional company tax and not a withholding tax ie the company tax charge on distributed profits goes up from 30 per cent to 33.5 per cent.

Under her other DTA's Brazil will continue to charge the 5 per cent on distributed profits remitted to residents of the partner country.

Article 4 (Fiscal domicile)

Mr Hopkins said that the United Kingdom likes to include the second sentence of paragraph (1) of its draft to exclude from the benefits of the agreement a person who is exempt from tax under the Vienna Convention. The paragraph prevents him from getting a benefit which he does not have under the Vienna Convention.

After some discussion, it was provisionally agreed to add to Article 27 (Diplomatic and Consular Officials) a paragraph on the following lines:-

"Notwithstanding the provisions of Article 4, diplomats of a Contracting State who are covered by the Vienna Convention and who are serving in the other Contracting State shall not be considered residents of that other Contracting State".

Mr Hopkins agreed that if this proposed wording is found to be satisfactory the second sentence of paragraph (1) can be omitted.

Article 7 (Business profits)

Snr Dornelles was unhappy about the inclusion of the words "whether in the State in which the permanent establishment is situated or elsewhere" at the end of paragraph (3) of the United Kingdom draft. It might be thought that any expense abroad could be deducted and he did not wish to call attention to the position. Mr Hopkins replied that these words are included in our other agreements and omission of them from an agreement with Brazil could give rise to questions.

Snr Dornelles agreed to exchange letters with Mr Hopkins confirming that a British company established in Brazil would under the Convention be entitled to a deduction for expenses incurred outside Brazil which are connected with the permanent establishment there. The words at the end of paragraph (3) could then be omitted.

Mr Hopkins asked whether, without a business profits article, a Brazilian branch of a United Kingdom company would be entitled under Brazilian law to deduction for expenses incurred abroad. Snr Dornelles replied that paragraph (3) represents an extension of the branches rights under Brazilian law. If, for the benefit of its Brazilian branch, a London Head Office obtained technical advice from other sources for which it had to pay, the expenses could for the purposes of the Convention be allowed as a deduction against the branch profits, but this would not be the case under domestic law. Deduction would also be allowed under a convention for the salaries of Head Office staff working in London on, say, the plans of a road to be built in Brazil by the branch. Snr Dornelles said that United Kingdom companies work through subsidiary companies in Brazil, however, as branch profits, whether distributed or not are subject to the non residents withholding tax, although no further withholding tax would be payable on remittance of the profits to the United Kingdom.

Mr Hopkins asked what would be the position if a branch remitted money to the United Kingdom during the year to 31 December but would make its return 3 months later. Snr Dornelles replied that the physical act of remittance is important, the company would have to certify that its remittances had already borne the 25 per cent tax, ie they can only remit reserves or profits which have already borne tax. At this point Snr Dornelles confirmed that all income paid from Brazil to non residents is liable to withholding tax.

Management Fees

Mr Hopkins said that Management Fees are business profits unless they can be brought under other articles. It could be argued that management fees received by a parent company from its subsidiary would not be caught by the Independent Personal Services Article which should apply only to services rendered by individuals. If this is so they would fall under the Business Profits article and so be exempt from Brazilian tax. Snr Dornelles replied that this is why paragraph 5 of the Protocol is included; it is a principle of Brazilian taxation that the form used by the taxpayer cannot alter the concept of the law.

Mr Hopkins said that in taxing gross fees at 25 per cent or even 15 per cent, Brazil might be taking all the profit from the management services. We are reluctant to let a partner country charge withholding tax on management fees because they are not pure income. In a couple of recent agreements, however, we have recognised the right of the source country to tax the fees, but to allow the taxpayer a net income option.

Snr Dornelles replied that Brazil would not have the resources to investigate all expenses. Mr Hopkins said that if Brazil does not want to have a net income option, the withholding rate should be low or nil, but Snr Dornelles said he would want a higher rate with a tax sparing provision on the lines of his first alternative.

Snr Dornelles confirmed that Brazil would not allow as a deduction Management Fees paid by a Brazilian company to a 50 per cent controlling parent even when paid for bona fide commercial reasons. This does not constitute discrimination, as under Brazilian law, tax is payable on all payments to non residents, and different treatment for a United Kingdom resident receiving Brazilian income could not be justified. To relieve doubt about the position, paragraph 7 had been inserted in the Protocol. Mr Hopkins accepted that this provision did not offend the non discrimination article.

Mr Hopkins said that objectively speaking, Brazil was putting the companies from other countries into a difficult position unless they pushed up their price to cover Brazilian tax. Snr Dornelles agreed this might be so.

Wednesday am

Capital Gains

Brazil wants to tax gains on a sale by a United Kingdom parent company of its shares in a Brazilian subsidiary. Mr Hopkins said that the United Kingdom does not have a provision of this sort in any of its agreements. Snr Dornelles replied that if the right to tax dividends is given to the country of source, it is necessary to allow capital gains to be taxed in both countries, for otherwise companies would not distribute profits as dividends but increase capital and try to obtain capital gains. Brazil recognised the right of the state of residence to tax capital gains once it gives credit for Brazilian tax. Mr Hopkins replied that it is logical to tax capital gains in the state of residence because the capital comes from there. He also thought that after giving credit for Brazilian tax there would be little tax left for the United Kingdom, but Dornelles said that the Brazilian tax rate is only 25 per cent. There is a view in Brazil that although the charge to tax arises when the gain is made, the tax only becomes payable when the gain is remitted.

Mr Hopkins asked Snr Dornelles to consider the inclusion of a provision along the lines of Article 14(3) of the United Kingdom/Japan agreement, but Snr Dornelles replied that Brazil could not make any change in paragraph 3 of their draft Article which is included in all her conventions.

Independent Personal Services

Snr Dornelles said that Brazil considers all income generated in Brazil or capital exploited there to have a Brazilian source, irrespective of where the activity generating the income is performed. If they were to recognise that the state of residence has the exclusive right to tax independent Personal Services they would lose heavily - eg in the case of a Japanese lawyer going to Brazil for one day for a heavy fee. Mr Hopkins pointed out that under the Brazilian proposals they could tax if the payer was a permanent establishment or a company, but not if the payer was an individual, and asked whether, granted the right to tax Brazil would under the agreement be prepared to reduce its withholding rate. Snr Dornelles said that Brazil could make no changes in the independent personal services article. Mr Hopkins accepted that Brazil could go no further, but said that most management fees would be covered by the extended definition of royalties in the Protocol and he would like to refine it. Snr Dornelles said he could accept a definition referring to the supply of scientific, technical etc experience as in Article 10(5) of the United Kingdom/Australia DTA: Mr Hopkins said that the United Kingdom would consider this and write to Brazil.

Snr Dornelles said that for purposes of clarification he would be willing to include a provision that however long a person resided in Brazil and received Independent Personal Services, the fees would not be taxed there unless they were borne by a resident company or permanent establishment. Mr Hopkins said the United Kingdom could consider a form of words to cover this.

Mr Hopkins mentioned the case of a United Kingdom company selling machinery to a Brazilian concern and installing it over a fairly short period. Would Brazil distinguish between the payments for the machinery and for the installation? Snr Dornelles replied that in certain circumstances a contract would have to be registered with the Central Bank in order to obtain the installation services, which would be subject to withholding tax.

Students

Snr Dornelles said that as the word "gifts" in sub-paragraph (i) of the United Kingdom draft would present translation difficulties, they had substituted "remittances". It was agreed to use "gifts or donations".

After Mr Hopkins had explained the position of the student regarding United Kingdom personal allowances, Snr Dornelles accepted the exemption limit of £500 in sub-paragraph (2)

The Article was agreed.

Income not expressly mentioned

Snr Dornelles said that if Brazil does not know what other income exists she cannot give sole taxing rights to the other country. Mr Hopkins suggested omitting the Article but Snr Dornelles said that whilst he could not imagine a form of income caught by this type of article, it gave security to the honest taxpayer.

Mr Hopkins said that if the United Kingdom accepts Brazil's proposals this article should not present much difficulty. It was agreed to defer further consideration of the article for the time being.

Capital

Mr Hopkins outlined the United Kingdom's proposals for introducing a Wealth tax.

It was agreed to include a Capital article on the lines of the OECD model if either country has a capital tax or is likely to have one at the time of signature of the Convention.

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Elimination of double taxation

Mr Hopkins said that consideration of this article would have to be deferred for the time being whilst the Brazilian proposals for the elimination of double taxation were considered. He referred to paragraph (2) of the United Kingdom draft which requires the particular development reliefs and exemptions to be specified, and said that the possibility of changes in the law is covered by paragraph 2(b).

Mr Hopkins said that he would like the matching credit provisions to be reciprocal. Snr Dornelles was not enthusiastic but undertook to think about it. Mr Hopkins asked whether under the original proposals, Brazil wants the United Kingdom to give credit for all or part of the Brazilian tax given up under the Agreement. Snr Dornelles said that Brazil wished credit to be given as follows:-

Dividends - 25 per cent
Interest - 20 per cent
Royalties - 25/20 per cent

Snr Dornelles asked whether the United Kingdom was willing to give exemption to a United Kingdom resident for interest paid on Brazilian government bonds. Mr Hopkins reserved the United Kingdom's position and said that if a provision on these lines was acceptable it would have to be reciprocal.

Protocol

1. Paragraph 1 (Commissions)

Snr Dornelles said that commissions for services rendered, which are common in under-developed countries, presented problems for Brazil because they can be disguised as other forms of income. Mr Hopkins asked whether Brazil would require paragraph 1 of the Protocol if the 'sweep up' article gives both States the right to tax. Snr Dornelles said that the taxpayer would want to take commissions to Article 7.

Mr Hopkins said that he would be content to accept this paragraph if Brazil has problems but would consider whether there are any snags in this approach and whether it is necessary to provide a definition of commissions.

Paragraph 2

This provision is not in Brazil's other convention.

Snr Dornelles confirmed that if a United Kingdom resident has shares in a Brazilian company, the profits are subject to 30 per cent tax and are subject to withholding tax only if distributed.

Mr Hopkins accepted this paragraph. He would prefer to include it in the main article but has no objection to this form if Brazil would have presentational difficulties otherwise.

Paragraph 3

Accepted.

The other provisions of the Protocol have already been discussed.

At final meeting, Mr. Dornelles handed over copies of a note setting out Brazil's alternative proposals for resolving the difficulty of principle over the apportioning. A copy of the note is attached.

1st option

Mr. Dornelles confirmed that paragraph 3) applies to Brazil's original proposals with regard to tax apportioning as well as to the first option itself.

He also said that a 'matching credit' of less than the 20% shown in paragraph 4) would have to be accompanied by a smaller reduction in Brazilian tax.

Mr. Dornelles agreed with Mr. Hopkins that the matching credit period of twelve years in paragraph 4) could possibly be reduced, but that matching credit in respect of dividends could not be tied to a period of only five years.

2nd option

Mr. Dornelles explained that the 'certain limits' referred to in the second paragraph means the normal 25% withholding rate currently in force in Brazil.

Mr. Hopkins said that he appreciated the Brazilian gesture in making these alternative proposals. He felt, however, that the 1st option did not differ greatly from Brazil's original proposals so far as the United Kingdom's restrictions are concerned and it was impossible to forecast whether it could be accepted. The 2nd option was attractive from a practical point of view, but made no great difference to the existing position and again he could not forecast whether it would be acceptable to the United Kingdom.

Thursday 31 October

At this brief final meeting, Snr Dornelles handed over copies of a note setting out Brazil's alternative proposals for resolving the difficulty of principle over tax sparing. A copy of the note is attached.

1st option

Snr Dornelles confirmed that paragraph b) applies to Brazil's original proposals with regard to tax sparing as well as to the first option itself.

He also said that a 'matching credit' of less than the 20% shown in paragraph b) would have to be accompanied by a smaller reduction in Brazilian tax.

Snr Dornelles agreed with Mr Hopkins that the matching credit period of twelve years in paragraph d) could possibly be reduced, but that matching credit in respect of dividends could not be tied to a period of only five years.

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~~CONFIDENTIAL - SECURITY INFORMATION~~

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Brasilia, October 31st, 1974

From: Francisco Neves Dornelles
President, International Tax Studies Commission

To: Mr. Derek Hopkins
Assistant Secretary in the International Division
Inland Revenue

Reference: Brazil-United Kingdom Tax Convention

Dear Mr. Assistant Secretary:

The position of Brazil regarding the articles on Dividends, Interest, Royalties and Methods for the elimination of double taxation on income is the following:

1st option:

- a) it could be examined the possibility of reducing the Brazilian withholding tax on dividends, royalties and interest;
- b) the reduction of the Brazilian tax shall be connected with the concession by the United Kingdom of a matching credit of 25% in the case of dividends as well as royalties paid to a resident of the United Kingdom which controls more than 50% of the voting capital of the company paying the income. In the case of interest and other royalties the matching credit could be of 20%;

- c) it should be established a matching credit of 30% corresponding to corporation tax in Brazil, as well as for the withholding tax on dividends, interest and royalties, within the rates foreseen in letter b, in the cases where the Brazilian tax is reduced or relieved as a result of a policy of tax incentives;
- d) it could be considered the possibility of the matching credit be established for a limited period of time of at least twelve years.

2nd option:

If the United Kingdom does not grant a matching credit to compensate the reduction of the Brazilian tax, such a reduction cannot be granted.

As a consequence, in the Convention, the Contracting States would compromise themselves not to raise above certain limits the rates of their taxes on profits, including dividends, interest and royalties arising in one State and received by residents of the other State.

When we mention in both options the term "royalties" it is understood that it includes also payments of any kind paid as consideration for the supply of scientific, technical, industrial or commercial knowledge, information or assistance.

STAMPS AND TAXES DIVISION

BRAZIL

Note on Management Fees

Before the last round of talks with Brazil we suggested including in the Convention a Management Fees article limiting the Brazil tax to 12½ per cent of the gross fee with an option for the recipient to be taxed on a net income basis under the Business profits article. Dornelles said however that he did not want to include a net income option and would want to levy tax on the gross fee and the UK to give credit for tax given up in return for any reduction in the withholding rate.

If we do not have a Management Fees article we said that the income would fall to be dealt with either under 1) the Business profits article or 2) the Independent Personal Services (IPS) article. The effect of this, as I see it, would be that in the case of 1) there would be no Brazil tax if there is no permanent establishment in Brazil; where there is a permanent establishment there, Brazil could levy tax on the net income after the deduction of expenses including those incurred outside Brazil. In the case of 2) we were prepared to allow Brazil to tax where there was a fixed base in Brazil or where the recipient was present in Brazil for more than 183 days in the tax year.

Where liability to Brazil tax arose a UK national would under paragraph (1) of the Non-discrimination article be entitled to deduct the same expenses that a Brazil national in the same circumstances could have deducted. This would depend on the period of time spent in Brazil - if it is less than 12 consecutive months no expenses would be deductible - if it is more than 12 consecutive months the expenses incurred in Brazil would be allowable.

Dornelles said however that he did not want the Business Profits article to apply to Management fees and for this reason he wanted to include in the Protocol a provision that the IPS article was to apply where the recipient of the fee was a company as well as an individual. He was willing to write into the IPS article a provision that fees would not be taxable in the source country unless they were borne by a company or a permanent establishment there no matter how long the recipient resided in Brazil, in that country.

We said that we would consider the extension of "royalties" to include certain kinds of management fees. Before doing this there is a fundamental point which I think we should clarify.

In the absence of a DTA with Brazil we do not give credit unilaterally for the 25 per cent B withholding tax on management fees as it is a tax on gross receipts and consequently does not correspond to income tax or corporation tax in the UK [Section 498(6)]. Section 497(1) enables us to make a DTA with another territory "with a view to affording relief from double taxation in relation to income tax or corporation tax and any taxes of a similar character imposed by that territory". It would therefore seem that the Brazil tax levied on gross management fees is not a tax of a substantially similar character to income tax or corporation tax and that we do not have power to give credit under a DTA to relieve the double taxation for a tax calculated on a gross income basis. No problem would arise if there was a provision in the DTA for tax to be levied on the net income as the tax would then be of a substantially similar character to income tax in the UK.

STAMPS AND TAXES DIVISION

If we do not think it proper to give credit under the DTA we could have a provision in the Elimination of double taxation article on similar lines to the last sentence of paragraph (2) of Article XVIII of the 1967 German DTA (which is reproduced in the 1971 Protocol). Brazil would be unlikely to agree to reduce its withholding rate of tax on certain fees (Those which fall under the Royalties article) if we are not going to give any credit at all as they want us to give credit for more than the tax which would be payable of 15 per cent. Brazil would probably prefer that all Management fees should be dealt with under the IPS Article as this would not restrict the rate of Brazil tax except that expenses incurred in Brazil might be claimed in certain circumstances under the provisions of the Non-discrimination article. Another way of dealing with this would be to exclude from the Taxes covered article the Brazil tax on gross management fees.

There is a possible line of argument that, where Brazil reduces its rate of withholding tax to 15 per cent in respect of management fees under the Royalties article, we should regard this as a tax of a similar character to income tax by reason that the tax of 15 per cent may reasonably be said to approximate to the tax that would have been charged on the measure of profit. However I do not think that this alters the principle that it is a tax on gross receipts which we would not allow unilaterally and in any case it would not apply to those fees which fall under the IPS Article and which would suffer the 25 per cent tax.

This problem may also arise in the case of Iran where certain fees are taxed on the gross and has recently arisen on a Uganda case, (T1169/267/74) where a tax on gross management fees was introduced at a time when there was an existing DTA.

This was d/w in the particular context of Uganda.

Alf Adams

28 Jan 75

The Brazilians would be willing, I think, to accept a definition of royalties similar to that in our Australian I.N.Z. agreements where the definition includes payments for "the supply of scientific, technical, industrial or commercial assistance" but I do not think we intended these words to cover management etc. fees. In view of our very doubtful position on credit for taxes on gross ~~receipts~~ fees, we shall have to think very carefully before accepting any proposal which would enable Brazil to charge on the gross under a DTA. Perhaps we can look at this later in the light of possible developments in Kenya & elsewhere, when (+y) we undertake further discussions to the Brazilians.

Mr Hopkins

Original - PS 9006/76

BRAZIL: MATCHING CREDIT

1. I discussed the Department of Trade reactions to our Brazilian negotiations with Mr Lord on 20 March. Apparently the last letter to the Secretary of State had given the impression that we were changing our ground. I explained that we had given a fuller explanation of our difficulties than previously, but it became apparent that the Department had misunderstood our objection to the matching credit proposal. They had not realised that in addition to the normal matching credit for pioneer reliefs and to reciprocal reduction of withholding rates the Brazilians were asking us to give credit for their withholding taxes as if no reduction had taken place. It was accepted that this was rather greedy.

2. The Department are aware that other countries have not found this requirement an obstacle to concluding an agreement, but I explained that these countries all operated on the exemption method.

3. I suspect that opinion in the Department of Trade might well favour our giving matching credit on the lines proposed by the Brazilians, because it involves giving assistance to the trader or investor, and not a mere reallocation of the take between the two governments. If however we met the Brazilian demand we would have to do the same thing for other countries and the total cost could be very high. Such generosity towards foreign trade and investment would be out of line with current policy in relation to overseas as compared with domestic investment.

4. The comparison with France might lead other departments to make fresh representations in favour of the exemption system. This also would be a costly change in the tax system, involving a great deal of administrative complication in policing transfer prices, and would facilitate the diversion of profits to tax havens as much as trade and investment in countries with which we had double taxation agreements.

5. A Dept of Trade principal will get in touch to look at the figures. I see how much truth there is in the British companies' assertion that they must earn a lot more in Brazil to match the returns & remittances home of German & Japanese.

A H S

24 March 1975

Mrs Smallwood

DOUBLE TAXATION AGREEMENT WITH BRAZIL

1. Alan Lord's letter of 12 May.
2. I have checked a few figures as marked on page 1 of Industry's note. I am not sure whether the figure of new UK investment in Brazil for 1973 should not be £34.1 m not £24.1 m (Business Monitor Table 20 : appendix 1).

DOUBLE TAXATION AGREEMENTS

3. I understand that only Japan of the competitor countries listed in Table III on page 2 of the Industry note has a double taxation agreement with Brazil, signed in 1967 (reducing the withholding rate on dividends from 25% to 10%), a US draft not having been ratified and a West German one so far only initialled (note attached: appendix 2). I attach a table from the Brazil Brief showing reduced rates of withholding tax provided for by agreements with Brazil (appendix 3). I would not have thought that the fact that we did not have a double taxation agreement with Brazil fully explains why we have fared unfavourably vis-a-vis the other countries listed in Table III which also do not have a double taxation agreement with Brazil (although it is of course true that Japan is one of the two countries which have overtaken us in Table III).

INVESTMENT AND DIVIDEND FLOWS

4. It is interesting to note that the proportion of remitted profits over total profits is so high in the case of Brazil if the withholding tax is the discentive which Industry allege i e £16.2 m out of £39.6 m (40.9%) in comparison iwth a world total of £416 m out of £1,263 m (32.9%) (Business Monitor Table 3: appendix 4).
5. The 1973 Business Monitor shows that our net outward investment in Brazil in that year was £34.1 m out of a total for all areas of £1,624.4 m (2.1%) (Table 21: appendix 5) and our net outward earnings were £40.3 m out of a total of £1,458 m (2.8%) (Table 22: appendix 6). It is therefore arguable that such comparatively modest figures do not necessarily make a case for changing our basic principles of double taxation agreements accepted by most of our trading partners (cf the last sentence of paragraph 2 of Industry's note in this connection).

UNILATERAL RELIEF

6. Industry's note seems to ignore the fact that we give unilateral relief for Brazil's withholding taxes anyway (Brazil's basic company tax rate is 30%).

INVESTMENT IN BRAZIL IN GENERAL

7. I attach a copy of an article I found in the Library (appendix 7) which confirms that the Japanese are now the most dynamic investors in Japan and gives reasons for investment failures in Brazil.

P W FAWCETT
16 May 1975

17
BOLIVIA (Continued)

set up by the Industrial Bank. The Bank already acts as a channel for a high proportion of development loans from abroad-- at present estimated at around US\$40 million-- and will now make available to the mining sector some US\$400,000 in shares in the proposed development bank.

Meanwhile Raul Lopez, Minister of Mines, has said the government will be 'very flexible' on terms for foreign investment in mining. He recently outlined a number of important ground-rules for policy on mining investment: Bolivia is to retain a 70% interest in the overall production value of the country's mineral resources, and will have at least a 51% interest in any joint venture. It will however guarantee foreign investment, allow transfer abroad of all profits and allow full export of all minerals except gold-- 50% of which must remain in the country. The government plans to authorize 30-year concessions and permit 25% depreciation in the first two years of operation and 50% a year for the subsequent six years. Royalties are to be fixed in relation to individual metal prices--currently, for instance, these are 25% for tin.

At the same time the government has announced that it will be reducing royalty rates on low-grade copper ore and concentrates over the next three years. Royalties will be waived completely on concentrates with less than 10% copper content, will be cut by half on concentrates with between 10% and 15% content and by 5% on concentrates with under 24% copper content. Copper production in Bolivia has shown virtually no increase over the last few years, largely because high transportation and production costs and taxes have offered little incentive to development.

BRAZIL-GERMANY, DOUBLE TAXATION TREATY

Brazil and Germany signed a double taxation treaty (at technical level) in an effort to incentivate a greater flow of German investments (currently around the US\$520 million mark) into Brazil. The clauses of the agreement include exemption from taxes (in Germany) on dividends from investments in Brazil, reduction (in Germany) of the interest tax on loans and financing for Brazilian enterprises, and also interest on Brazilian government debt bonds; reduction (in Germany) of tax on earnings from technical assistance rendered by German companies to Brazilian.

EGYPT

TAX BREAKS TO LURE FOREIGN INVESTORS

BRAZIL'S DOUBLE TAXATION AGREEMENTS

WITHHOLDING RATES (GENERAL)

	DIVIDENDS	INTEREST	ROYALTIES
FRANCE	15%	15%/10%	10%/25%/15%
BELGIUM	15%	15%/10%	10%/25%/15%
PORTUGAL	15%	15%	10%/15%
NORWAY	25%	25%	15%
JAPAN	10%	10%	10%
SWEDEN	no restriction	no restriction	15%
U.S.A. *	-/20%	15%	15%
FINLAND	25%	15%	10%/25%/15%

* Not yet ratified
and not likely to be.

GERMANY
(initialled)

15%

15/10%

15/25%

RESTRICTED



BRITISH EMBASSY

BRASILIA

6 August 1975

20/2

I P Gunn Esq
Secretaries' Office
Inland Revenue
Somerset House
London WC2R 1LB

Dear Gunn,

Many thanks for your letter T1169/242/74 of 24 July.

2. I had a word yesterday with Dornelles who was recently promoted to the position of Procurator-General of the Ministry of Finance but is continuing to supervise double taxation negotiations. He told me that final agreement had not yet been reached with the Canadians although they had almost got there. He was expecting a Canadian draft on the two outstanding points and promised that as soon as agreement was reached he would let me have the details. It transpires that he will himself be in London during the third week of September for a meeting of the International Fiscal Association. Although he expects to be rather fully occupied with that meeting I believe that he would welcome a chance to meet Barry Pollard if a mutually acceptable time could be found, e.g. over lunch. He expects in any case to be going to the UN meeting in December but I hope that before then it may be possible to arrange for a further round of talks at which you might explore for a way forward out of the present impasse.

3. Dornelles said that he would be glad to receive another visit from yourselves here or to visit the UK himself for talks. Perhaps you would let me know whether Pollard will be in London during the meeting of the IFA and would like to arrange a meeting with Dornelles.

4. Meanwhile the German/Brazilian agreement was signed on 27 June in Bonn. The final text was the same as that given to you last August. You may also like to have the enclosed summary of the double taxation agreements already in force between Brazil and other countries.

5. Could I also ask whether Humphreys & Glasgow have been in touch with you about the disadvantages which they claim to have suffered as a result of the absence of an Anglo/Brazilian double taxation agreement? Our Consulate-General in Rio had heard direct from them, and I was told again by the Secretary-General of the Brazilian Ministry of Industry and Commerce last week,

/that

RESTRICTED



that the higher rate of withholding tax which H&G had to pay had tipped the balance in a close competition for a major petro-chemical contract in Bahia last year.

Yours sincerely,

Donald Cape

D S Cape

Enc

The CBI Sub-Group on double taxation came to a special meeting in the Board Room on 6 August to discuss the Brazilian Double Taxation Agreement. Those present were: Mr Horleliffe (Baillet-Latour), Mr Crowe (ICT), Mr Evans (Commercial Union), Mr Gray (PTZ), Miss James (Shell) and Mr Morant (CBI). Mrs Smallwood, Mr Collins and Mr Adams represented the Board.

I outlined the reasons for having a discussion on Brazil. There was a good deal of pressure on the trade side to have an agreement, almost regardless of cost and content. We were still in negotiation with Brazil but seemed unlikely to reach agreement because of a range of problems. The first was the Brazilian concept of matching credit, which includes not only credit for pioneer reliefs in the usual sense but also credit for tax foregone under an agreement by reduction of withholding tax rates. This was something which we could not do under our enabling powers, and was something which could be costly for the country if we had to make agreements, or revise agreements on similar terms with developing countries generally.

Matching credit was not however the only problem. There are a number of features of the Brazilian tax code which are expensive for British investors and are unorthodox by western fiscal standards. It was probably assumed that if we had an agreement it would remove or modify these features, but present indications were that this was unlikely to happen. The most important of these was the treatment of royalties; royalties paid to a related foreign company are disallowed in the computation of the paying company, and are also subject to withholding tax. There is also the additional remittances tax which the Brazilians regard as non-negotiable and which applies ^{to} branch profits as well as to profits of subsidiary companies, the charge on commissions and the treatment of service payments as royalties.

The question for discussion was whether an agreement on those lines was worth having to British industry either on its own or as the precursor of other similar agreements with developing countries.

The general reaction was unfavourable. Those present felt that if we conceded the Brazilian point of view about royalties British interests would be wide open in other countries to having royalties treated in the same way as dividends. There was not however identity of view because some companies would benefit substantially from pioneer relief for operations in the North Eastern Territories, while others would obtain no pioneer relief. Naturally none of them would refuse matching credit for reductions in withholding taxes, but that was not something for which British interests would press. All those present could see risks in accepting the Brazilian treatment of royalties, which they assume would spread to any other Latin American countries with which we might conclude an agreement, to developing countries in the Far East, and to Africa.

It was accepted that the consequence of having unilateral relief was that the only real loss from the absence of an agreement was pioneer relief. Competitors in countries which have concluded an agreement with Brazil were of course benefiting from the matching credit for reduced withholding taxes, whether given as a credit or as a consequence of exemption methods. Mr Norcliffe took the opportunity to stress once again the benefits of the exemption method which automatically transferred to the investor the benefits of pioneer relief. In his view the application of the exemption method to trade dividends would be of great advantage to international trade. (This is of course a familiar argument, and our policy is firmly in favour of the exemption method.) It was pointed out that there are ways by which companies can mitigate the effects of the situation, and in particular it was hoped that we would not be too rigorous in the application of Section 485 in relation to royalties. I said that one could give no undertaking about Section 485; it would obviously be impossible for us to ignore any blatant breaches of the arm's length principle and there could be criticism from the PAC if that happened which would be damaging to the companies as well as to the Revenue. The underlying point they made was however taken.

Mr Morant for the CBI then asked how confidential these consultations were because in order to clear the lines with the CBI he would have to raise the question with his Council. This consists of some 400 members and I said that on grounds of confidentiality we could not support this. There was then a useful discussion from which it appeared that the CBI Secretariat (but not the Overseas Tax Panel) are well aware of the powerful trade and political pressures in favour of having an agreement (apparently any agreement) with Brazil which he thought could lead to an explosion in the autumn. His personal view was that the Revenue and Treasury Ministers could be under pressures from other Ministers which might lead to an agreement, in spite of the unsatisfactory features that had been discussed. Much of the pressure is based on ignorance of the effects of unilateral relief and of the likely terms of a treaty, and it appears that much of it is generated in Brazil and by companies whose only overseas operations are, or are likely to be, in Brazil and which operate on the basis of official handouts. To such companies it might well appear that the absence of a double taxation agreement was a serious disadvantage and they would be unlikely to know about the possibilities of mitigation which are familiar to larger and more experienced companies.

It is alleged that the Brazilian tax authorities has spoken very freely to British interests, particularly city interests about the importance of an agreement, but it is not clear that they have given an accurate account of the matter. In particular it is alleged that they have indicated that if ^{we} were to give way on matching credit they would give way on royalties. The fact is however that both the history of our negotiations and the evidence of other treaties indicates that the royalties point is indeed non-negotiable. Mr Crowe's view is that it is up to the

CBI to make representations to the Brazilian authorities about what they regard as unsound taxation in particular of royalties. I said that whatever happened we could not breach the normal rule of preserving the confidentiality of discussions between governments and in the end it would probably be counter-productive to do so. I would however be very glad to have particulars of any published leaks but it was thought that there had been none. The CBI will no doubt have to consider how to deal with the situation in which it is speaking with two voices, and I said that we had taken note of this helpful discussion and would see what action was appropriate at the right time.

AHS
7/8

Copies to:

Mr Pollard
Mr Collins
Mr Gunn
Mr Fawcett
Mr Adams ✓

BRAZIL

Apart from the question of credit against UK tax for Brazilian tax given up under the agreement, the main outstanding points are as follows:-

1. Taxes covered.

The Brazilians want to exclude from the provisions of the Convention - and therefore to be able to charge without ^{exclusion} ~~reduction~~ - their taxes on activities of minor importance and on excess remittances.

The minor activities tax has not yet been applied, although the enabling legislation exists. It would take the form of an additional charge of 20% to be withheld from profits and dividends distributed to individuals and legal persons resident or domiciled abroad from activities considered to be of minor importance to the Brazilian economy.

The excess remittance tax is levied at progressive rates from 40% to 60% on the amount by which dividends and other profits distributed to non-residents exceeds 12% of the foreign capital registered at the Central Bank of Brazil.

In our view all Brazilian taxes on income, profits and capital gains should be covered - in order to maintain the scope and balance of the Convention - but Brazil attaches great importance to their exclusion. They are not covered by any other DTA made by Brazil.

2. Branch profits.

Under Brazilian law the profits of a Brazilian branch of a United Kingdom company are liable to non-residents withholding tax, whether or not they are remitted to the United Kingdom. Brazil wants to retain the right to levy such a tax under the Convention at a rate not exceeding 15% of the gross profits determined after payment of the corporation tax thereon.

The matter is probably not of great practical importance in the context of Brazil as few UK companies work through branches there. Presumably, however, the Brazilians would want us to give credit for all or part of the Brazil tax given up under the Convention as well as for the 15% tax paid. In their French DTA, tax is levied at 15% and the French give credit at 20%.

3. Capital gains.

The Brazilians want to preserve in the Convention their right under their law to tax all capital gains arising in Brazil to a United Kingdom resident with the exception of gains from the alienation of ships or aircraft. Whilst recognising their right to tax gains from the alienation of immovable property situate in Brazil, our position has been that they should not be entitled to tax gains attributable to Brazilian movable property unless it

is connected with a permanent establishment there. Apart from the few Conventions from which we have omitted a capital gains article (usually because the other country does not tax such gains) the furthest we have so far gone in this particular direction is in Article 14(3) of our agreement with Japan which provides that capital gains from the alienation of shares in a company may be taxed in the country in which the company is resident, although certain minor disposals are excluded from the paragraph. The Brazilians rejected our offer to include such a provision in the Convention. They will not make any change in paragraph 3 of their draft article which appears in their agreements with France, Germany, Belgium and Spain. The article in their Japan agreement is on OECD lines, but this dates from 1967.

~~Under Brazilian law, expenses incurred in Brazil would be deductible.~~

// Royalties and management fees

The Brazilians want to extend the definition of royalties to include income derived from "the rendering of technical assistance and technical services" ie tax would be withheld from the gross amount of the payment for such assistance and services at the rate specified in the royalties article and Brazil would want us to give credit for the reduced Brazilian tax paid and for all or part of the tax given up under the article. Mr Hopkins said at the Brasilia talks that most types of management fee would be covered by this definition and he would like to refine it. The Brazilians replied that they would accept a definition of royalties including payments for the supply of scientific, technical or commercial assistance" as in our Australian agreement.

We ought, however, to think again about our offer to consider an extended definition of royalties going some way to accept Brazil's proposals because:-

- (i) acceptance would mean that Brazil could tax gross fees coming within the definition
- (ii) whilst it is arguable that the above-mentioned words in the Australian agreement would cover management fees, we did not intend to make such a concession
- (iii) there are grave doubts about our power to give credit for Brazilian tax levied on a gross fee (unless the rate is low enough to be equivalent to tax at the full rate on the net income)

Brazil will not accept a Management Fees article containing a net income option.

N.B. Our agreement with New Zealand - which the Brazilians did not mention at the Brasilia talks - contains a definition of royalties on the lines mentioned above, but unlike our Australian DTA it also provides an election to be taxed under the business profits article.

5 Independent personal services

Under Brazil's proposals, other fees for services would generally be caught by the IPS article and thus be liable to Brazilian tax at the full non-residents' rate of 25%. Brazil wants to ensure that fees paid by a Brazilian subsidiary to its UK parent company, which would not be caught by the Business Profits article, do not escape Brazil tax, and therefore wants the IPS article to apply to activities "exercised by a company or civil society" as well as by an individual - as in their German agreement.

Brazil will not accept an IPS article containing a fixed base or 183 day test but wants the right to tax services given by an individual, company or civil society if payment for those services is borne by a company resident in Brazil or by a permanent establishment situate there. Their German agreement contains an article on these lines. The length of time spent by the recipient in Brazil is immaterial - but under this Article Brazil could tax fees paid to a United Kingdom company (as well as an individual) whether or not the services are rendered in Brazil, provided the payer is a Brazilian company or permanent establishment. Although payments made by a Brazilian individual would not be caught by the Article, it represents a considerable widening of Brazil's taxing powers compared with our normal type of IPS article. Brazil could for example tax cases where the recipient of the income spends only a short time in the country, eg a UK lawyer going to Brazil for only a day for heavy fee ^{and in many} ~~summary~~ cases, it seems that expenses would not be deductible under Brazilian law.

6 Commissions

Brazil also wants to include a provision that nothing in the Convention shall prevent a Contracting State from taxing commissions arising in that State and paid to a resident of the other State in connection with services rendered by such a resident. There is a provision on these lines in the Brazil/Germany DTA.

At the Brasilia talks, Mr Hopkins agreed in principle to accept this provision but we ought to look again at commissions where the Brazilian tax would not be restricted to the net.

7 Non deduction of royalties

Dornelles confirmed at the Brasilia talks that Brazil would not allow under the Convention deduction for royalties paid by a Brazilian subsidiary company to its UK parent which controls at least 50% of the voting capital of the Brazilian company, even where the payments can be shown to have been made for bona fide commercial reasons. The Brazilian requirement, which reflects Brazilian domestic law, would extend to payments for technical services and technical assistance if these are brought within the definition of royalties.

ORAL

THURSDAY 7TH AUGUST 1975

La - West Lothian

MR TAM DALYELL: To ask Mr Chancellor of the Exchequer, when he hopes to introduce a double taxation relief agreement with Brazil.

DRAFT REPLY

As soon as current negotiations with Brazil have been brought to a satisfactory conclusion.

/NOTES FOR SUPPLEMENTARIES

ANNE KIRKNESS

1 August 1975

CONSEQUENCES OF ACCEPTING BRAZIL'S PROPOSALS ON MATCHING CREDIT

8. The distinction between tax "spared" under the development incentive provisions of Brazilian law and tax given up under the agreement itself is not simply a matter of technique. Acceptance of Brazil's proposals could only stimulate outward investment from this country to Brazil but whilst this might be welcome so far as it led to increased trade between the United Kingdom and Brazil, it would mean that we were giving an inducement to investment in Brazil compared with investment elsewhere, including the United Kingdom itself. This would involve changes in tax policy which would have not only revenue consequences but implications for the balance of payments, and the appropriate level of overseas, as opposed to domestic, investment. The effects could be significant if, as seems likely, the Brazilian agreement sets a precedent for other developing countries and becomes a model for our agreements with them.
9. Furthermore, we would bear a larger share of the burden of relieving double taxation than under existing agreements with other capital importing countries. These countries accept restrictions on their right to tax payments made to United Kingdom residents and, in return, we give credit against United Kingdom tax only for the reduced tax charged there.
10. It would also 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. The countries which have accepted Brazil's proposals are mostly countries which relieve overseas trading income in this way. We think that the credit method of relieving double taxation is superior to the exemption method in several respects (mainly in the control it provides against tax avoidance).

EFFECT OF ABSENCE OF AN AGREEMENT

11. The main consequence for a United Kingdom taxpayer of not having a double taxation agreement with Brazil is that he continues to be liable to the full rate of Brazilian withholding tax on dividends, interest and royalties. But his total tax bill is not necessarily higher than under an agreement because credit is given unilaterally against his United Kingdom tax for the Brazilian tax he has paid. Compared with exemption or reduction of Brazilian taxes this affects his cash flow, because he first pays Brazilian tax and later is given credit for it against his United Kingdom tax bill, and it may involve extra work in claiming relief; but at the end of the day he will normally be no worse off than if he paid a reduced amount of Brazilian tax - United Kingdom residents operating in Brazil are therefore at a disadvantage compared with competitors from countries which have an agreement with Brazil only in relation to tax "spared" in Brazil, whether under the terms of an agreement itself or under such incentive relief provisions of Brazilian law as we agreed to include for matching credit purposes.

BENEFITS TO BE OBTAINED FROM AN AGREEMENT

12. Perhaps the most important benefits of double taxation agreements are intangible. By providing clear and equitable rules for the treatment of income which is subject to double taxation, such agreements foster trade and investment between the partner countries particularly in the case of developing countries they often introduce an element of certainty into an otherwise vague and confusing fiscal situation, and they give protection against discriminatory taxation. In the case of Brazil, however, 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.

UK/BRAZIL DTA

List of points of difficulty

1. Credit for tax given up under DTA

The Brazilians insist that in return for any reduction under a DTA in the rate of their withholding tax, which would take effect only after 3 years, on dividends, interest and royalties flowing to the United Kingdom we should give credit against United Kingdom tax for all or part of the Brazilian tax given up as well as for the reduced Brazilian tax paid at the following rates:-

Dividends - 25 per cent.

Interest - 20 per cent.

Royalties - 25 per cent where received by a United Kingdom resident controlling more than 50 per cent of the voting capital in the company paying the royalties.

20 per cent in other cases.

If the United Kingdom does not give credit for tax given up the Brazilians have suggested that the DTA should limit the withholding tax to the rate currently in force in both countries (25 per cent in Brazil).

2. Taxes covered by the DTA

The Brazilians are adamant that a DTA with the United Kingdom should not restrict their right to levy the excess remittance tax and the tax on activities of minor importance.

All DTAs concluded by Brazil exclude these taxes.

3. Independent personal services

Brazil do not accept the concept of a fixed base and want to retain the right to tax if the payment is borne by a company or a permanent establishment in Brazil. Such a provision is contained in Brazil's agreements with France, West Germany, Belgium and Spain. *The DTA with Japan has a fixed base rule.*

4. Royalties/Management fees

Brazil want to tax as royalties, payments to United Kingdom residents for technical assistance and technical services. They cannot accept a Management fees article containing a net income option. Brazil would accept a definition of "royalties" as shown in the United Kingdom/Australia DTA. Other fees not falling within the Royalties article would be dealt with under the Independent personal services article even if received by a company.

The definition of "royalties" in the United Kingdom/Australia DTA includes the words "for the supply of scientific, technical, industrial or commercial knowledge, information or assistance" and was taken from the United Kingdom/New Zealand DTA. This latter agreement however, unlike the one with Australia, contained a provision that the recipient of the royalties could elect to be taxed under the business profits article.

We were subject to criticism that the definition of "royalties" in the United Kingdom/Australia DTA was too wide and Mr Johnstone replied to Mr A G Davies pointing out that the definition was perhaps not as wide as Mr Davies appeared to think (PS 924/68). Nevertheless, so far as I am aware, we have not concluded an agreement since then containing these words.

There is a further difficulty to our agreeing to the Brazilian proposals. Would we be exceeding our statutory powers by giving credit for Brazilian tax which was charged on a gross fee without regard to any expenses?

(The definition of "royalties" as extended by the Protocols in Brazil's agreements with West Germany and Spain includes payments for technical assistance and technical services.) The agreements with France and Belgium do not contain an extended definition.

Tefar,

5. Deduction of royalties

Brazil will not agree to allow as a deduction in computing profits, royalties paid by a Brazilian company to a United Kingdom resident controlling 50 per cent or more of the voting capital in the paying company. This would apply also to payments for technical assistance and technical services and reflects Brazilian domestic law.

6. Capital gains

Brazil want the right to tax all capital gains (including those made by a United Kingdom parent company on the disposal of its shares in a Brazilian subsidiary) except those relating to ships and aircraft operating in international traffic.

Such a provision is included in Brazil's agreements with France, ~~West Germany~~, Belgium and Spain. *The DTA with Japan is on OECD lines.*

7. Commissions

Brazil do not want a DTA with the United Kingdom to restrict Brazil's right to tax commissions at the rate of 25 per cent.

(There is an express provision to this effect in the Brazil/
West Germany DTA.)

8. Branch profits

Brazil charges a non-residents withholding tax of 25 per cent on the profits (after deduction of tax at 30 per cent) whether distributed or not. Brazil insist on retaining this right but they would be prepared to reduce the tax to 15 per cent, if we gave credit for the 25 per cent. *France 15% - credit for 20%; Belgium 15% - exempt from Belgium tax*

Japan 10% - credit for 10%

9. Interest

Brazil want interest paid by a Government of one country to be exempt from tax in the other country. *Not included in DTA with*

Belgium & France

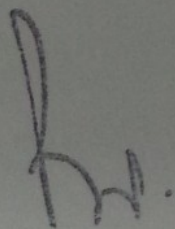
cc Mrs Smallwood
Mr Gunn ✓

NOTE OF TELEPHONE CONVERSATION ON 26 SEPTEMBER 1975

1. After much difficulty - all arrangements for meeting him having failed - I finally managed to speak to Mr Dornelles this afternoon on the telephone before his departure tomorrow morning for Brazil.

2. Mr Dornelles was his usual polite and cordial self but it was nevertheless quite apparent to me that he was not keen for us to meet. In our brief conversation he made it clear that there had been no change in thinking on the Brazilian side about the terms on which a treaty could be made. Since clear-cut proposals and alternatives had been put in writing by Brazil to the UK the next move, as he saw it, was for the UK to decide whether to accept Brazil's terms or not. Brazil's attitude had neither hardened nor weakened: it was completely unchanged.

3. Mr Dornelles suggested that since we would both be attending the UNO meeting in New York in December we should take the opportunity to talk, in some detail, about the respective Brazilian and UK positions and consider whether there was any point in resuming formal discussions early in 1976. I readily agreed to this suggestion and this was how matters were left.



B POLLARD

CONFIDENTIAL

DOUBLE TAXATION: UNITED KINGDOM/BRAZIL

SUMMARY OF BRAZILIAN DEMANDS

The Brazilians will reduce under an agreement their rate of withholding tax on dividends, interest and royalties flowing to the United Kingdom only if credit is given against United Kingdom tax for all or part of the Brazilian tax so given up, as well as for the reduced Brazilian tax paid and for tax 'spared' under pioneer reliefs given by Brazilian law in order to promote development there. Any reduction of the Brazilian rate on dividends, and on royalties paid by a Brazilian company to its United Kingdom parent would only take effect 3 years after the agreement enters into force.

The Brazilians also want to preserve in an agreement a number of features of their domestic tax code. They want to continue to:-

- a. disallow deduction in computing profits, for royalties paid by a Brazilian subsidiary company to its United Kingdom parent;
- b. charge their additional tax or excess remittances of dividends and other profits;
- c. tax commissions arising in Brazil and paid to a United Kingdom resident;
- d. impose their withholding tax on the profits (whether remitted or not) of Brazilian branches of United Kingdom companies. They will reduce their rate to 15% three years after the agreement enters into force if the United Kingdom gives credit for all or part of the tax so given up as well as for the reduced Brazilian tax paid.
- e. extend the definition of royalties to include payments for technical assistance and technical services;
- f. tax other service payments by extending the Independent Personal Services article to companies as well as individuals and dispensing with the fixed base concept;
- g. tax all capital gains (including those made by a United Kingdom parent company on the disposal of its shares in a Brazilian subsidiary) except gains relating to ships or aircraft operating in international traffic.

Note
prepared for
meeting
with CBI

October 1975

BRIEF FOR THE SECRETARY OF STATE FOR TRADE
DOUBLE TAXATION AGREEMENT: BRAZIL

BACKGROUND

We already have a limited double taxation agreement with Brazil covering shipping and air transport profits. Recent negotiations for a comprehensive double taxation agreement have revealed several major difficulties, the main one being the Brazilian insistence that in return for any reduction under an agreement in their rate of withholding tax on dividends, interest and royalties flowing to the United Kingdom, we should not only - as is usual in agreements - make corresponding reductions in any withholding tax we would impose under our general law but should also give credit against United Kingdom tax for all, or part, of the Brazilian tax so given up, as well as for the reduced Brazilian tax actually paid under an agreement. The Inland Revenue has statutory powers to give credit for Brazilian tax "spared" under special incentive laws designed to encourage economic development there - and it has agreed in principle to do this - but it cannot under existing legislation, give credit for Brazilian tax given up under the agreement itself. Any extension of the Inland Revenue's existing enabling powers would require legislation in a Finance Bill and involve changes in tax policy which would have not only revenue consequences but also implications for the balance of payments and the appropriate level of overseas, as opposed to domestic, investment.

We are prepared to give credit for Brazilian tax actually paid on income flowing to the United Kingdom and thus, to relieve double taxation. We already do this under the statutory provisions for granting unilateral relief.

If the Brazilian proposal were accepted it would represent a cost to the United Kingdom Exchequer. The benefit would go to United Kingdom residents deriving dividends, interest or royalties from Brazil who would pay less tax than on similar income arising in the United Kingdom or in other countries with which we have an agreement.

Unfortunately even if the point were conceded there is no early prospect of a satisfactory agreement because the Brazilians are not prepared to give up certain features of their tax law which are unacceptable to many United Kingdom interests and could involve a net additional burden to them after the allowance of United Kingdom credit for Brazilian tax paid.

It is hoped to hold further informal talks in the next 2-3 months.

SPEAKING NOTE

The Secretary of State could say that he recognises the importance of a double taxation agreement between Brazil and the United Kingdom which would foster trade and investment and be evidence of co-operation between the two countries. He could if

appropriate add that the Minister must however be aware that the Brazilian proposals are at variance with internationally adopted standards and that we could not accept them without changes in our policy and our law. Nevertheless we hope that a mutually satisfactory agreement can be achieved.

Agreed
Approved
Enclosed
RHP
R/po

NOTE OF TELEPHONE CONVERSATION

Mr R Hewes, D of I, telephoned about Brazil.

He thanked me for sending the brief for the Secretary of State on the DTA position with Brazil and said he would like to suggest amendments.

In paragraph three, he said that at present with no DTA we were giving credit for the 25 per cent Brazilian withholding tax. If under a DTA we gave credit at the same rate even though only 15 per cent had actually been paid could we then say that the Brazilian proposal represented a cost to the UK Exchequer?

He also thought that where a UK resident had unrelieved Brazilian tax because of ACT, it was not wholly correct to say that he would pay less tax than on similar income arising in the UK or in other countries with which we have an agreement.

He suggested that the paragraph might read as follows:-

"If the Brazilian proposal were accepted the benefit from the Brazilian reduction in withholding tax, instead of going at least partly to the UK Exchequer, would go to UK residents deriving dividends, interest or royalties from Brazil. In some cases they would pay less tax than on similar income arising in the United Kingdom or in other countries with which we have an agreement."

Replying to his first point I said that I appreciated his argument but thought that the comparison should be between the UK giving credit for the actual Brazilian tax payable under a DTA (which is what we do) and the UK giving credit for tax at the rate of 25 per cent (which is what the Brazilians want us to do). In this case there is clearly a cost to the UK Exchequer. He seemed doubtful about this. I said I would prefer to retain the first sentence because we wanted to make the point that by agreeing to give matching credit there would be a cost to the Exchequer.

As far as the other point was concerned I said that it seemed to be misleading to say "In some cases they would pay less tax " and thought it would be more accurate to say "In most cases ".

After some discussion the following paragraph was agreed:-

"If the Brazilian proposal were accepted it would represent a cost to the UK Exchequer since the benefit from the Brazilian reduction in withholding tax, instead of going at least partly to the UK Exchequer, would go to UK residents deriving dividends, interest or royalties from Brazil. In most cases they would pay less tax than on similar income arising in the United Kingdom or in other countries with which we have an agreement."

His final point concerned the words in the Speaking Note - "internationally adopted standards". He said that it might be argued from the Brazilian point of view that their proposals were in line with the standard they had set for agreements. He suggested that the words "general international practice" be substituted. I said we had no objections to this.

Alf Adams

14 Oct 75

There is no prospect of concluding
an agreement with Brazil on our
existing law and practice.

The law could not be changed in
time for agreement this year, and
it is unlikely that anything could
be done about the practice until
after the election. We cannot
therefore have a second round
of negotiations at the time suggested,
and it would be better to explain

the situation informally.

They have been there twice,
and in view of that and of
our inability to accept their
call it wd. be tactful to go
to Brazil.

AHS
12/9

A L S Coltman Esq
British Embassy
Brasilia

W. H. H. H.

M. H. H. H.

Pl. copy to CRE 37906/2.
+ also to IR (copy to ICI, M. H. H. H.)
with a little covering note.

OUT FILE

HAPP

23/9

16 September 1974

1. On Wednesday we received a visit from Stefan Steinberg, the local Humphreys and Glasgow representative. He told the Consul-General and me that Petrobras had approached Humphreys and Glasgow to ask if they would be prepared to submit a tender for the construction of an ammonia/urea plant to be built in Parana. Apparently Petrobras are only approaching two companies, H and G and WDS of Germany. The process the Brazilian organisation would like to use is the Shell/German (Lurgi) one. At present there are certain problems over the reluctance of Lurgi to release certain production drawings. Sr Steinberg said that H and G had first to get the drawings from Lurgi, and at present the position could really only be described as one of guarded hope.
2. The plant, which is to be run by Petrobras and not Petroquisa, although it may be turned over to a Petrobras subsidiary at a later date, is to be based on surplus oil from the REPAR refinery in Parana. Production would be about 1000 tons of ammonia per day and 1200 tons of urea. It is estimated that about \$35-40 million in supplier credit will be needed for the project. The man in overall charge is Leopoldo Miguez de Mello, a significant choice inasmuch as he is the number two at Petrobras; his assistant is Ivo Ribeiro, the former Industrial Director at Petroquisa.
3. The main stumbling block for a successful H and G bid, as seen by Sr Steinberg, is the lack of a double taxation agreement between the UK and Brazil. Germany's DTA has, of course, been initialled and consequently they have a starting advantage. It appears that Humphreys and Glasgow will probably have to load their bid by about 15% to cover taxes.
4. The Consul-General explained to Sr Steinberg that the next round of UK/BRAZIL DTA talks was due to take place in November and only after these would we be able to say whether an agreement was likely. We said that if agreement on basics is reached during this round we might hope for the initialling of a DTA by the middle of next year.

...

18 SEP 1974

5. So here we have another case which may be prejudiced by our lack of a DTA. It was Sr Steinberg who calculated that the difference could be as much as 13%, probably more than H and G could absorb unilaterally. You may therefore wish to bear this case in mind for any briefs you prepare for the next round of talks. The principle rather than the case itself should be used to illustrate the problems as Sr Steinberg stressed that plans were still confidential.

D N Simmons

cc São Paulo
CRE2
Invisible Section, DOT

COMMERCIAL IN CONFIDENCE



DEPARTMENT OF ~~TRADE~~ AND INDUSTRY

1 VICTORIA STREET

LONDON S W 1

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01-~~2027~~ 215 3830

25 October 1974

By Hand

Mrs A H Smallwood
Inland Revenue
Secretaries' Office
Somerset House
LONDON WC2R 1LB

Dear Mrs. Smallwood,

ANGLO-BRAZILIAN DOUBLE TAX TREATY

I understand that you are very shortly to resume in Brasilia the negotiations which were begun in London in November last year.

As you know, we have been concerned that the corporation tax system should not so limit the scope for tax sparing as to damage the UK's ability to export to and invest in developing (and highly competitive) overseas markets. For this reason, we place great importance on the conclusion, as quickly as possible, of double tax agreements with our developing trading partners which will allow for tax sparing. You will recall that our preference has been for unilateral legislative action but that we accepted, rather reluctantly, your strongly preferred alternative of dealing with the problem through DTAs on a country by country basis.

Brazil is a prime example of the sort of country we have in mind in this context. Last November, immediately prior to your first round of formal negotiations with the Brazilians, I wrote to Hopkins setting out our strong interest in the successful conclusion of an agreement and - with some diffidence, given the technical nature of the subject - a few detailed matters arising from the draft agreement tabled by the Brazilians. Having followed subsequent events with great interest, I think it worth repeating two points which are clearly closely connected and are evidently at the heart of the second round of negotiations. First, at the technical level, as we suspected might become the case, the main open question between Inland Revenue and the Brazilian Finance Ministry has emerged as the latter's insistence on guaranteed tax sparing in return for a reduction of the rate of withholding tax on dividends, interest and royalties. Second, at the broader level, we would find it hard to defend a situation in which British traders and direct investors find themselves in a less favourable position than their competitors from other developed countries in respect of taxation of profits arising from their Brazilian operations.

As things stand at the moment, we see a danger that British companies may be placed at a permanent competitive disadvantage. We have some specific evidence of orders being lost by British companies apparently because of their relatively lower post-tax returns forcing them to quote higher prices in compensation and there is a fair volume

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of more general complaint from such quarters as Canning House, the CBI and the British commercial community in Brazil. Moreover, it appears that the Brazilians have concluded or are about to conclude DTAs with all our major competitor countries which include a tax sparing concession in return for reduced Brazilian withholding taxes (a notable exception being the United States, which, perhaps significantly, like the UK but unlike most of the other countries, gives double tax relief by credit rather than exemption).

I should perhaps also add that during his recent visit to Brazil, the Secretary of State for Trade emphasised to the Brazilian Minister of Finance his interest in the early conclusion of the DTA, and the latter promised to ensure that his officials took speedy action. Against this background perhaps I could sum up our interest by saying that first we should like to see the early conclusion of a DTA in order to give UK firms the protection and advantage which it affords. Second, we hope the arrangements when they are made will not leave our traders and investors at a competitive disadvantage in relation to the scale of taxation.

Yours sincerely

Jack Gill

(J GILL)

7739

D S Cape Esq
British Embassy
BRASILIA
Brazil

28 November 1974

Thank you for your letter of 18 November enclosing the rather unusual pin-up photograph. I think I told you that a number of photographs were taken, and before we left the Brazilians gave us several copies.

We thoroughly enjoyed our stay in Rio de Janeiro. On the Friday morning we had two quite useful meetings with representatives of British business interests and in the afternoon we had a brief chat with the Ambassador. The rest of the time we devoted to sightseeing!

Our talks with the Brazilians were definitely worthwhile, and Ian Gunn and I greatly appreciated the many ways in which you and Lester Coltman helped us during our stay in Brasilia.

D HOPKINS

For the file pl.
28/11



British Consulate General
Avenida Paulista 1938

Telephone 287-7722 Telex 021-848
Caixa Postal 846 01310 São Paulo

H.E. Mr. Derek Dodson, CMG. MC,
H.M. Ambassador,
British Embassy,
Brasilia.

Your reference

Our reference

Date 31 October 1974.

My dear Ambassador,

DOUBLE TAXATION AGREEMENT BETWEEN BRITAIN AND BRAZIL.

At the request of the British Chamber of Commerce in Brazil, I attach a memorandum on the above subject which the Chamber has drawn up for the information of the Inland Revenue. I would be grateful if Peter Davies, to whom I am copying this letter, could pass a spare copy of the enclosure to the representatives of the latter who, I believe, will be with him tomorrow.

2. In presenting this memorandum the Chamber wish to emphasize the prime importance of encouraging both British investment in Brazil and the transfer of British technology to this market. The nature of Brazilian Government policy is such that, for the majority of consumer and basic industrial products, the potential of the market can only be tapped by manufacture within the country, either through direct investments or through "Manufacture under License" agreements. The experience of Chamber members has shown that such investments have often resulted in increased exports from Britain, both of basic plant and machinery and of components and materials not available within Brazil, and in due course bring substantial returns to Britain in the form of profit remittances.

Yours sincerely,

George

G.E. Hall
H.M. Consul-General.

cc: Mr. Davies, Rio.

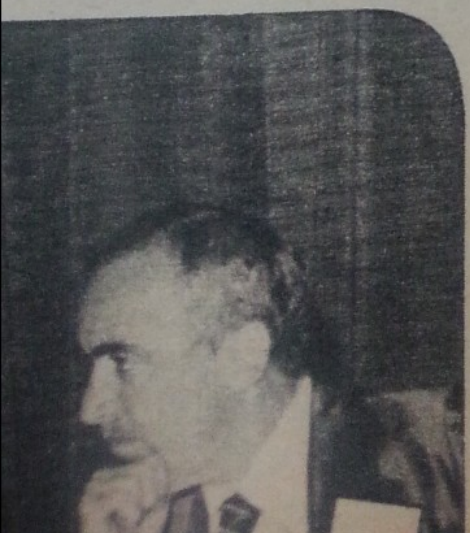
Estado-nação... Catarina, eng.º Colombo Macha... conferiu a Medalha do Mérito Anita Garibaldi ao industrial Carlos Cid Renaux (foto) pelos relevantes serviços prestados ao estado.



O Sr. Francisco Dorneles — presidente da Comissão de Estudos Tributários do gabinete do Ministro Mário Henrique Simonsen — chefou a



n uma solenidade
bagli — falou sobre
as quais o Dr.
Professor



O Sr. Francisco

Dorneles — presidente da Comissão de Estudos Tributários do gabinete do Ministro Mário Henrique Simonsen — chefiou a delegação brasileira que, em Brasília, manteve negociações com a missão inglesa chefiada pelo Sr. D. Hopkins — chefe da Assessoria de Tributação Internacional do Inland Revenue. As negociações prendem-se à assinatura do acordo entre o Brasil e o Reino Unido, visando a eliminar a dupla tributação de renda atualmente em vigor.

DA

UO

Your reference

Our reference

31 October 1974



BRITISH EMBASSY
BRASILIA

18 November 1974

20/1

D Hopkins Esq
Inland Revenue
Secretaries' Office
Somerset House
London WC2R 1LB

Dear Derek,

I hope you enjoyed your stay in Rio de Janeiro and did not find too great a pile of paper awaiting you on your return to London. You may like to have the enclosed photograph from the main Brazilian illustrated magazine which is usually better known for its photographs of film stars and bathing beauties than for recording double taxation negotiations. I do hope your discussions here will make further progress possible once you have time to consult UK Ministers.

I am also enclosing a translation of a further article by Donnell in the Jornal do Brasil in case this is of interest.

Yours ever,

Donald Cape

D S Cape



AGREEMENTS REDUCE THE FISCAL BURDEN

Interest earned in Brazil and paid to persons resident or domiciled abroad are generally subject to income taxes in both countries. The double taxation agreements signed by Brazil have among their objectives that of reducing the fiscal burden on the interest as well as to prevent, in certain situations, that the reduction or elimination of the Brazilian taxation will be completely or partially annulled by the taxation of the country where the creditor lives.

These agreements do not establish or increase taxes. They simply define the tributary competence of the contributing States and, in some cases, establish the maximum limit of taxation on certain incomes. In this way, if the double taxation agreement establishes that the taxes on Brazilian interest paid to persons resident or domiciled abroad shall not exceed 15%, it means that, in cases where the level of Brazilian taxation on such interest - as assessed by law - is superior to this level, it must be reduced to 15%. In cases where it is less than 15%, the level determined by the internal law shall prevail.

AGREEMENTS IN FORCE

The capital exporting countries tax interest earned in Brazil and through the agreements permit that those resident or domiciled in their countries credit against their taxes, ~~the taxes~~, the taxes that are levied in Brazil on that interest.

For instance, the interest paid to persons who reside in Belgium or France arising from loans under Resolution No 305 of the Central Bank of Brazil, of October 24, 1974, are subject in Brazil to a 5% tax. Belgium and France, when taxing this interest permit their residents to benefit from a credit of 15% and 20% respectively.

The double taxation agreements signed by Brazil with Belgium, France, Finland, Japan, Portugal, Norway and Sweden are already in force. The agreements signed with Denmark will come into force on January 1, 1975. The agreements with Germany, Spain and Austria have already been initialled at the technical level, and there is every indication that they will come into force in 1975. Brazil has started the negotiation of similar agreements with Italy, England, Switzerland, Luxembourg and the Netherlands which should be concluded in 1975. The Swedish text, signed in 1968, was re-negotiated and should come into force in 1975.

The table below indicates the taxation established for interest earned in Brazil and paid to persons resident or domiciled in the countries with which double taxation agreements have been signed which are already in force.



INLAND REVENUE
Secretaries' Office
Somerset House London WC2R 1LB

Telephone 01-836 2407 ext 489

Senhor F N Dornelles
Comissao De Estudos Tributarios
Internacionais
Gabinete do Ministro da Fazenda - Sala 1023
Ministerio da Fazenda
RIO DE JANEIRO
Brazil

Your reference

Our reference T1169/217/1967

Date 8 April 1974

Dear Senhor Dornelles

UNITED KINGDOM/BRAZIL DOUBLE TAXATION CONVENTION

At the conclusion of our talks in London last November we agreed that it would be necessary to have a further round of talks. I am writing to you now to ask whether you have any dates in mind and to summarize the position as we see it.

2. I think it is fair to say that while we made considerable progress last November and the discussions were constructive and helpful, we had to leave unresolved a number of major difficulties. It might be helpful therefore if I list those articles on which I think we reached agreement and then briefly set out what I understand to be our differences on the remaining articles.

3. According to my notes we reached agreement on the text of the following articles (the numbering follows your original draft):

- | | |
|-------------|-----------------------------------|
| Article 1: | Personal Scope |
| Article 3: | General Definitions |
| Article 5: | Permanent Establishment |
| Article 6: | Income from Immovable Property |
| Article 8: | Shipping and Air Transport |
| Article 9: | Associated Enterprises |
| Article 15: | Dependent Personal Services |
| Article 16: | Directors' fees |
| Article 17: | Artistes and Athletes |
| Article 18: | Pensions |
| Article 19: | Governmental Payments |
| Article 20: | Teachers and Researchers |
| Article 21: | Students |
| Article 25: | Mutual Agreement Procedure |
| Article 26: | Exchange of Information |
| Article 27: | Diplomatic and Consular Officials |
| Article 28: | Methods of Application |
| Article 29: | Territorial Extension |
| Article 30: | Entry into Force |
| Article 31: | Termination |

In the case of Articles 3, 5, 8, 18, 19, 20, 21, 25, 26 and 30 we handed you revised drafts which incorporated amendments to your original drafts which we had agreed. The rest of the agreed articles were as in your original draft with the exception of Article 6 (Income from Immovable Property) which followed the original United Kingdom draft.

4. The articles on which we did not reach agreement were:

Article 2:	Taxes covered ✓
Article 4:	Fiscal Domicile ✓
Article 7:	Business Profits ✓
Article 10:	Dividends ✓
Article 11:	Interest ✓
Article 12:	Royalties ✓
Article 13:	Capital Gains ✓
Article 14:	Independent Personal Services ✓
Article 22:	Income not Expressly Mentioned ✓
Article 23:	Elimination of Double Taxation ✓
Article 24:	Non-discrimination

Our discussions of these articles revealed some important differences of principle between us. I have attempted to summarize these in paragraphs 5-10 below, while dealing with the less important matters in paragraph 11. If you disagree with my summary I should be glad if you would let me know.

5. Taxes covered

We like our Double Taxation Conventions to cover all taxes on income and profits: the omission of any such taxes reduces the scope, and may often affect the balance, of a Convention. While therefore we appreciate the reasons why you wish to exclude your taxes on excess remittances and on activities of minor importance from the Convention we would prefer them to be included.

6. Dividends, Interest and Royalties.

We did not come to any agreement about the rates of withholding tax on dividends, interest and royalties principally because you regard the question of the rates of withholding tax as linked with the treatment for United Kingdom credit purposes of any withholding tax given up by Brazil under these articles. This is the major open point on the Elimination of Double Taxation Article and I comment on it in paragraph 9 below. A less important open point on the Dividends Article is your proposal that any reduced rate of withholding tax on dividends should apply only after 3 years from the date of entry into force of the Convention; on further consideration we would be prepared to accept this. I enclose for your consideration a revised draft of an Interest Article which takes account of some of the points raised at our talks. As you will see we have included a paragraph covering our Export Credit Guarantee Department and I hope that you can accept this. I am afraid the United Kingdom would find it difficult to give up its taxing rights in respect of Government interest arising in Brazil and we have therefore not included in the revised draft a paragraph on the lines of your paragraph 3(b). We also feel that commission of the sort referred to in your draft Protocol is something quite distinct from interest and that it should properly be dealt with under the Business Profits or the Independent Personal Services Article as appropriate. As you said that you would have administrative difficulties about paragraph 4 of our original draft we have not included it in this revised version. Although the definition of Royalties in your draft follows the OECD Model

definition, the extension in the Protocol to cover payments for technical assistance and technical services in our view goes too wide. You said at the talks however that you would consider our proposal to resolve this difficulty by including a Management Fees Article and I am therefore enclosing a draft of such an Article for you to look at.

7. Capital Gains

I believe your position is that you wish to preserve the right of the state of source to tax all capital gains with the exception of gains from the alienation of ships and aircraft etc owned by a resident of the other state. This would mean that Brazil would not be prevented by the article from taxing a gain on the sale by a UK parent company of its shares in a Brazilian subsidiary. Our position was that a country should be able to tax gains on all immovable property situated in its territory but not immovable property owned by a resident of the other country unless it were connected with a permanent establishment.

8. Income not Expressly Mentioned

In paragraph 6 above I referred to the treatment of commission and to our wish to see this covered by a Management Fees Article and not by the Royalties Article. I understand however that a withholding tax is levied in Brazil on all payments made to non-residents: if this is so we think it particularly important that the Income not Expressly Mentioned Article should give the state of residence the exclusive right of taxation so that any payments made in Brazil to UK residents which did not consist of dividends, interest, royalties or management fees would be free from Brazilian withholding tax. As you know we also argue on more general grounds that this article should give exclusive taxing rights to the state of residence.

9. Elimination of Double Taxation

As we explained last November the United Kingdom is prepared to give matching credit against United Kingdom tax for Brazilian tax spared under Brazilian laws designed to promote economic development. You want us to go further, however, and to give credit against United Kingdom tax for all or part of the Brazilian tax given up under the Convention on dividends, interest and royalties. I am afraid, as we made clear last November, that our existing statutory powers do not permit us to do this. Legislation in the form of Finance Bill provisions would be needed to extend these powers and would raise a number of fundamental questions of policy. Indeed of all your proposals this presents the most difficulties for us: on the other hand I recognise that you feel very strongly about this and what I should like to do at the next round of talks is to explore the possibilities of arriving at a compromise solution which would involve concessions but no major surrender of principle on either side.

10. Non-discrimination

While we wish to follow the OECD Model Article you wish to limit the scope of the article in two respects. You would like to disallow as a deduction for tax purposes royalties paid by a Brazilian company to

a United Kingdom parent company which holds at least 50 per cent of the voting capital of the Brazilian company. While we recognise the problems which Brazil faces with regard to payments of this sort we feel that all royalty payments should be allowable deductions under the Convention where they can be shown to be paid for bona fide commercial reasons. You would also like to be able to impose your branch tax, at the same rate as your withholding tax on dividends, on the profits of branches of United Kingdom companies. While we remain opposed in principle to this we would be prepared to reconsider the matter in the light of whatever we agree to do with regard to dividends.

11. Minor matters

The differences between us on the remaining three articles on which we did not reach agreement are less important.

- (a) With regard to Article 4 (Fiscal Domicile) you were worried about our proposed addition to the first paragraph of the words "The term does not include any individual who is liable to tax in that contracting state only if he derives income from sources therein". We explained last November that the words were intended primarily to cover the position of diplomats and were similar to the additional sentence which the OECD Committee on Fiscal Affairs has recently agreed should be inserted in paragraph 1 of Article 5 of the Model Convention. This sentence reads as follows:

"But this term does not include any person who is liable to tax in that Contracting State in respect only of income from sources therein or capital situated in that State."

This additional sentence seems to us to represent a minor improvement on the existing text and one which we would like to see incorporated in any Convention between our two countries, but perhaps we could discuss the matter further at our next round of talks.

- (b) Our draft of Article 8 (Business Profits) differed from your draft in that paragraph 3 of our draft was rather longer than yours. Following our discussions last November we are now quite prepared to omit the words in brackets in our draft but we would still like to retain the additional words at the end of the paragraph viz "whether in the state in which the permanent establishment is situated or elsewhere".
- (c) In most of our Conventions the Independent Services Article provides that a country can tax income derived by a resident of the other Contracting State in respect of professional services only if he has a fixed base in that country and only to the extent that his income is attributable to that fixed base. We would prefer the Independent Services Article in a Convention between our two countries to be on similar lines but as you have made it clear that you are opposed to the inclusion of the fixed base requirement we would not want to insist on it. We nevertheless think that your existing draft goes rather too wide and we would like to discuss some possible amendments with you. I enclose a draft which includes as an alternative to the fixed basis requirement a 183 day residence text.

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- (d) There are a number of minor matters which I have not mentioned in my review of the major issues in paragraphs 5-10 above. In the Elimination of Double Taxation Article, for instance, you would like provisions requiring the United Kingdom, as the country of source, to give credit for Brazilian tax against the United Kingdom tax on the profits of a United Kingdom permanent establishment of a Brazilian enterprise. During our talks in November we pointed out that this would be contrary to universally accepted principles of double taxation agreements and would be very difficult for us to accept. Again there may be points of a very minor technical or drafting nature which one or other side may wish to raise with regard to any of the articles: for instance in Article 18 (Pensions) we would like to substitute references to £2,000 for the references to US \$4,000.

12. I hope you will find this letter helpful. Rather long though it has turned out to be it does not purport to be an exhaustive list of all the outstanding matters but, as I mentioned earlier, if you disagree with my summary of the major issues or feel that I have omitted an item of major importance I should be glad if you would let me know. I should also welcome any other comments or proposals you care to make and in particular any points which occur to you with regard to the draft Management Fees Article. I do not think that there is any point in disguising the fact that on a number of important matters we hold widely differing views: at the same time I am hopeful that at our next round of talks we shall be able to put together a package of proposals which taken as a whole will prove acceptable to both sides.

With kind regards.

Yours sincerely

D Hopkins

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NOTE OF MEETING AT SOMERSET HOUSE ON 7 JUNE 1974

Present:

1. A L Coltman - 1st Secretary (Commercial)
Designate, Brasilia
2. D Hopkins }
I P Gunn) - Inland Revenue

Mr Hopkins referred to our recent meeting with Mr Davies, the First Secretary (Commercial) Designate at Rio de Janeiro. Mr Coltman explained that the Trade Consulate at Rio is concerned mainly with trade promotion, whereas that at Brasilia deals principally with matters of policy and with the Brazilian government. He thought that control of the trade mission was likely to pass from Rio to Brasilia in the near future.

Mr Hopkins outlined the history of our double taxation negotiations with Brazil, and explained that we already have an agreement covering air transport and shipping profits. Brazilian interest in a full agreement reviewed about 3 years ago and we were faced with strong pressures from trade and commercial interests. Because of commitments on either side, full talks were not held until November 1973 when agreement was reached on a number of articles - about two thirds of a convention.

Mr Hopkins then explained our credit method of relieving double taxation as against the exemption method, and said that we use the credit method for all income, unlike EEC countries who exempt direct dividends and branch profits.

The Brazilians charge tax at 25% on everything going from Brazil, and are prepared to reduce their rates under the agreement to 15% provided we give credit for at least part of the tax so given up. Mr Hopkins explained our difficulties over tax sparing and said that whilst we understand the Brazilian view, as the income flow is all one way, we cannot do what they want. This would require legislation and would be a major policy decision for us because of the implications for investment policy. If we gave way to the Brazilians we would have difficulties with our other agreements and would be faced with losses of tax and on the balance of payments current account. It may be that the climate for foreign investment will be less favourable under the present administration than under its predecessor. Mr Hopkins emphasized, however, that we are prepared to give matching credit for tax spared under the laws of Brazil in order to promote economic development.

Mr Coltman remarked that Brazil already had a number of double taxation agreements with other countries, but we pointed out that she has no agreement with either the United States or Germany, two of her major trading partners. The Germans had failed to reach agreement at recent talks. Mr Hopkins said that we should not over

emphasize the importance of a DTA. It ^{generally} only affects income flowing from one country to the other whereas in the short term a company will not remit much in the way of profits and will not be too bothered by the absence of an agreement. In any event, we give unilateral relief for Brazilian tax.

Mr Hopkins said that he did not want to suggest that there was little hope of an agreement. In a recent letter to Brazil which reviewed the whole position, we had made certain concessions and suggestions and had in particular suggested that we hoped at further talks to explore ways of compromising our main differences without major surrender of principle.

Mr Coltman thought that our prospects of agreement might have improved over the last few months. Until recently, the Brazilian boom had made them believe that they could dictate terms but recent problems ^{there} might mean that they are now anxious to encourage other countries to increase their investment there. Mr Coltman did not know, however, whether the new team of Ministers in Brazil would prove to be more flexible than their predecessors.

Mr Hopkins remarked that Sr. Dorivelles, with whom we had been dealing in our negotiations, had recently been promoted and this is a good sign. At a meeting of the UN Expert Group he had given Mr Hopkins the impression that he was satisfied with the way things had gone at the talks. At the UN he would see that other developing countries such as Indonesia are not as rigid as Brazil and this too is a good thing. Moreover, the UN Ad Hoc Group is shortly to publish guide lines for DTA's with developing countries which, although not entirely satisfactory, do not depart greatly from the OECD model. This might influence the Brazilians, who regard the OECD model as a rich mans club.

27 June 1974

20/1

H M Carless Esq
Latin American Department
Foreign and Commonwealth Office
London SW1

UK/BRAZIL DOUBLE TAXATION AGREEMENT

1. Please refer to the correspondence resting with your letter to Hopkins in Inland Revenue (Ref ALB 20/1 of 21 June) about this.
2. Dornelles, who has just returned from the Washington shoe subsidy hearings, lunched with me on 24 June. He said that he hoped to be able to send a considered reply to Hopkins' letter of 8 April within the next couple of weeks. The Brazilians would probably be proposing that the next round of talks be held here in October as they would be very tied up with other questions until then. He promised to let me have shortly a copy of the text (which is still confidential) of the agreement reached with the Germans in the negotiations here 2 weeks' ago and expressed the hope that we would also be able to reach agreement on a similar text. I confined myself to saying that there might be some difficulty about this since British and German tax laws were I thought somewhat different.
3. I had previously been given an account by my German colleague of the quite tough negotiations which ended in agreement on 15 June. The Germans hope that it will be possible to sign the agreement in August when a German Economic Minister will be visiting Brasilia. This may not be easy as the agreed text was in English. This has now to be translated into German and Portuguese and recent experience in the case of some of the Scandinavian countries has been that reaching agreement on translation can delay signature by as much as 2 years. One of the points at issue was that the Brazilians wish^{ed} to delay the reductions in withholding tax agreed until 3 years after entry into force of the Double Taxation Agreement. The Germans resisted this since it would enable the Brazilians, having secured the additional attraction of

/German

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German investment which they desire through publicity about the signature of the agreement, then to delay grant of the actual reductions in tax by delaying ratification of the agreement. In the end the Germans persuaded the Brazilians to agree that the reductions in tax should come into effect on set dates - 1977 in the case of royalties and 1978 in the case of dividends and interest. My German colleague thought that if they had accepted the Brazilian formula, he did not think the reductions would have taken effect until 1980. The French in their agreement had secured an immediate reduction in the case of royalties.

4. The agreement reached was apparently somewhat complicated but in general amounted to a reduction of withholding tax to 15%, and to only 10% in the case of interest on certain financial credits, following the French example. In general the Germans agreed to grant a tax credit as if withholding tax had been paid at a rate of 20%. (In other words the enterprises concerned would benefit 5%, and the German Government 5% from the new arrangement.) The tax credit would however be granted as if the withholding tax had remained at 25% in certain cases where dividends were being paid by a Brazilian subsidiary to the parent company in Germany. The position varies, and will vary, according to the percentage of a Brazilian company owned by the Germany company. My German colleague said that the German bargaining position was not very strong since they already were granted tax credits on a unilateral basis. But they had been able to make use of the fact that the Brazilians were interested in reaching agreement in order to attract further German investment. The agreement would remain in force indefinitely but after 3 years either side could ask for a renegotiation.

5. I am enclosing 2 additional copies in case you wish to pass them to Hopkins and to Economist Department.

D S Cape

c.c. Mr A G Munro, RIO DE JANEIRO
Mr M J Treble, CRE 2, DOT

CONFIDENTIAL

Some good analysis
made here. Let's
wait & see what
N. Cape suggests.

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gfs

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R to me pl.
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RECEIVED IN REGISTRY NO. 18 - 2 MAY 1974 A18 20/1
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S Cape Esq
British Embassy
Brasilia

25 April 1974

cc Mr Tarleton, Economics

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UK/BRAZIL DOUBLE TAXATION RELIEF AGREEMENT

1. In his letter of 16 April to Hugh Carless, Robert John said we should be commenting on some of the points which are proving difficult to resolve in the negotiation of the Double Taxation Relief Agreement. These were set out in Hopkin's letter of 8 April to Dornelles.

2. There are clearly one or two major obstacles in principle which have arisen. We have agreed to discuss the subject at our meeting in Brasilia on 1 May. But it may help if I consider here one or two of the most important difficulties identified by Hopkins and offer some preliminary comments on how these might be circumvented.

3. As Hopkins says (his paragraphs 6 and 9) the most serious difficulty for the Inland Revenue is Brazilian insistence that the tax credit, awarded by the Inland Revenue against withholding tax levied in Brazil on dividends, royalties and interest payments, should, as the price of Brazilian reduction from the present 25 per cent to 15 per cent (in line with the majority of Brazil's existing DTR agreements), remain at or near the previous higher Brazilian tax level. Apparently, this runs contrary to one of the canons of British tax legislation. On the other hand, the Inland Revenue have now been able to concede an additional credit against the UK tax liability for taxes spared by the Brazilians on income arising in Brazil where the income concerned is instead applied to economic development. This is a step forward. I have made a comparison of how this area is treated in Brazil's main existing DTR agreements viz. with Japan, Sweden, Norway, Finland, France, Belgium and Portugal. With the exception of Norway and Finland, each of the other contracting governments appears to have been prepared to meet the Brazilians in some way or other on the question of an additional tax credit for withholding tax. The Norwegians appear to have been unwilling to grant any additional tax credit in these areas; consequently, their investors here continue to pay withholding tax in Brazil at 25 per cent, and the same rate applies to interest payments from Brazil. They did, however, obtain a reduction to 15 per cent in withholding tax on royalties of various kinds. The Firms seem to have gone for a halfway house

solution with dividends continuing to bear the 25 per cent withholding tax, but both interest and royalties bearing only 15 per cent; in these two last cases, Finland has agreed to give a higher credit against Finnish tax. The Swedish agreement is one of the earliest ones and does not follow the standard form. But as I understand its rather obscure wording the Swedes have granted a tax credit at the 25 per cent level even if, as I imagine is the case, the Brazilians have agreed to reduce withholding tax on dividends and interest payments to Sweden.

4. From previous conversations I have had with Dornelles, I believe there is no possibility of the Brazilians agreeing to reduce withholding tax on dividends, interest payments or royalty and technical assistance payments to Britain (which is after all one of our main objectives from the point of view of trade promotion), unless the additional tax credit is offered by the Inland Revenue. With this corpus of precedents already in force, the Brazilians are most unlikely to make an exception in our case. At the most, we might obtain Norwegian terms, i.e. a reduction to 15 per cent in the case of royalties and technical assistance payments with the other remittances being taxed at 25 per cent. But I do not believe that this will provide the incentive we want to obtain for British investors nor the parity of treatment needed by British financial institutions. These are, after all, two of our major income earning categories in Brazil. The background to Brazilian philosophy on the additional tax credit point is well spelt out in Tallboys' letter 20/2 of 6 December to Daly here, of which you have a copy, as do Latin American Department.

5. We therefore need to consider what device can be designed to enable the Inland Revenue to give an additional tax credit on these categories of payments without sacrificing anything of principle or being obliged to seek amending legislation in Parliament. Frankly, I see the last course as a non-starter, though it does look, from the example of Brazil's other Agreements, as though the United Kingdom is out of step on this point with a considerable number of her trading partners. Perhaps a formula could be devised which had the effect of putting the Brazilian tax saved by the reduction in their withholding tax rate into some category which might qualify as "economic development" from the I.R.'s point of view. Perhaps a formula could be found to present these reductions in withholding tax as designed to stimulate foreign investment and help Brazil gain the benefit of access to foreign loans and technology needed for her development. There may be a measure of casuistry here, in that we might thus obtain the substance of compromise without offending against dogma. But it can well be argued that so far as dividends on investment are concerned, a reduction in withholding tax does not enable foreign firms to repatriate more money in net terms; instead it makes dividends cheaper for foreign subsidiaries here, thus enabling them to retain larger profits in Brazil for local re-investment. If you see merit in this line of approach, perhaps the Department would like to try it on the Inland Revenue.

6. As for the other points in Hopkin's letter, there seems generally to be scope for compromise. I doubt whether the Brazilians will make difficulty over the splitting up of the definition of royalties into a Royal Article and a separate Management Fees article. On the matter of Capital Gains (Hopkins para 7) and "Income not Expressly Mentioned" (para 8), there seems some room for compromise. On the Non-Discrimination point (para 10) I do not see the Brazilians giving way on the expensing against Brazilian Corporation Tax of royalties paid by a Brazilian company to a UK parent which holds at least 50 per cent of the subsidiary. This treatment is regarded by the business community here as one of the respects in which the Brazilians firmly believe themselves to be able to obtain technology on the cheap. I believe there was some ill history here when Volkswagen first established themselves in Brazil, and the official position is now very rigid.

7. As for an approach to Dornelles, I would suggest that I call on him some time in early May simply to see how things stand on the signing of his reply to Inland Revenue. I should not get drawn into matters of substance. | 76

A G Munro

cc FCPD Fullerton Esq., LAD, FCO
H J Treble Esq., CRE2, DTI

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Foreign and Commonwealth Office
London SW1A 2AL

Telephone 01- 930 8440 ext 212

D Hopkins Esq
Inland Revenue
Secretaries' Office
Somerset House
London WC2R 1LB

Your reference

Our reference

ALB 20/1

Date

21 June 1974

Dear Hopkins,

UK/BRAZIL DOUBLE TAXATION AGREEMENT

1. On 8 April, under reference T1169/217/1967, you were kind enough to send us copies of your letter to Sr Dornelles. The Embassy passed the original of your letter on to Sr Dornelles but you may be interested to see the comments which Mr Munro in Rio has made and I enclose a copy of his letter of 25 April to Donald Cape in Brasilia.
2. Cape asked Sr Martins of the Brazilian Ministry of Foreign Affairs towards the end of May how matters were progressing. Sr Martins said that study of your letter had begun but he was not optimistic about rapid progress being made, as those concerned, especially Dornelles in the Finance Ministry, would be heavily engaged during the next couple of months with other questions, including the US shoe subsidy hearings and the double taxation negotiations with the Swedes, Danes and Germans. The Swedish agreement was being revised to bring it into line with Brazil's other agreements, withholding tax being reduced from 25% to 15% and the Swedes giving a corresponding credit. The Danish agreement would be on the normal lines, but there was a tough battle in progress with the Germans who, in return for reduction of the withholding tax from 25% to 15% were only prepared to offer a tax credit based on a 20% tax. This, in the Brazilian view, amounted to the German tax authority pocketing the difference between 25% and 20%.
3. However there is some doubt as to what is acceptable to the Brazilians. In their treaties with France and Belgium (concluded respectively in September 1971 and June 1972 - see treaty extracts enclosed) they have generally reduced withholding taxes on dividends, interest and royalties from 25% to 15% against which France and Belgium grant a 20% tax credit. This looks very much like splitting the difference halfway - from

/the Brazilian



the Brazilian tax cut of 10% the opposing tax authority mops up 5% and leaves the balance 5% to flow through to investors. Presumably the Germans have those precedents in mind. Would it not be appropriate, if a practical compromise is to be achieved, for the UK to seek a similar arrangement?

4. Cape has questioned whether the argument that a reduction in withholding tax does not enable foreign firms to repatriate more money in net terms, is valid, and asks whether that is not in fact the object of the exercise. He has expressed dismay at your statement in your letter to Dornelles that "any reduced rate of withholding tax on dividends should apply only after 3 years from the date of entry into force of the Convention", but adds that he presumes that British firms considering investment in Brazil will be looking to the longer term, so that it is arguable that this should not affect their decisions.
5. Munro has explained that the point he was seeking to make in his letter was that the level of basic withholding tax does not affect the calculation of the amount which can be remitted from Brazil in the form of dividends without incurring additional withholding tax at penal levels. Investors can remit, net, each year, 12% of their registered capital investment in Brazil averaged over a 3 year period. In the longer run, however, a reduction in the basic withholding tax contributes to an increased transfer of dividends in that it permits a higher level of re-investment of profits in Brazil, thus expanding the capital base for the calculation of remittances in future years. A reduction in withholding tax does have an immediate beneficial effect on loans and on technical assistance payments, by making the cost of these cheaper to Brazil and therefore boosting business for the UK.
6. I hope these observations may be of some help to you.

Yours ever,

Hugh Carless

Hugh Carless
Latin America Department

Copies to: Mr Tarlton, Economists Dept
Mr A G Munro, RIO DE JANEIRO
Mr D S Cape, BRASILIA
Mr M J Treble, CRE 2, DOT



BRAZIL
BRIEF No 16
DOUBLE TAXATION RELIEF AGREEMENT

16.1 BACKGROUND. In 1966/67 the UK and Brazil attempted, unfortunately without success, to conclude a comprehensive double taxation agreement to provide equitable rules for the treatment of income subject to taxation by both countries and a stable fiscal background - with all that entails for business confidence and investment - against which the nationals of one country could operate in the other. However, it did prove possible to conclude an agreement relating only to shipping and air transport profits and this came into force in 1968. Further exploratory talks about a comprehensive agreement took place in London in March 1972 and there was a first round of formal negotiations in London in November 1973. Agreement was reached on many points but a number of important ones remained unsettled, hopefully to be cleared up in the next round of talks later this year.

16.2 The sticking point in the negotiations has mainly been the Brazilians' insistence that the UK should agree to give credit against UK tax for all or part of any Brazilian tax on dividends, interest and royalties which they agree to give up under the convention by way of an incentive to UK firms. Thus, the UK Exchequer would bear the difference between the notional tax rate and the actual rate paid by the company with a consequent loss of revenue. In fact, whilst UK statutory powers exist to permit such an arrangement where a developing country's general laws grant specific concessions in order to promote economic development, amending legislation in a Finance Act would be necessary - if such a course of action were thought desirable - to permit the UK to enter into arrangement to give credit for tax given up under a double taxation agreement itself and not under the general law of a developing country. At the next round of talks possible ways round these difficulties will be explored to see whether there is any way of aiming at an acceptable result which would not involve legislation in the UK.

16.3 Because of their different fiscal laws some other countries have been able to meet the Brazilians on this point, usually because they can exempt certain overseas income from taxation anyway and the need for and cost of an extra matching credit is avoided. The UK on the other hand taxes income on a world-wide basis, giving credit unilaterally against UK tax payable on overseas income for any foreign tax already charged on that income. Thus, as a general rule double taxation is fully relieved. To the extent, however, that UK companies do not benefit from what would effectively be a subsidy from the UK Exchequer on the level of the Brazilian withholding tax (say 10/15% instead of 25%) on interest, royalties and dividends but have to absorb or pass on to the consumer the extra tax paid then they are undoubtedly at a competitive disadvantage as compared with companies from other countries which do receive such relief. (This point has been put forward on numerous occasions by UK businessmen in Brazil and by the CBI.)



BRIEF

16.5 Bearing in mind the legislative constraint mentioned in paragraph 16.2 the Secretary of State will wish to avoid being drawn into discussion of the precise terms which an agreement might take. Should the question of the agreement be raised, however, it can be answered as follows:

- a) The UK Government remains keen to bring to an early conclusion the current negotiations on a UK/Brazil double taxation agreement. It sees this agreement as an important step in the development of trade and economic co-operation between the UK and Brazil.
- b) The UK Government hopes that the technical difficulties which were identified in the last round of negotiations in November 1973 can be overcome. The UK tax authorities are looking forward to receiving shortly the proposals of the Brazilian Minister of Finance for the next round of discussions, which we should like to see held before the end of the year.

IC/1

15 August 1974

CETI-C-123/74

Rio de Janeiro, August 27, 1974

Mr. D. Hopkins
Inland Revenue
Secretaries' Office
Somerset House
London WC2R 1 LB

Reference: Convention for the
avoidance of double taxation
between Brazil and the United
Kingdom.

Dear Mr. Hopkins,

I thank you for your letter dated April 8, 1974
in which you presented a summary of the situation of the Brazil-
United Kingdom Tax Treaty.

2. On this subject I would like to confirm that we
have already agreed upon the following articles:

- Article 1 - Personal scope ✓
- Article 3 - General definitions ✓
- Article 5 - Permanent establishment ✓
- Article 6 - Income from immovable property ✓
- Article 8 - Shipping and air transport ✓
- Article 9 - Associated Enterprises ✓
- Article 15 - Dependent Personal Services ✓
- Article 16 - Director's fees ✓
- Article 17 - Artistes and Athletes ✓
- Article 18 - Pensions and annuities ✓

- Article 19 - Governmental payments ✓
- Article 20 - Teachers and researchers ✓ *Students? see 4.9(ii) below.*
- Article 24 - Non discrimination *not agreed*
- Article 25 - Mutual agreement procedure ✓
- Article 26 - Exchange of information ✓
- Article 27 - Diplomatic and consular officials ✓
- Article 28 - Methods of application ✓
- Article 29 - Territorial extension ✓
- Article 30 - Entry into force ✓
- Article 31 - Termination ✓

Enclosed, I am sending texts retyped of all articles already agreed upon.

3. Therefore, the following Articles are still pending:

- Article 2 - Taxes covered ✓
 - Article 4 - Fiscal domicile ✓
 - Article 7 - Business profits ✓
 - Article 10 - Dividends ✓
 - Article 11 - Interest ✓
 - Article 12 - Royalties ✓
 - Article 13 - Capital gains ✓
 - Article 14 - Independent personal services ✓
 - Article 21 - Students *see 4.9(ii) below*
 - Article 22 - Income not expressly mentioned ✓
 - Article 23 - Elimination of double taxation ✓
- Protocol

4. With the purpose of facilitating our future negotiations I would like to add some comments regarding the pending points:

4.1. Taxes covered

It would be difficult, particularly for political reasons, to negotiate the excess remittance tax and the tax on

activities of minor importance. As you can see, in all Conventions signed by Brazil, those taxes have never been negotiated.

I would like to call your attention to the fact that the excess remittance tax in practice is applied only to the part of distributed profits which exceeds in a year 16 per cent of the original investments plus reinvestments registered in the Central Bank of Brazil. The enclosed table shows how such a tax is applied.

4.2. Business profits

I would prefer not to include in paragraph 3 the sentence "whether in the State in which the permanent establishment is situated or elsewhere".

The Brazilian proposal for such paragraph recognizes the right of the permanent establishment to deduct expenses incurred abroad without ostensibly calling attention to such a right.

The Brazilian proposal has been formulated to overcome the Tax Administration's fears that the taxpayer with the support of the sentence you have proposed might deduct excessive expenses incurred abroad.

4.3. Reduction of withholding tax

The Brazilian Government agrees in reducing its withholding taxes on dividends, interest and royalties once it has the guarantee that such a reduction will constitute a benefit to the private sector and not a transference of resources to the Treasury of the State of which the investor is a resident. In order to have that guarantee a tax sparing must be granted by such a State.

The granting of a tax sparing would eliminate the major difficulties regarding the articles of dividends, interest, royalties and methods for the elimination of double taxation.

4.4. Dividends

I believe you have accepted the period of three years for the enforcement of the tax reduction. Such a period corresponds to the average term for new investments to mature, as well as to stimulate reinvestments. As to the other pending point - lower tax rate for dividends paid to mother companies - I must tell you that unfortunately, we cannot accept your proposal. In the Conventions signed by Brazil, the Brazilian withholding tax has been established without taking into consideration the recipient of the dividends and such a tax has never been and cannot be established at a rate lower than 15 per cent.

4.5. Interest

Brazil agrees that interest arising in a Contracting State and paid to the Government of the other State be exempt from tax in the first-mentioned State. Following the same reasoning we think that interest paid by the Government of one State to a resident of the other State should be exempt from tax in this other State.

In case you believe the United Kingdom could not exempt from tax interest indicated in the last mentioned situation, I would ask you to examine the possibility of granting a tax sparing as if a tax on such interest had been paid in Brazil.

Paragraph 3 of your proposal has a very broad scope. We could accept a paragraph more or less similar to the one included in the Convention signed with France or to the one included in the Convention initialled with Germany, the copy of which I am sending you on a private basis.

4.6. Royalties and Management fees

I thank you for the Article you sent to me about Management fees, the draft of which I consider to be quite clear.

However, in the former Conventions signed by Brazil we have never included an article about Management Fees and I am afraid that the inclusion of such an article in the Convention with the United Kingdom might give the impression that the situation covered by this article had not been covered in the Conventions we have signed before, which in reality has not occurred.

As you can see in the Conventions we are sending to you, we have included in the Protocol a clause stating that some situations covered by your Management fees article are covered by the definition of Royalties. In other words, the clause of the Protocol gives a broader sense to the OECD Model definition of royalties. Although, I must confess that I like very much your article on Management fees and that I believe that such a point shall not constitute an obstacle for the signature of the Convention. The tax on such fees should be established at the rate of 15 per cent and not 12,5 per cent.

With regard to paragraph 4 of article 13 of the United Kingdom proposal discussed in London, I would like to mention that at that time I said I believed that situation was covered by nº 7 of the Brazilian Protocol.

4.7. Capital gains

I understand, by your letter, that you are willing to agree with paragraphs 1 and 2 adopted by the OECD model, and related to immovable and movable property to permanent establishments.

With respect to taxation foreseen in paragraph 3 of our proposal, such taxation is directly connected to the provisions of Article 10. In fact, when the right of taxing dividends is also granted to the State where the paying company is a resident, it becomes indispensable to allow that capital gains as defined in paragraph 3 of Article 13 may be taxable in both Contracting States. Otherwise, instead of paying dividends, companies could try to obtain capital gains, what would be a loss of revenue for the State where such company is situated.

4.8. Protocol

The provisions of the Brazilian law do not allow that royalties paid by a company of Brazil to a resident of the United Kingdom which holds more than 50 percent of the voting capital of that company be deducted. We do not believe this disposition to be discriminatory because the non-deductibility is not based upon the fact that the company is controlled by a resident of the United Kingdom. This general procedure is applied to any resident abroad which holds more than 50 percent of the capital of the company paying royalties.

The tax rate applied on dividends is the same applicable to the withholding tax on profits of a permanent establishment. In fact, we understand that although a permanent establishment is juridically different from the subsidiary they should deserve a similar fiscal treatment under the economic standpoint of view.

We are sending you a copy of the Protocol in which is included a clause about commissions that has also been included in the Protocol with Germany. I would appreciate very much to hear your comments on the subject.

4.9 Minor matters

(i) Article 17 - Independent activities

Brazil considers to be from Brazilian source every kind of income which is paid by an individual or a corporation domiciled in Brazil to a non-resident, irrespectively of the place where the activity generating such income is carried out.

In accordance with the Brazilian tax law, income derived by a non-resident in respect of professional services carried out in Brazil for a period not exceeding 12 months is not subject to tax in Brazil provided that the payment of such income is not borne by a resident of Brazil.

The draft of the Convention does not change the situation covered by the Brazilian internal law.

On the other hand, the Brazilian proposal establishes that income paid by a permanent establishment situated in Brazil or by a company resident therein to a non-resident in respect of independent activities is subject to tax in Brazil even if such activities are carried out outside of Brazil. Such a clause has been included in all Conventions signed by Brazil.

(ii) Article 21 - Students

We would appreciate it if you could examine the possibility of increasing the exemption limit to at least £ 1.000.

(iii) Article 4 - Fiscal domicile

Based on your information we have no objection in accepting your proposal to include in paragraph 1 the wording "The term does not include any individual who is

liable to tax in that Contracting State only if he derives income from sources therein".

However, we would like to receive additional explanation about the subject in order to be able to understand better the objectives and purposes of such inclusion.

iv) Article 22 - Income not expressly mentioned

We believe that income of the kind should be taxable in both States due to its own characteristics and meaning. Considering that such income cannot be identified, there would be no reason to attribute the exclusiveness of taxation either to the State of residence or to the State from which income is derived.

I would like to say that we have not included in the proposal we sent to you any clause which has not been included in the Conventions we have signed before. I am sending you the Convention we have initialled with Germany. We could sign a quite similar one with you.

I would like to suggest that a 2nd. round of negotiations be settled in principle for the period between November 4 to December 14.

The week of 10 to 16 of November would be the least convenient one because we will have a National holiday in Brazil.

In case you believe there are still many pending points which should be solved before a second round of formal negotiations take place, we could think of two possibilities as follows:

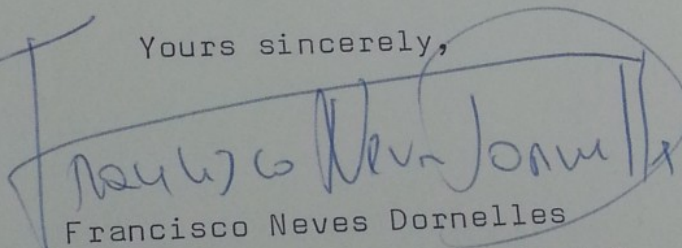
1st) you would come to Brazil on an informal basis in order to clarify any doubt still existing. Once we

arrive at the conclusion that a Convention can be initialled a British Delegation would come to Brasilia for the final negotiations;

2nd) a member of the International Tax Commission of the Ministry of Finance could go to London on an informal basis. Once we clarify all the remaining problems a British Delegation would come to Brasilia in November or December for the second round of negotiations.

Looking forward to hearing from you soon, I remain

Yours sincerely,


Francisco Neves Dornelles
President of the International
Tax Studies Commission

Enclosure:

- 1) Articles 1, 3, 5, 6, 8, 9, 15, 16, 17, 18, 19, 20, 24, 25, 26, 27, 28, 29, 30 and 31
- 2) Table - Excess Remittance Tax
- 3) Convention Brazil x France
- 4) Convention initialled with Germany.

? where.

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BRITISH EMBASSY
BRASILIA

3 September 1974

20/1

D Hopkins Esq
Inland Revenue
Secretaries' Office
Somerset House
London WC2R 1LB

✓ Smallwood
Could we discuss this please
before you go on leave
84
12/9

M Hopkins

I think that an informal talk
would be the best way to
proceed in the circumstances
12/9

UK/BRAZIL DOUBLE TAXATION NEGOTIATIONS

1. Sr Dornelles asked me to call at the Finance Ministry yesterday and gave me the enclosed letter for transmission to you. He also gave me a copy.
2. You will note Dornelles' suggestion that if you believe more progress should be made before a second round of formal negotiations takes place, either you should come out to Brasilia, or the Ministry should send someone to London, for informal talks. This may reflect a fear expressed some weeks ago to me by the official concerned in the Ministry for External Relations that damage could be done to the development of Anglo/Brazilian economic relations if a further round of negotiations was seen to be held without making much progress towards the conclusion of an agreement. I asked Dornelles which procedure he would personally prefer and he said that his preference would be for you to come out here for informal talks. Since he and his assistants are heavily engaged in discussions with our various competitors - in addition to the French and German agreements, whose texts are enclosed, the Brazilians have just concluded an agreement with the Danes - there would be considerable advantage in fixing a date either for informal or formal talks, so as to maintain our place in the queue.
3. You will also note that Dornelles' paragraph 4.3 makes no suggestion on how to make progress on the problem of granting credit for Brazilian withholding tax spared as a result of the reductions, which we wish to see secured under the agreement. Article 24(3) of the agreement with the Germans and Article 22(D) of the agreement with France record the compromise, basically of a 50/50 split of the reduction, agreed in those cases (see paragraph 4 of my letter to Carless in FCO of 27 June).