

Mr Radford

cc Mr Kerby

TAXATION

1. I should report the latest chapter in the fantastical history of our attempts to move Inland Revenue on 'matching reliefs'. You last saw the papers in June: the background is shown at flag A. Briefly, after 18 months or so of frustration Ministers agreed (following an approach by Mr Amery about the Sudan) that FCO/ODA/DTI officials should discuss further joint action, possibly at Ministerial level. Officials agreed to recommend another Ministerial approach, a draft minute for the Foreign Secretary was prepared, and FCO were to draft the covering report to our Ministers.

2. I was about to ask about progress on this when, on Friday last, Mr Kerr (FCO) telephoned to explain the delay and the latest state of play. Their PVS has since agreed that a Ministerial approach should be deferred in favour of further attempts at official level. The reason is a recent letter (arising out of the Irish DTA) from the Minister of State, Treasury to FCO sharply critical of their attitudes in recent months. The letter (not being circulated) mentions attempts to re-open matters of established policy, the deliberations of the Raw Materials Working Party and advice given through FCO to a dependent territory 'in negotiation' with IR about a DTA.

3. In the circumstances, FCO do not think a further Ministerial approach would be rewarding just at present. Their PVS proposes instead to tackle the new Chairman of the Board of IR when he calls (as he will), with the aim of getting joint inter-departmental talks going at official level if possible. If not, the idea of a Ministerial effort will be revived. FCO are preparing a piece of paper for the PVS which will not go into any detail.

4. As this was a joint initiative, FCO might have told us earlier; but reading both on and between the lines it would be difficult to disagree with their conclusion that a Ministerial approach on the general topic had better be put on ice for the moment. As to 'official' prospects, Mr Kerr has been somewhat cheered by a friendly IR reception at recent talks about the Sudan, when IR contrary to expectations apparently hoped to complete the draft of a DTA some time in September. Moreover, there seem to have been recent Protocols/DTAs concluded with Cyprus, Jamaica and Malaysia - I have sent for copies to study. Straws in the wind, perhaps - anyway, they don't weigh against the decision.

5. FCO are not reporting to Ministers again yet, what is now proposed being sufficiently covered by the original remit. I think we can take our time from FCO in this, and if you agree will keep in touch with them, reporting to Mr Harris (or his successor) when available.

Bunne

S A Bunce

21 August 1973

(FRJ)

Today

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I agree: M'Cambridge

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(PTO)

Please see minutes overleaf on latest developments, which I mentioned to you.

2 I've put opposite copies of the DTA's / Protocols referred to. No special joy here. The previous Jamaica DTA was one of those which provided for 'matching'. So was the old Malaysia one, but it ^{had} lapsed so the new one is an advance (Malaysia being one of our top priority targets). As for the scope of matching, this seems much as before, except that in the Malaysia one tax spared on certain royalties will be credited also.

3. Until we can establish contact with IR & get their own progress report, I suggest our successors should watch in 'Trade & Industry' where these Orders are announced.

Bonne

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PC.

B.V. to me
on 11/9.

Bonne

5/9

Mr. Bence (through Mr. Kirby).

I will arrange for X1 below.

4:14

I am glad to have seen these papers — perhaps for the last time! I suggest that they should be B.V. to Mr. Peckham (through Mr. Kirby) to see on, say, 24 September, so that he can have an opportunity to read some of the minutes and perhaps find out from Mr. Kerr what action, if any, the FCO have taken.

Meanwhile, it would be useful to place on this file an extract X/ from Mr. Radford's minute of 17 August to Mr. King, and from Mr. King's reply which specifically mentioned taxation.

might care to see this, if he has not seen it already.

What we are still not receiving from the Revenue is any regular information about which Agreements are being renegotiated (or which new Agreements are being negotiated), and what is being done about matching relief in each case. As ever, it is this kind of normal (elsewhere in Whitehall) interdepartmental communication which is lacking.

James
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Mr Pearson

In paragraph 13 of Cmnd 4656 - British Private Investment in Developing Countries - and in the 1972 PAR (paragraphs 15(t) and 88) attention was drawn to certain tax problems which are believed to inhibit British private overseas investment, in particular the failure of the British tax authorities to match tax advantages offered by the developing countries. We and the FCO have put pressure on the Board of Inland Revenue to do something to mitigate this problem, both when it comes to the consideration of general tax policy and by negotiating more double taxation agreements.

2. You will not be surprised to learn that our efforts to move the BIR have not been very successful and we have been contemplating a renewed approach, using the UK's short fall in 1972 from the 1% target as evidence of the need to do everything we can to keep up the private flows. As it happens, the BIR have recently been able to show some significant progress in the negotiation of double taxation agreements and I am doubtful whether, for a number of reasons, this is a suitable time to renew pressure on them. The FCO, who were themselves very much seized of this question and at one time were contemplating an approach to the Treasury at Ministerial level, have now had second thoughts; they may however still take up some aspects of the problem at the PUS level.

3. In these circumstances I should be glad to know whether you think the argument that our performance is falling short of the 1% target is one that we should deploy in this context, or whether (bearing in mind Lady Tweedsmuir's assurance at the UNCTAD conference) it is better to reserve this for use in discussions with the Treasury about maintaining the volume of official flows. My own feeling is that the tax problems are not so directly connected with the trend of private investment flows to the developing countries as to give us very much leverage on the BIR.

R E RADFORD *REL*
20 November 1973

Mr Kerby

Reference

We spoke about Mr Peckham's minute of 27 November.

2. I discussed with Mr Kerr our proposal to ask the Inland Revenue for a progress report on their negotiation and renegotiation of Double Taxation Agreements. Mr Kerr thought that such a list of countries would be very useful but he preferred us not to ask the Revenue, at this stage anyway, for an indication of whether provision for matching relief was being made in individual Agreements. Mr Kerr emphasised that the F.C.O. are playing the taxation question very carefully at the moment and he asked that, pending Mrs Smallwood's response, we confine ourselves to the general statement in (68) about the future provision of matching relief in DTAS.

3. Consequently, I had a word with the relevant desk officer in the Revenue, Mr Fawcett (Mr Lewis' successor) who, much to my surprise, readily agreed to provide such a list. It would take several days to prepare but he promised to send it to us as quickly as possible. This is very welcome co-operation and I did not miss the opportunity of trying to create more cordial I.R./O.D.A. relations. Progress at last!

J C Machin

J C Machin
29 November 1973

Mr. Peckham

With reference to your minute of 27 November, you will wish to see Mr. Machin's minute above.

2. If Mr. Machin has succeeded (? by taking advantage of the innocence of a new arrival in the Revenue, or because the Revenue genuinely want to cooperate now - it is hard to tell) in obtaining a detailed statement of recent, current and proposed double taxation negotiations, it will be an important step forward.

Excellent - like to know the outcome.

Mr. Machin

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Mr. Peckham

With reference to my minute of 29 November, Mr. Fawcett of the Revenue has just telephoned to say that regrettably, he is now unable to provide the list of DTA's. Apparently, Mr. Smallwood (his Under-Secretary) got wind of his 'innocent' promise explained to him the old Revenue arguments for not complying with our request & instructed him to give me a polite refusal.

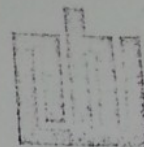
2. Clearly embarrassed, Mr. Fawcett went on to say that the Revenue were making considerable progress on the negotiation & renegotiation of DTA's. I reassured him that our requests for a list was not to enable us to monitor the Revenue's progress but simply to have centrally in the OBT, a list for information purposes. He accepted this but then reiterated Mr. Smallwood's old chestnut that the Revenue's negotiations & draft DTA's are "confidential". I did not pursue this with him in view of Mr. Kerr's desire

to play things carefully at the moment.

3. Presumably we now await the promised response from Mrs Smallwood. However, I must say that I find the confidentiality argument of the Revenue most discouraging & I think it is intolerable that a Government Department sh^d. persist in this opting out of the normal Whitehall consultation. After all, the Revenue is now pressing ahead with negotiations & I fail to see why they ~~as~~ need to be so secretive about details. In fact, as paragraph 7 of E/56 indicates, we c^d. even be of some help to them in their programme for negotiation of DTA's. In this context a list of progress w^d. be most useful to all concerned & I gather from Mr Fawcett that it w^d. be quite simple to prepare - if it doesn't exist already. Therefore, unless Mrs Smallwood's response is more encouraging than this preliminary ~~etc~~ reaction w^d. seem to indicate, I recommend that we seriously consider resurrecting the paper at

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16 September 1974

UK AID PROGRAMME

- 1 The impact of the increased cost of oil imports on the United Kingdom's balance of payments is unlikely to be a short-term difficulty, but rather will probably last for a considerable number of years. Prolonged substantial balance of payments' deficits may well stimulate criticism of the official aid programme and may even lead to demands for it to be reduced. The CBI believes, however, that for both humanitarian and self interest reasons the United Kingdom should continue, despite such difficulties, to provide aid to the Third World on the same scale as at present. But, since aid funds must continue to be limited, they must be used as effectively as possible both from the recipients' and the United Kingdom's point of view. Two key elements in such effectiveness are the criteria by which aid funds are allocated and the terms on which they are provided.

Criteria for Allocation

- 2 The CBI believes that the two principal objectives of economic aid to developing countries should be the related ones of their needs in humanitarian terms and their long-term economic development. The CBI accordingly considers it right that the bulk of the UK's economic aid should be given to the countries in greatest economic need and, insofar as a distinction is valid, it believes that the present balance of aid as between those needy countries and those which offer opportunities for British trade and investment, is about right. However, the CBI wishes to make the following additional points:
 - (a) Obviously greater consideration needs to be given, at least in the immediate future, to those countries whose economies have been, and continue to be, most affected by the rise in the price of oil, fertilizers, grains and commodities generally. However, these increases have created a world-wide problem which should be resolved as far as possible through international action, notably by the multilateral agencies.
 - (b) Within the most needy group there should be a shift in the aid given, from Africa to Asia, notably India.
 - (c) Emphasis should also be given to those countries which
 - i contain substantial UK commercial interests;

ii offer the best potential markets for UK business - both for exports and investments;

(d) Where alternative projects are of comparable social value aid should be used to finance those producing the most commercial benefit to the UK;

3 There can normally be no objection to the provision of aid from which the donor benefits as well as the recipient provided it is consistent with the basic objectives of economic aid.

4 The CBI warmly welcomed the references in the Minister's speech in Luxembourg to the need for a more global EEC development policy and one which would entail a shift in the emphasis of the EEC's aid away from Africa. It will be seen that the CBI's recommendations are in the same sense viz, they would involve a shift away from Africa towards Asia and Latin America since on a per capita basis African countries have tended to receive on average more bilateral aid than have Asian countries with lower per capita incomes.

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5 It is essential that in determining the geographic pattern of aid disbursements that ODM should take full account of the total efforts - and not simply their response to the oil crisis - of other aid donors. Should all the major donor countries and multilateral development institutions decide to concentrate on a particular group of countries or on a single aspect of development, for example the least developed countries and rural development, this could lead (a) to a greater volume of funds being made available than could be effectively absorbed by the countries concerned and (b) to the neglect of other important aspects of development. Lack of consultation and co-operation between individual donors could easily lead to a misallocation of scarce resources and could even produce distortions in development.

Terms

6 The terms on which aid is provided should be tailored more closely to the financial resources of the recipient country. The oil crisis has demonstrated even more clearly than before that the world cannot be divided neatly between the rich and the poor. There is a wide spectrum of countries ranging from the very poor to the very rich within which no clear dividing lines can be drawn for all purposes. It may well be that all aid flows to the very poor should be in the form of grants but equally, in order to make the best use of the funds available, the richer of the less developed countries should mainly receive

loans at rates of interest which they can afford.

- 7 The United Kingdom Aid Programme has intentionally moved away from interest-bearing loans and the great bulk of new loans are interest free. However, the ODM supports the use of interest-bearing loans where appropriate and has provided a few loans at fixed rates of interest ranging from 2 to 7½ per cent. More could be done in this respect. In particular, selective use should be made of the so-called "credit-mixte" mechanism. The use of aid funds to soften commercial export credit terms can be a useful way of ensuring that developing countries can import the essential goods and services they require to maintain their development while at the same time reducing the amount of aid funds required to purchase the goods in question. The involvement of private capital releases aid funds which can be diverted to countries in greater need. Obviously, such a mechanism is suitable only for a small range of countries and possibly also for a limited range of imports. "Credit-mixte" should not be used in cases where the purchaser is able to pay the full commercial rates. They should only be used to enable a country to import goods and services which would not otherwise have been purchased. It is recognised that in a tight supply situation there would be a cost to the UK balance of payments to the extent that the goods and services involved could have been purchased by other countries at full commercial rates. Nevertheless, the CBI strongly believes that further consideration should be given to this question which should not be dismissed out of hand.

Official Aid and Private Investment

- 8 It is sometimes suggested that public and private sector flows to developing countries are substitutes. This is not so. The roles of the two flows are essentially complementary, although different in motivation and character. Thus, official capital transfers on concessionary terms, are best able to finance social projects such as schools and hospitals and the basic infrastructure necessary to provide a platform for development. The private sector supplies know-how and resources needed to build up the industrial capability required to sustain development.
- 9 We believe the ODM should pursue a deliberate policy of using aid funds in association with private investment flows when either such a use is requested by the host Government concerned or where such an association is likely to be of benefit to developing countries as a whole. In this connection we strongly recommend that:
 - (a) the pre-investment study scheme introduced by the ODA and which was beginning to establish itself when it was suspended, should be maintained. If, however, the Minister of Overseas Development decides that this is not a proper function for her Ministry, financial and operational

responsibility for the scheme should be transferred to the British Overseas Trade Board. Should the Board not have the necessary personnel, management of the scheme might be taken over by the Overseas Projects Group of the Department of Trade.

(b) The use of capital aid to finance infrastructure associated with a particular private investment and to facilitate joint ventures with British companies should be continued.

- 10 Another measure (not the responsibility of the ODM) which could be taken by HMG to encourage private investment in developing countries is the granting of pioneer tax relief. The renegotiation of existing double taxation agreements which do not include such relief, and the negotiation of further double taxation agreements should be encouraged. In such negotiations full weight should be given to the overall commercial interests of the United Kingdom and, in the case of developing countries, to the development needs of the country concerned. Thus negotiations should not be left exclusively to the Inland Revenue (whose main concern naturally is minimisation of loss to the Exchequer) but when policy issues are under discussion, should include the ODM, FCO, D & T etc.

Other Points

- 11 There should be a progressive multinational untying of aid but the United Kingdom should not move further or faster than other major donors.
- 12 UK aid funds should continue to be used to purchase essential spare parts, capital equipment and raw materials required by private companies in order to maintain or expand production in cases e.g. where the host country is unable to make the necessary foreign exchange available.
- 13 ODM should continue to do all it can to ensure that its aid efforts are followed up by recipient governments. This is particularly important in the area of technical assistance and consultancies.

Conclusion

- 14 The United Kingdom aid programme should not be reduced but while accepting its primarily humanitarian role the CBI believes it should be made more effective by:

- i continuing to give emphasis, within the constraints imposed by humanitarian and long term economic development considerations, to countries and projects bringing most commercial benefit to the United Kingdom;
- ii taking full account of the efforts of other aid donors and of the private sector.

studies scheme is run by their Department of Trade and is not funded from aid. She is perfectly happy for the British Overseas Trade Board to introduce a scheme on similar lines if they think fit to do so.

Para 10 - Pioneer Tax Relief

CBI: negotiations should not be left exclusively to the Inland Revenue. The ODM, FCO, and Department of Trade should be in on policy.

Comment

They certainly are, but the detailed negotiations are a matter for the Inland Revenue.

/Other Points

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24 August 1973

COPY NO 41

HER MAJESTY'S TREASURY
COMMONWEALTH FINANCE MINISTERS' CONFERENCE 1973

DOUBLE TAXATION AGREEMENTS - MATCHING CREDIT FOR
PIONEER RELIEFS

Note by the Inland Revenue

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SPEAKING NOTE

The United Kingdom is ready to give matching credit for pioneer tax reliefs as part of a comprehensive double taxation agreement with a developing country. A number of the United Kingdom's agreements with Commonwealth countries already provide for matching credit.

BACKGROUND NOTE

1. This note provides background briefing on the topic which may be raised in discussions on aid, or informally.
2. Many developing countries encourage investment in new industries and other approved projects by granting tax holidays or similar tax incentives for a limited period. If a United Kingdom company makes such an investment, the incentive may be frustrated because the United Kingdom tax on the overseas profits remitted to the United Kingdom is usually effectively increased by the amount of the tax given up overseas because the United Kingdom has to give the company less credit for overseas tax against its United Kingdom tax liability. In paragraph 13 of the White Paper on British Private Investment in Developing Countries (Cmd 4656

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the Government undertook to keep this problem in mind in relation to the new corporation tax system.

3. There has been statutory provision since 1961 for allowing credit against United Kingdom tax on overseas profits for the overseas tax given up by virtue of relief for the promotion of development; the provision applies only if the relief is covered in a double taxation agreement. Where it applies the United Kingdom investing company, and not the United Kingdom Exchequer, receives the benefit of the incentive given by the overseas country. The provision has been used only sparingly in the past and only a handful of our double taxation agreements at present provide for matching credit for overseas tax holidays. We are however engaged in a general renegotiation of the dividend articles in our agreements to take account of the new corporation tax system and we have taken the opportunity to offer matching credit for pioneer reliefs to all the developing countries with whom we have double taxation agreements. We also offer matching credit to any developing countries with which we enter negotiations for the first time. This initiative has been widely welcomed (even by those countries which do not at present have such reliefs) and we expect the number of agreements in force with these provisions to increase considerably over the next year or so. This will provide a useful encouragement to British private investment in developing countries.