HOW TO DESIGN A REGIONAL TAX TREATY AND TAX TREATY POLICY FRAMEWORK IN A DEVELOPING COUNTRY

1. Introduction

A well-designed regional tax treaty to which developing countries are signatories will include provisions securing minimum withholding taxes on investment income and technical service fees, a taxing right in respect of capital gains from indirect offshore transfers, and guarding against-treaty shopping. A tax treaty policy framework—national or regional—that specifies the main policy outcomes to be achieved before negotiations commence would enable developing countries with more limited expertise and lower capacity for tax treaty negotiations to avoid concluding problematic tax treaties.

This note provides guidance for members of regional economic communities in the developing world on what should and should not be included in a regional tax treaty and how to design on a common tax treaty policy framework for use in negotiations of bilateral tax treaties with nonmembers.[1]

Regional Economic Communities

There are many regional economic communities[2] that include countries at all levels of economic development.[3] The extent to which they coordinate/harmonize[4] their members' tax policies varies: some regional communities have concluded regional tax treaties[5] and/or have developed a regional model tax treaty for negotiations with noncommunity member countries[6] or established hard law such as European Union (EU) Directives as a means of furthering community members' efforts to coordinate/harmonize tax policy.

Regional Tax Treaties

A regional tax treaty is a multilateral tax treaty concluded only among member countries of a regional economic community.[7] Although its main purposes may differ across communities, it generally aims to showcase political commitment for regional integration and facilitate economic and trade activities within the community by ensuring the elimination of double taxation, and reducing source taxing rights.[8] It also strengthens cooperation between tax authorities in the

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[1]As guidance for developing countries on tax treaty negotiations, the Platform for Collaboration on Tax released "Toolkit on Tax Treaty Negotiation" that provides capacity-building support to developing countries on tax treaty negotiation (https://www.tax-platform.org/publications/PCT_Toolkit_Tax_Treaty_Negotiations_Online_Version). The guidance may be also found in the UN Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (2019).

[2]A regional economic community is a form of regional integration to foster cooperation and economic integration, such as a free trade area, a monetary union, or a custom union.

[3]For example, Africa has ten regional economic communities, all of which are components of the African Union: AMU (Arab Maghreb Union), CEN-SAD (The Commission of Sahel-Saharan States), CEMAC (Central African Economic and Monetary Community), COMESA (Common Market for Eastern and Southern Africa), EAC (East African Community), ECCAS (Economic Community of Central African States), ECOWAS (Economic Community of West African States), IGAD (Intergovernmental Authority on Development), SACU (Southern African Customs Union) and SADC (Southern African Development Community). WAEMU (Western African Economic and Monetary Union) is an economic and monetary union within ECOWAS. In addition, the Africa Continental Free Trade Area, which is the third of six stages in establishing an African Economic Community by 2028, entered into force on May 30, 2019.

[4]Tax 'coordination' is meant here cooperative tax setting, where community members change their domestic tax system to one compatible with the aims of the community by giving up parts of their autonomy in tax matter. Tax 'harmonization' is tighter than tax coordination, meaning that members' domestic tax system are almost identical in tax bases and/or tax rate.

[5]For example, the Nordic Tax Treaty, WAEMU Tax Treaty, and CEMAC Tax Treaty.

[6]For example, the Association of Southeast Asian Nation (ASEAN) Model Tax Treaty and the Common Market for Eastern and Southern Africa (COMESA) Model Tax Treaty. While the African Tax Administration Forum (ATAF) is not a regional economic community, it has a model tax treaty. The ATAF Model Tax Treaty aims to promote common regional (African) policy and enhance a consistent approach.

[7]Thus, a regional tax treaty differs from a multilateral tax treaty that is open to any countries such as the Convention on Mutual Administrative Assistance in Tax Matters (MAAC) or the MLI.

[8]A regional tax treaty also aims to provide tax certainty to taxpayers through dispute resolution mechanisms and apply a uniform taxation rule.

region through articles on exchange of information or assistance in the collection of taxes.

Depending on its content and the administrative capacity of member countries, however, a regional tax treaty may inadvertently increase base erosion risks for member countries. For example, if a member country (A) has a bilateral tax treaty with a nonmember country (B) that is a no- or low- tax jurisdiction, then residents of B may exploit benefits of the regional tax treaty as if B has a bilateral tax treaty with other member countries of regional treaty (C, D, and so on). Country C, for example, may have a policy not to conclude a bilateral tax treaty with a country like B. Thus, when a regional economic community decides to begin negotiating a regional tax treaty, the member countries should review one another's existing tax treaties and domestic tax laws in the same manner as countries do prior to commencing negotiations of bilateral tax treaties.

Regional Tax Treaty Policy Frameworks

A regional model tax treaty is an agreement among community members on preferred tax treaty positions to pursue in negotiations of a bilateral tax treaty with noncommunity countries.[9] It may help members reduce differences in bilateral tax treaties between individual members and noncommunity countries. However, a regional model tax treaty in itself does not prohibit members from concluding a bilateral tax treaty with noncommunity members that deviates from the regional model tax treaty. To prevent a member country from concluding a bilateral tax treaty that may undermine the community's effort to coordinate/harmonize tax systems and increase base erosion risks for member countries, the community needs a regional tax treaty policy framework.[10] Such a framework requires member countries to observe bottom-line (non-negotiable) positions on key source taxing rights in negotiations and prevents members from concluding a bilateral tax treaty with prescribed types of countries. A regional tax treaty policy framework could mitigate negative spillover effects and reduce the risk of erosion of member countries' revenue base through treaty shopping. For example, if the framework includes countries like B in the previous subsection as a country with which the framework prohibits members from concluding a bilateral tax treaty, Country C could mitigate a risk that residents of Country B exploit benefits of the regional tax treaty in their transactions with residents of C.

As the IMF paper on spillovers in international taxation[11] discussed, developing countries do not necessarily need to conclude tax treaties to attract foreign investment at any expense.[12] Although the empirical evidence on the investment effects of tax treaties is mixed,[13] tax treaties could reduce the tax revenue of developing countries by reducing source taxing rights and through treaty shopping.[14] Developing countries can eliminate the double taxation of their residents, with no need for treaties, by the enactment of domestic laws.[15] Since most developing countries are capital importers, any risk of double taxation for their residents would likely be of only secondary concern.[16] In most cases, other tax treaty objectives could be achieved through the enactment of domestic laws and other measures.[17] Tax treaties have a spillover effect, because the benefits of a tax treaty with one country can be exploited by residents of third countries, and possibly the rest of the world. In effect, a resident of a third country could enjoy treaty benefits through a tax treaty network or the domestic laws of its residence

[9]The regional tax treaty policy framework should also apply to negotiations of a bilateral tax treaty with other member of regional economic community, and to a regional tax treaty but in this case source country taxing rights such as ceiling rates of withholding taxes on investment income might be reduced.

[10] The regional tax treaty policy framework should include a regional model tax treaty.

[11] International Monetary Fund (IMF) (2014).

[12]IMF (2014); IMF (2019) summarizes the key developments in tax treaties since the 2014 paper.

[13]For a positive impact, Di Giovanni (2005), Neumayer (2007), Millimet and Kumas (2007), and Barthel and others (2010). For no or negative impacts, Blonigen and Davies (2004), Blonigen and Davies (2005); Egger and others (2006); Louis and Rousslang (2008).

[14]There will be further and unanticipated revenue loss if a resident of a third country can exploit benefits of the treaty concluded by a developing country.

[15]Foreign tax credit or exemption arrangements in domestic laws can alleviate double taxation of residents. However, corresponding adjustments that solve economic double taxation caused by transfer pricing adjustment can be provided only where competent authorities (meaning a representative in each treaty partner country who will be responsible for implementing the tax treaty and its provisions) agree under mutual agreement procedures (which is a dispute resolution mechanism between competent authorities provided in tax treaties,) in some countries.

[16]Some developing countries are regional hubs for foreign direct investment, and their resident companies may have foreign-source income.

[17]For example, a tax information exchange agreement (TIEA) or the MAAC enable the tax administration to use exchange of information.

Box 1. Trade Mis-Invoicing and Tax Treaties

As the G20 Leaders' Communique September 2016 recognized, illicit financial flows (IFFs) via trade mis-invoicing are regarded as hampering the mobilization of domestic resources in developing countries, in particular. While the estimated size of IFFs via trade mis-invoicing varies, one study estimated IFFs from Africa at over $50 billion per annum (WCO 2018). As some aspects of trade mis-invoicing relate to transfer pricing, an article on associated enterprises in tax treaties (Article 9 of the Organisation for Economic Co-operation and Development [OECD] and United Nations [UN] Model Tax Conventions) may be relevant to trade mis-invoicing. However, domestic tax laws enable tax administrations to correct transfer pricing whether a country concludes any tax treaties—regional or bilateral—or not. An article on Exchange of Information (EOI) in tax treaties (Article 26 of OECD and UN Model) may also be relevant to trade mis-invoicing, since improved tax administration capacity to obtain information and data from tax treaty partners would benefit customs administrations, which are primarily responsible for addressing trade mis-invoicing if cooperation arrangements to share information between tax administration and customs administration officials are in place in a country.

country.[18] Accordingly, developing countries generally do not face an urgent need to conclude a regional tax treaty or a bilateral tax treaty. These countries should first build their capacity for tax treaty negotiations. If they have problematic treaties in force, then renegotiating such treaties is likely to be a higher priority than negotiating new ones.

However, even if a developing country takes a cautious approach to negotiating a tax treaty, it could be the case that other countries propose tax treaty negotiations; the government department in charge of tax treaty negotiations experiences pressure to commence. In such cases, a tax treaty policy framework could prevent the developing country from concluding a problematic treaty.[19] If a developing country is a member of a regional economic community that endeavors to coordinate/harmonize members' domestic tax policies, it is desirable to have a regional tax treaty policy framework. Such a framework would be in lieu of, or in addition to, a national tax treaty policy framework, irrespective of whether the regional economic community has a regional tax treaty.

A regional tax treaty policy framework and a regional model tax treaty may also enable community members to conduct group negotiations of a bundle of bilateral tax treaties with a noncommunity member because the community members have common preferred and bottom-line positions.

As further background information, Box 1 explains how tax treaties relate to trade mis-invoicing and Box 2 explains the ongoing discussions on international corporation taxation.

The remainder of the note is structured as follows. The second section discusses tax policy issues to consider when a regional economic community concludes a regional tax treaty; third section discusses the importance of a regional tax treaty policy framework and a regional model tax treaty, as well as how to design and enforce the framework; fourth section discusses how group negotiations of tax treaties with noncommunity members can work and the benefits that group negotiations can offer; and the final section summarizes.

2. Regional Tax Treaties

Overview

Table 1 shows regional tax treaties of regional economic communities in developing countries.[20]

The structure of these treaties is similar to the Organisation for Economic Co-operation and Development (OECD) Model or the United Nations (UN)

[18]An anti-treaty shopping clause could prevent such spillover effect, in theory, if the tax administration is capable of applying the clause properly.

[19]For example, a treaty that waives source taxation on investment income.

[20]In addition to the regional taxation treaties shown in Table 1, some regional treaties for mutual assistance in tax matters exist among developing countries, for example, the SAARC (South Asian Association for Regional Cooperation) Income Tax and Mutual Assistance Treaty (2011). The latest IBFD database does not indicate any other tax-related regional agreements of developing countries.

Box 2. International Corporate Taxation

The IMF Policy Paper (2019) summarized the current situation:

"*The international corporate tax system is under unprecedented stress. The G-20/OECD project on Base Erosion and Profit Shifting (BEPS) has made significant progress in international tax cooperation, addressing some major weak points in the century-old architecture. But vulnerabilities remain. Limitations of the arm's-length principle—under which transactions between related parties are to be priced as if they were between independent entities—and reliance on notions of physical presence of the taxpayer to establish a legal basis to impose income tax have allowed apparently profitable firms to pay little tax. Tax competition remains largely unaddressed. And concerns with the allocation of taxing rights across countries continue. Recent unilateral measures, moreover, jeopardize such cooperation as has been achieved.*"

At the G20's request, the Organisation for Economic Co-operation and Development's (OECD) Inclusive Framework is currently working on a two-pillar solution in international corporate taxation to address the tax challenges of the digital economy. Pillar 1 proposes a unified approach that revises nexus and profit allocation rules. Pillar 2 proposes a global minimum tax, which includes four main components: an income-inclusion rule; an undertaxed payments rule, a subject-to-tax rule, and a switchover rule. The proposed solution would require the revision of existing tax treaties and would affect regional tax treaty policy frameworks.

The OECD aims to reach a global agreement on both pillars by mid-2021.

Table 1. Regional Tax Treaties of Regional Economic Communities in Developing Countries

Regional economic community	Member countries that signed	Entered into force
Andean Community	Bolivia, Colombia, Ecuador, and Perú	2005
CARICOM (Caribbean Community)	Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago	1994
CEMAC (Central African Economic and Monetary Union)	Cameroon, Central African Republic, Chad, Republic of Congo, Equatorial Guinea, and Gabon	1966
WAEMU (West African Economic and Monetary Union)	Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo	2009

Source: International Bureau of Fiscal Documentation (IBFD).

Model. As discussed in Section 1, a regional tax treaty aims to facilitate economic and trade activities within the community[21] by ensuring the elimination of double taxation and reducing source taxing rights.

Among these treaties, the Caribbean Community (CARICOM) treaty provides that only a source country has a taxing right on investment income. It provides zero percent as a ceiling rate for source taxing rights on dividends. As such, dividends paid to residents of other CARICOM members will not be taxed in either the source country or the resident country.[22] This "nontaxation anywhere" situation[23] may have developed to promote economic and trade activities among community members, as mentioned in Section 1, or to avoid double taxation at the entity and shareholder levels. However, it may lead to treaty shopping and base erosion by multinational enterprises (MNEs). Suppose, for example, that an MNE (P), which a resident of a third country (non-CARICOM member) (X), has invested in a company (T) in a

[21]Brooks (2010) indicated that the CARICOM treaty has potential advantages in facilitating trade, preventing or reducing tax evasion and avoidance through exchange of information, developing common approaches to treaty interpretation, and reducing administrative costs.

[22] Article 11 of the CARICOM treaty provides:

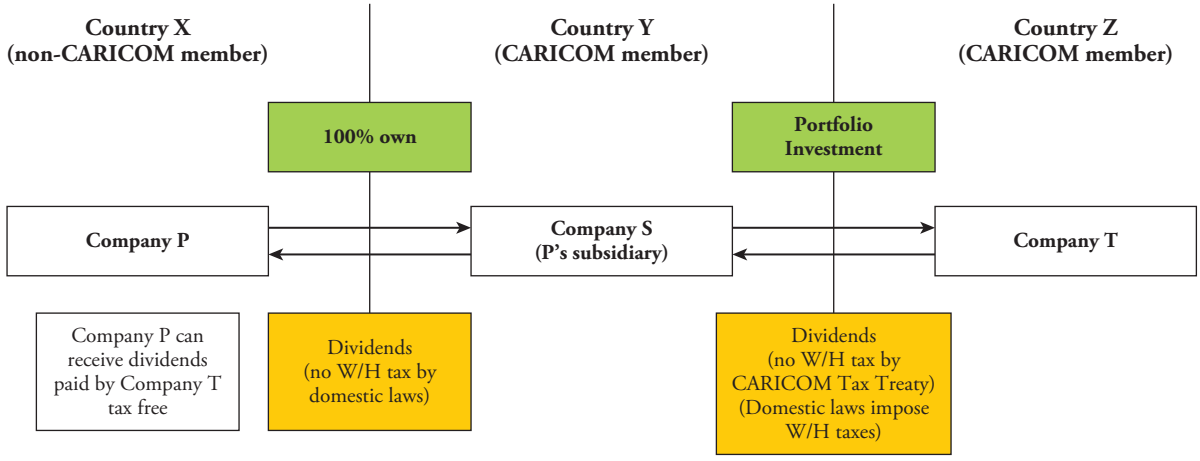
"1. Dividends paid by a company which is a resident of a Member State to a resident of another Member State shall be taxed only in the first-mentioned State.

2. The rate of tax on the gross dividends shall be 0% percent."

A ceiling rate of tax on the dividends from preference shares, interest, and royalties is 15 percent in the CARICOM treaty.

[23]Income of a dividend-paying company is subject to CIT.

Figure 1. Example of Tax-Free Dividends



Source: IMF staff.
Note: CARICOM = Caribbean Community; W/H = withholding.

CARICOM member country (Z) with which country X does not have a tax treaty. Dividends paid directly by T to P would then be subject to a withholding tax under country Z's tax law.[24] If, however, P invests in T through a subsidiary (S) established in another CARICOM member country (Y) whose domestic laws do not withhold taxes at the source on dividends paid to nonresidents by its resident,[25] then the MNE can receive dividends paid by T in Country Z on a tax-free basis[26] (Figure 1 and Table 2). This undermines the efforts of other CARICOM members not to conclude bilateral tax treaties that waive source taxation on dividends with a non-CARICOM member country. Since the CARICOM treaty does not include any provision on anti-treaty shopping,[27] the subsidiary is eligible for the benefits of the CARICOM treaty, even if the subsidiary does not conduct any active business activities. MNEs could achieve the same effect by establishing a subsidiary in a non-CARICOM member country that concluded a bilateral tax treaty waiving source taxation on dividends with a CARICOM member and then purchasing shares of a company in another member country.[28]

The Andean treaty provides that only a source country has a taxing right on interest and does not provide a ceiling rate on withholding taxes on investment income, so the domestic laws of each member country will apply. Thus, the CARICOM-type treaty shopping problem does not arise in the Andean treaty.

Similarly, the Central African Economic and Monetary Union (CEMAC) and the West African Economic and Monetary Union (WAEMU) treaties also provide that a source country has a taxing right, but without restricting the taxing rights of a resident country. The CEMAC treaty does not provide a ceiling rate

[24]For example, Jamaica does not have a bilateral tax treaty that waives source taxation on dividends with a non-CARICOM member country and its domestic law imposes a 33.3 percent withholding tax on dividends paid to non-residents.

[25]As is the case for St. Lucia, and St. Vincent and the Grenadines. Barbados also exempts a withholding tax on dividends by a resident company paid to nonresidents from income earned from sources outside of Barbados.

[26]If Country X exempts dividends received from overseas subsidiaries regardless of the tax burden of the subsidiaries, the dividends received by P from T are not subject to any tax other than a corporate income tax in Country Z.

[27]The Andean treaty does not include any anti-treaty shopping provision, either. The CEMAC and WAEMU treaties do not have an anti-treaty shopping provision as recommended by the final report on BEPS Action 6; the WAEMU treaty has a beneficial ownership requirement for the articles on dividends and interest. Among contracting states of the CARICOM treaty, Barbados, Belize, and Jamaica signed the MLI and included the CARICOM treaty as agreements covered by the MLI. However, as only Barbados has ratified the MLI, anti-treaty shopping provision in the MLI is not applicable to the CARICOM treaty as of January 15, 2021. For other regional tax treaties, Columbia, Peru, Gabon, Burkina Faso, Cote d'Ivoire, and Senegal signed or ratified the MLI, but they did not include their regional tax treaties as agreements covered by the MLI. (https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm)

[28]It is also possible for residents of a CARICOM member (Z) to receive dividends from a company (T) in his/her country (Z) tax free by establishing a company (S) in country (Y) and having S purchase T's shares ("round tripping").

Table 2. CARICOM Members' Withholding Taxes on Dividends Paid to Nonresidents and Tax Treaties Waiving Source Taxation on Dividends

	Withholding tax rate on dividends paid to nonresidents in domestic law (in percent)		Bilateral tax treaties waiving source taxation on dividends	
Country	Qualified companies*	Others	Qualified companies*	Others
CARICOM	0	0		
Antigua and Barbuda	25	25	UK	UK
Barbados	0/15/25	0/15//25	Bahrain, Cyprus, Luxembourg, Qatar, Singapore, Spain***, Switzerland, UAE, UK	Bahrain, Cyprus, Qatar, Singapore, Switzerland, UAE, UK
Belize	15	15	UK	UK
Dominica	15	15	none****	none****
Grenada	15	15	Switzerland, UK	Switzerland, UK
Guyana	20	20	none	none
Jamaica	33.33	33.33	none****	none****
St. Kitts and Nevis	10	10	UK	UK**
St. Lucia	0	0	none	none
St. Vincent and the Grenadines	0	0	none	none
Trinidad and Tobago	5	10	Spain*** *****	none

Source: IBFD.
Note: CARICOM = Caribbean Community.
* = "Qualified companies" are those owning a certain percentage of voting shares of a dividend-paying company.
** = The treaty with Monaco waives source taxation on dividends if a beneficiary owner is an individual.
*** = These treaties include anti-abuse clauses.
**** = A country does not have a bilateral tax treaty that waives source taxation on dividends.
***** = The zero rate applies with respect of participations of at least 50 percent of the capital. The 5 percent rate applies to at least 25 percent participation and 10 percent for the rest.

on withholding tax on investment income,[29] and the domestic laws of each member country will apply. The WAEMU treaty provides a 10 percent ceiling rate on a withholding tax on dividends and 15 percent on interest, and royalties, which are lower than or the same as those provided by domestic laws.

Tax Policy Issues in Considering and Designing a Regional Tax Treaty

Costs and Benefits of a Regional Tax Treaty

As discussed in Section 1, a regional tax treaty could facilitate further integration of economic and trade activities among community members by ensuring the elimination of double taxation and reducing source taxation that increases after-tax return of investment. However, as members reduce source taxation, the direct effect is to lose revenue equivalent to such reductions.[30] Moreover, if a regional tax treaty includes lenient provisions that could be used for tax planning or tax avoidance, the treaty would increase the base erosion risks for members. Further regional integration, however, would be expected to lead to higher economic growth and corresponding increases in tax revenue for members. Thus, whether to conclude a regional tax treaty depends on community members' assessment of the costs and benefits of the treaty. However—and as is also the case in considering bilateral treaties—quantitative assessment of the costs and benefits would be difficult for developing countries because even data on revenue from withholding taxes at the source on payments to nonresidents by country of recipients may not be available.

Which, then, is more desirable, a regional tax treaty or bilateral tax treaties between community members? A regional tax treaty could better facilitate regional integration than bilateral tax treaties between community members (unless a regional economic community has a regional tax treaty policy that requires it members to conclude a bilateral tax treaty with other members with identical contents on key provisions). An ill-designed regional tax treaty, however, would increase

[29]The CEMAC treaty waives source taxation on royalties if they are taxed in a resident country.

[30]If cross-border income and investment flows between members are balanced and members eliminate double taxation by means of a credit system, the amount of foreign tax credit allowed to residents would also decline. Thus, the amount of net revenue loss caused by a regional tax treaty under this assumption could be marginal.

risks of treaty shopping by residents of non-members of the community because a member's effort to counter treaty shopping would be compromised by the regional treaty (as discussed above using the CARICOM treaty as an example). The direct effect on tax revenue and future increases in tax revenue that are expected from higher economic growth would be similar.

Harmonization as a Substitute for a Regional Tax Treaty?

Where a regional economic community harmonizes members' tax policies, and each member's domestic law provides the elimination of the double taxation of its residents, these community rules and domestic laws could achieve most of objectives[31] of a regional tax treaty. If member countries need to conduct mutual agreement procedures, the exchange of information and assistance in collection, a tax treaty could better facilitate such cooperation among member countries than domestic laws. A regional tax treaty that only covers mutual agreement procedures and cooperation between tax authorities, such as exchange of information, could be an option.

Extent of Tax Coordination/Harmonization Sought

A regional economic community could have hard regional laws requiring each community member to impose a minimum rate of corporate income tax (CIT)[32] and withholding taxes on investment income paid to nonresidents, and the hard laws could require that members not conclude a bilateral tax treaty with nonmembers that could be abused for purposes of tax avoidance. Such a regional economic community could facilitate intragroup trade and investment by concluding a regional tax treaty that waives source taxation on investment income, without causing a risk of tax avoidance or treaty shopping. However, there are few examples[33] of communities with a substantial body of tax coordination law. The EU, for example, maintains a directive that requires its members to keep the minimum value-added tax (VAT) rates,[34] but it does not have a directive or other hard law on CIT rates.[35] The EU's Code of Conduct for business taxation[36] requires its members to roll back existing tax measures that constitute harmful tax competition and to refrain from introducing any such measures in the future. However, the Code of Conduct is not a hard law.[37]

Some regional economic communities composed of developing countries have introduced or are trying to introduce coordination/harmonization rules on direct taxes. However, these rules on both direct and indirect taxes have not been enforced strictly[38] due to the lack of a mechanism to monitor and enforce the rules. For example, these developing country communities do not have equivalents to the European Court of Justice for the EU[39] or state aid rules of the EU[40]. Unless there is hard law that requires members to abide by minimum rates of CIT and withholding taxes on outbound payments, and a credible mechanism to monitor and enforce the hard law, a regional tax treaty could function as a potential tax treaty with the rest of the world, including no- or low-tax jurisdictions.[41] This is also true for bilateral tax treaties; however, the implications are exacerbated in the case of a regional tax treaty, given the multiplicity of treaty partners..

Existing Bilateral Tax Treaties with Noncommunity Members

The provisions of existing bilateral tax treaties concluded by community members should be checked

[31]To facilitate further integration of economic and trade activities among community members by ensuring the elimination of double taxation, reducing source taxation, providing tax certainty to taxpayers, and applying a uniform taxation rule.

[34]Among other things, the VAT directive provides 15 percent as the minimum standard rate and 5 percent as the minimum reduced rate. The directive also provides detailed rules on a VAT such as places of taxable transactions. The directive is available at https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32006L0112. Its implementing regulation is available at https://eur-lex.europa.eu/legalcontent/EN/ALL/?uri=CELEX%3A32011R0282.

[35]The Parent-Subsidiary Directive (PSD), the Saving Directive, and the Interest and Royalties Directive require EU members not to impose source taxation on investment income paid to nonresidents in prescribed cases. However, a new anti-abuse clause was added to the PSD in 2015, and the Saving Directive was repealed in January 2016.

[36]https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31998Y0106%2801%29

[37]The minimum standards of the Base Erosion and Profit Shifting recommendations and the internationally agreed standard for tax transparency may not be hard laws unless defensive measures for non-compliant jurisdictions are strictly applied.

[38]Mansour and Rota-Graziosi (2013).

[39]Even if a community has a regional court of justice, it rarely functions well (Mansour and Rota-Graziosi 2013).

[40]Paragraph 1 of Article 107 of the Treaty on the Functioning of the European Union provides: "Any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."

[41]Even if the treaty has anti-treaty shopping provisions, it may take time for most developing countries to effectively detect and address treaty shopping.

before negotiating a regional tax treaty. If the existing bilateral treaties waive or significantly reduce source taxation on investment income, these bilateral treaties may give rise to tax planning through the regional tax treaty. Some of the tax treaties shown in Table 2 were concluded before the CARICOM tax treaty was signed. Although it is possible, in theory, to revise a tax treaty, it may be extremely difficult for a developing country to revise a treaty in the direction of increased taxation of investment income.

Even if an existing treaty does not waive or provide low rates for source taxation on investment income, it is important to check whether the treaty has a most-favored-nation (MFN) clause relating to withholding tax rates. An MFN clause in a tax treaty requires a contracting state to reduce the ceiling rates in the existing treaty to the same level as those provided in the new or revised treaty with another contracting state.[42] If a regional tax treaty provides a lower ceiling rate on investment income than that provided in a member country's existing treaty with an MFN clause, the ceiling rate of the regional tax treaty may apply to that existing treaty. If a regional tax treaty waives source taxation, the ceiling rate of existing treaties with MFN clauses may be[43] reduced to zero.

It is also necessary to check whether the contracting parties to existing bilateral treaties of community members include countries with zero or low CIT rates or harmful tax regimes. For example, if a community member concludes a bilateral tax treaty with a noncommunity member that has a significantly low CIT rate or harmful tax regime as provided by the EU's Code of Conduct or OECD's Forum on Harmful Tax Practices[44], with which other members will not conclude a bilateral tax treaty, the noncommunity member could benefit indirectly from a regional tax treaty.

Need to Keep Minimum Withholding Taxes on Investment Income

Given the experience of other regional economic communities, it is unlikely that a regional economic community of developing countries will agree to a hard law that requires members to keep a minimum level of taxation on investment income paid to nonresidents and a minimum CIT rate[45] or that imposes limits on tax incentives, such as tax holidays. If this is the case, then a regional treaty to waive source taxation on investment income could provide a strong incentive for MNEs to invest in the regional community through a member country that provides the most generous tax incentives or exempts withholding taxes on investment income paid to nonresidents under their statutes or bilateral treaties. The regional treaty would thereby facilitate further tax competition among community members. Thus, a regional economic community of developing countries should keep a certain level of source taxation on investment income in its regional tax treaty.[46] Similarly, if members of the community intend to maintain source taxation on technical service fees paid to residents of noncommunity members, which was added to the 2017 version of UN Model (Box 3), or capital gains from offshore indirect transfer (Box 4) in their bilateral treaties, they should include an article on technical service fees or capital gains from indirect transfers in the regional tax treaty. Otherwise, provisions in bilateral tax treaties could be avoided by using a regional tax treaty.

Whether a regional tax treaty can provide lower ceiling rates on withholding taxes on investment income than members' bilateral tax treaties with nonmembers will depend on whether a regional economic community has a regional tax treaty policy framework or other constraints in mitigating possible spillover effects.

[42]For example, Article 10(6) of the Protocol to the South Africa-Sweden Tax Treaty provides: "If any agreement or convention between South Africa and a third state provides that South Africa shall exempt from tax dividends (either generally or in respect of specific categories of dividends) arising in South Africa, or limit the tax charged in South Africa on such dividends (either generally or in respect of specific categories of dividends) to a rate lower than that provided for in subparagraph (a) of paragraph 2, such exemption or lower rate shall automatically apply to dividends (either generally or in respect of those specific categories of dividends) arising in South Africa and beneficially owned by a resident of Sweden and dividends (either generally or in respect of those specific categories of dividends) arising in Sweden and beneficially owned by a resident of South Africa, under the same conditions as if such exemption or lower rate had been specified in that subparagraph."

[43]Some MFN clauses are not related to investment income, and not all MFN clauses are automatic. Some only require renegotiation.

[44]The OECD's "Harmful Tax Practices – 2018 Progress Report on Preferential Regimes indicates the criteria for assessing preferential tax regimes (https://www.oecd.org/tax/beps/harmful-tax-practices-peer-review-results-on-preferential-regimes.pdf). The latest per reviews results are available at https://read.oecd-ilibrary.org/taxation/harmful-tax-practices-2018-progress-report-on-preferential-regimes_9789264311480-en#page1.

[45]It is likely desirable to align the minimum CIT rate with the Global Minimum Tax that could be agreed on Pillar 2 approach or even exceed the rate of that Global Minimum Tax.

[46]This should also be considered when a regional community introduces a rule that requires its members to reduce source taxation on investment income derived by residents of other community members by domestic laws instead of a regional tax treaty.

Box 3. Technical Service Fees

A treaty article on technical service fees allows a source country to impose a withholding tax at the source on gross payments in relation to managerial, technical, and consultancy services at a rate to be negotiated by the contracting states. The UN introduced an article on technical service fees as Article 12A in the 2017 update of the UN Model, based on the following considerations[1]:

- A source country has limited scope for taxing income from technical services provided cross border if a service provider does not have a fixed base or permanent establishment in the source country.
- The uncertainty as to whether fees for technical services can be taxed as royalties is undesirable for both taxpayers and tax authorities.
- The inability of a source country to tax fees for technical services provided by nonresident service providers may result in the erosion of the tax base of the source country and profit shifting by MNEs; the problem is especially serious for developing countries because they are disproportionately importers of technical services and often lack the administrative capacity to control or limit such base erosion and profit shifting.

The OECD Model has not included an article on technical service fees to date.

[1]UN Model Commentary on Article 12A (pp. 318-322, https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf)

Box 4. Taxation of Offshore Indirect Transfers

Offshore Indirect Transfers (OITs) is the sale of an entity owning an asset located in one country by a resident of another country.

The tax treatment of OITs has emerged as a significant issue in many developing countries in recent years. A country in which an immovable asset is located can tax gains from direct transfers of the asset. Where shares of an entity owning an immovable asset are transferred, a country in which the underlying asset is located ("location" countries) have encountered challenges in taxing capital gains realized on such transfer. Depending on the definition of immovable assets, the assets typically cover land and buildings but may also include mineral rights, and can also possibly be expanded to capture telecom licenses and other rights issued by government that give rise to location specific rents.

The Platform for Collaboration on Tax (PCT) – a joint initiative of the IMF, OECD, UN and World Bank Group – has developed a toolkit that provides practical and coherent guidance for developing countries on considerations that might arise when deciding to tax OITs, types of assets to tax in such cases and how to design and implement OIT taxation in domestic law. (https://www.tax-platform.org/sites/pct/files/publications/PCT_Toolkit_The_Taxation_of_Offshore_Indirect_Transfers.pdf)

Article 13(4) of the 2017 version of OECD and UN Model Tax Conventions allows a location country to tax a capital gain realized on OITs where the value of the interest sold is principally (more than 50 percent) derived from immovable property in the location country. While the majority of the existing bilateral tax treaties do not include Article 13 (4) of the Models, as Article 9 of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) is equivalent to Article 13(4) of the Model, signing the MLI and opting for Article 9(4) to apply will enable the signatory to modify their existing covered bilateral treaties efficiently, but only if their relevant treaty partner also elects for Article 9(4) to apply (which is not guaranteed).

Need for Anti-Treaty Shopping Provisions

To prevent MNEs from claiming the treaty benefits of the regional tax treaty through its subsidiaries in low- or zero-tax community members,[47] an anti-treaty shopping provision should be included. The Base Erosion and Profit Shifting (BEPS) Final Report on Action 6 (Box 5) requires, as a minimum standard, that countries include in their treaties a principal purpose test (PPT) provision, or the limitation on benefits (LOB) provision, or both. Developing countries may

[47]Including those with no/low source taxation on investment income paid to nonresidents.

Box 5. Limitation on Benefits Provision and Principal Purpose Test Provision

The BEPS Report on Action 6 requires countries to include in their treaties as the minimum standard:

(1) the combination of a principal purpose test (PPT) provision and limitation on benefits (LOB) provision, or

(2) a PPT provision alone or

(3) an LOB provision, supplemented by a mechanism to deal with conduit financing arrangements not already dealt with in tax treaties.

LOB provision: a specific anti-abuse rule that limits the availability of treaty benefits to entities that meet certain conditions, which are based on the legal nature, such as a public company test, ownership in, and general activities of the entity; and that seeks to ensure a sufficient link between the entity and its state of residence.

PPT provision: a more general anti-abuse rule based on the principal purposes of transactions or arrangements. Under this rule, if one of the principal purposes of transactions or arrangements is to obtain treaty benefits, these benefits would be denied unless it is established that granting these benefits would be in accordance with the object and purpose of treaty provisions.

experience difficulties in applying a PPT provision, however, because of the challenges they face in assessing facts and circumstances that often occur outside of their jurisdictions. While the LOB provision is complicated, it would be safest to include both the PPT and LOB provisions.

As it is likely to take years for tax administrations in developing countries to build the capacity to apply anti-treaty shopping provisions effectively—even if the regional treaty includes such provisions—it is desirable to keep minimum source taxation on investment income, technical service fees, and capital gains in the regional tax treaty.

Existing Regional Tax Treaty

If a regional economic community has a regional tax treaty in force, then community members should periodically review the existing treaty, the bilateral tax treaties and domestic laws of each member.[48] They should revise any provisions of the regional treaty that may increase the base erosion risks for member countries. For example, if Jamaica needs to stop treaty shopping by residents of a non-CARICOM member using the CARICOM tax treaty, the article on dividends (Article 10) should be revised, or at a minimum, anti-treaty shopping provisions should be included.

3. Regional Tax Treaty Policy Framework

Need for a Regional Tax Treaty Policy Framework

Tax Treaty Policy Framework

The tax treaty policy framework[49] is intended to enable the relevant authorities for tax treaty negotiations—in most cases, the ministry of finance[50]—to prepare for and conduct negotiations efficiently and to avoid concluding problematic treaties.

A tax treaty policy framework should include the following: (1) the most desirable policy outcomes to be pursued in negotiations (model treaty), (2) the minimum (non-negotiable) positions on important points that should be preserved in negotiations ("bottom lines"), and (3) the policies for dealing with countries that do not appear suitable for a comprehensive tax treaty.[51] A tax treaty policy framework also

[48]Changes in tax laws in a treaty partner after the treaty entered into force could expose the other treaty partner to an unanticipated risk of treaty abuse. To prevent this, each treaty signatory's domestic tax laws should be monitored. The US 2016 Model Tax Treaty includes a new article entitled "Subsequent Changes in Law" (Article 28), which enables either the US or its treaty partner to cease granting treaty benefits in certain circumstances when changes to domestic tax law are enacted after the treaty has been signed. Paragraph 101 of the Commentary on article 1 of the 2017 OECD Model Tax Convention includes a provision similar to that in the US Model as an example.

[49]Comprehensive data on the existing tax treaty policy framework are not available.

[50]A foreign affairs ministry may be the ministry in charge of treaty negotiations. However, given the required expertise for tax treaty negotiations, the ministry of finance most often plays the primary role in negotiating substantial matters.

[51]If a country has no CIT or an extremely low CIT rate, there is no/little risk of significant double taxation, but a tax treaty with such country could create or increase nontaxation in either country. The MLI noted the need to ensure that existing agreements for the avoidance of double taxation on income are interpreted to eliminate

Box 6. Outline of a Typical Tax Treaty Policy Framework

1. Tax treaty objectives
2. Context of treaty policy: Evaluation of key factors, such as international tax norms and key aspects of a country's economy, including main sources of tax revenue
3. How to choose treaty partners[1]
- Countries with which to conclude tax treaties[2]
- Countries with which to avoid concluding tax treaties[3]

4. Preferred treaty provisions
- Scope
- Distributive rules such as business profits, dividends, interest, royalties, technical service fees, and capital gains, including offshore indirect transfer
- Elimination of double taxation
- Nondiscrimination
- Mutual agreement procedures
- Exchange of information
- Assistance in the collection of taxes
- Anti-treaty shopping and avoidance

5. Flexibility (priorities) and nonnegotiable positions (bottom lines)

[1]This decision should be based on an analysis of the costs and benefits. However, as discussed in Section 2, it is difficult to make quantified assessment of the costs and benefits in developing countries. Thus, selection of countries for treaty negotiation will be based on judgment of senior government officials using criteria provided in the tax treaty policy framework.

[2]For example, countries with economic relations, those with double taxation cases, or those seeking to strengthen economic ties.

[3]For example, countries with no- or low-tax burdens, those with tax regimes or tax administration that could be used for tax avoidance/evasion, or those with a poor track record in cooperating with other tax administrations.

provides guidance on which existing treaties should be revised. Box 6 shows an outline of a typical tax treaty policy framework. To promote political acceptability, a tax treaty policy framework should be approved by the ministry of finance's senior management.[52] Once the tax treaty policy framework is approved, it helps negotiators to avoid concluding tax treaties that compromise the bottom-line positions (or worse). The bottom-line positions of the tax treaty policy framework are confidential.[53] Some countries publish[54] a model tax treaty that explains the most desirable policy outcomes to be proposed in negotiations. Publishing a model tax treaty and using it as an initial draft for negotiations may not help a country to achieve desirable policy positions, because both negotiating countries need to make concessions. Thus, starting with a treaty draft that includes more source taxation than the country's model tax treaty, while not publishing the model tax treaty may be a practical approach for developing countries. However, in negotiations with an advanced country, a developing country may not necessarily be able to achieve a significantly different outcome, because the skilled treaty negotiators of the advanced country may not be so affected by such an approach as they can guess the real preferred policy positions by checking treaty precedents of the developing country. Further, the advanced country generally has a stronger bargaining position.

Role of the Regional Tax Treaty Policy Framework

A regional tax treaty policy framework[55] can serve an important role in underpinning the economic community's efforts to coordinate/harmonize tax systems. In the absence of a common treaty policy framework,

double taxation with respect to the taxes covered by those agreements without creating opportunities for nontaxation or reduced taxation through tax evasion or avoidance. While there is usually no need to conclude a comprehensive tax treaty with countries with no CIT or an extremely low CIT rate, there is a need for a Tax Information Exchange Agreement with such no- or low- tax jurisdictions or the MAAC because such countries could be more likely used for tax avoidance or evasion than countries with a certain level of a CIT rate. The OECD's final report on BEPS Action 6 provides useful guidance on tax policy consideration that are relevant to the decision of whether to enter into a tax treaty or amend an existing treaty.

[52]A minister of finance or deputy. It is preferable that the policy framework be agreed on a whole-of-government basis (PCT 2021).

[53]No one would disclose cards voluntarily in a card game.

[54]For example, the U.S publishes its model income tax convention. (https://www.treasury.gov/resource-center/tax-policy/treaties/documents/treaty-us%20model-2016.pdf). The Netherlands also publishes its tax treaty policy.

[55]As mentioned in Footnote 6, ASEAN, COMESA, and ATAF have a model tax treaty but comprehensive data on regional tax treaty policy frameworks are not available.

community members could defeat regional agreements on minimum tax rates and similar measures by providing for exceptions in treaties. A coordination/harmonization plan without a common treaty policy is porous.[56]

The risks of treaty shopping and base erosion may be especially significant for the regional economic communities of developing countries, because they often lack effective anti-avoidance rules, as well as the tax administration capacity to enforce them. It should also be considered that many developing countries compete with their neighbors and peers by providing tax incentives to attract foreign direct investment. In light of these special factors, a regional tax treaty among developing countries needs to be carefully designed—and the case for a regional tax treaty policy framework is much stronger than it is for advanced countries. A community member can have its own national tax treaty policy framework in addition to a regional framework. However, its own policy framework should be in line with the regional framework, while modifying components that are not bottom-line elements. If a country has no or few tax treaty experts, as is the case in many developing countries, it would be most practical to rely on the regional tax treaty policy framework rather than seek to develop a national treaty policy.

Community members should review any regional tax treaty policy framework on a regular basis, for example, every five years,[57] and whenever there is a significant development in international taxation issues, such as changes in the UN or OECD Model. Otherwise, the regional tax treaty policy framework, in particular, a regional model tax treaty, could become outdated, and negotiations based on the framework could lose their efficiency. It is also important to monitor whether and how member countries comply with the policy framework and share information on the latest negotiations through peer reviews; such monitoring should be conducted regularly, at least once a year.

Similarly, a regional tax treaty should be updated if significant changes are made to the regional tax treaty policy framework.[58] The procedures for reviewing and revising the regional tax treaty policy framework should be specified in its terms.[59]

The components of a regional tax treaty policy framework would be similar to a single country's tax treaty policy framework. In addition, regional rules or codes of conduct on tax competition or coordination/harmonization[60] and a regional tax treaty should be evaluated in the context of treaty policy.

Enforceability of the Regional Tax Treaty Policy Framework as a Norm

Whether to make a regional tax treaty policy framework as a hard law that requires community members to comply strictly may depend on how strictly other rules on coordination/harmonization of the tax system require member to comply and on the ability to enforce such an agreement. Where the community members do not agree to make a regional tax treaty policy framework as a hard law, the use of soft law rules would be a feasible option. For example, community members can exert peer pressure by checking one another's compliance at a regular meeting of tax treaty negotiators/tax policy makers and reporting to a ministerial level meeting.

How to Design a Regional Tax Treaty Policy Framework

OECD Model versus UN Model

To promote efficiency in tax treaty negotiations, community members should follow, to the extent possible, the widely accepted international norms for tax treaties provided in the OECD and UN Model Tax Conventions.[61] Following international norms relieves negotiators of the need to explain common treaty provisions, because both model conventions have detailed commentaries. This is especially important for developing countries that have limited expertise and experience in tax treaty negotiations. The negotiators of developing countries will instead be able to focus on substantial issues, such as the rate of withhold-

[56]If a community has no hard law to coordinate/harmonize domestic tax policy at present but intends to introduce rules, a regional tax treaty policy framework is still useful in preventing tax competition. A regional tax treaty policy framework could narrow the room for tax planning, because the framework requires members to conclude tax treaties that are identical in key provisions.

[57]For example, the tax treaty policy of the Netherlands has been revised in 1996, 1998, 2011, and 2020 since its publication in 1987. The U.S. Model Income Tax Convention has been revised in 1981 (draft), 1996, 2006, and 2016 since its publication in 1976.

[58]There may, for instance, be cases in which the ceiling rates for withholding taxes on the investment income of a regional tax treaty are lower than those of the bottom-line position of the regional tax treaty policy framework.

[59]A ministerial level meeting of the regional economic community, which approved the tax treaty policy framework, can be used to ensure the agreed review and revision procedures be implemented.

[60]For example, the code of conduct may include types of tax incentives that member countries should avoid adopting.

[61]Pickering (2013), 29.

ing taxes at the source on investment income, or the technical service fees, or the definition of a permanent establishment.

Community members thus need to decide which model should be the starting point of their regional tax treaty policy framework. The two models have many identical or similar provisions; however, the UN Model, which was drafted with developing countries in mind, preserves more source taxing rights than the OECD Model. For example, as mentioned in Section 2, the 2017 UN Model includes an article for withholding taxes on technical services fees,[62] while the 2017 OECD Model does not. Accordingly, regional communities of developing countries may find that they prefer the UN Model.[63]

Preferred Positions

Community members need to decide their preferred positions for all substantive provisions for the community, including whether to comply with international norms or deviate from them. As a general matter, countries should generally adhere to international norms for provisions that do not affect source taxing rights, such as provisions dealing with the elimination of double taxation, nondiscrimination, mutual agreement procedures and exchange of information.[64] Whether to include arbitration in an article on mutual agreement procedures depends on the decision of community members.[65] The UN Model provides alternative drafting that include arbitration (Alternative B), but the provision on arbitration differs from that of the OECD Model. Inclusion of arbitration is optional in the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI).

For other provisions, however, members may consider deviating from international norms if there are clear and strong reasons to do so. Examples include provisions on a branch profit tax, which is a withholding tax on the after-tax income that non-resident corporations earn through a permanent establishment, to the extent that such earnings are not reinvested. Unless such provisions have legitimate reasons and other members are in agreement, it would be prudent to align with international norms. Countries should, in the course of negotiations, be able to explain to counterparties why they have chosen in some instances to depart from international norms.[66] It is also useful to engage in discussions at international fora so that countries can propose new provisions that have not yet become international norms. For example, a treaty provision applying treaty benefits only to income subject to tax in a resident country,[67] which is an effective approach to address treaty shopping, could be included in the preferred positions in anticipation of future adoption in the UN[68] or OECD Model. Members can discuss whether to include new provisions in the framework at a regular meeting of tax treaty negotiators.

Flexibility and Nonnegotiable Positions

Member countries need to have clear internal views on which of their preferred positions are bottom-line positions that are nonnegotiable and make negotiators walk away, and which have some degree of flexibility in negotiation. Since tax treaty negotiations are negotiations between two sovereign countries, it is unrealistic to expect that one party will agree to all the preferred positions proposed by its counterparty. Some bottom-line positions may be backup positions of preferred positions. When member countries derive their bottom-line positions from provisions that are identical in both the UN and OECD Models, it is less likely that negotiators will fail to reach agreement.[69] Similarly, bottom-line positions that deviate from one or both models—for example, with respect to technical

[62]Article 12A of the UN Model.

[63]The UN Model Commentary includes alternative drafting that could meet the needs of developing countries so that a developing country can tailor the provision to meet its needs.

[64]Pickering (2013), 37–38.

[65]The version prior to the 2017 update of the OECD Model had the following footnote on a paragraph on arbitration (Article 25 (4)):

[In some states] *national law, policy or administrative considerations may not allow or justify the type of dispute resolution envisaged under this paragraph. In addition, some States may only wish to include this paragraph in treaties with certain States. For these reasons, the paragraph should only be included in the Convention where each State concludes that it would be appropriate to do so based on the factors described in paragraph 65 of the Commentary on the paragraph. (to continue).”*

[66]Pickering (2013), 43.

[67]A subject to tax rule clause applies to undertaxed payments that would otherwise be eligible for relief under a tax treaty. This clause is based on the idea that certain treaty benefits would only be granted if the item of income is sufficiently taxed in the other state.

[68]As another example, the 20th session of the UN Committee of Experts on International Cooperation in Tax Matters discussed the addition of a new Article 12B (Income from Automated Digital Services) to the UN Model (UN 2000).

[69]As all OECD member countries made public their reservations to the OECD Model, a developing country negotiating with an OECD member country can find the counterpart’s positions that deviate from the OECD Model in advance. Some non-OECD member countries also made reservations to the Model.

service fees—have a greater likelihood of becoming problematic in negotiations.[70] This does not necessarily mean that countries should not insist on such positions. As stressed above, developing countries do not necessarily need to conclude tax treaties to attract foreign investment at any price.[71]

Bottom-line positions for developing countries may include provisions on maintenance of minimum withholding rates[72] for dividends, interest, royalties, technical service fees, taxation of capital gains from offshore indirect transfer, and anti-treaty shopping. Bottom-line positions should be treated as strictly confidential.

In deciding preferred and bottom-line positions, members need to consider several factors relevant to determining the appropriate balance between raising revenue and encouraging inbound investment.[73] These include the following:

- Key aspects of the members' national economies, including the main sources of revenue and areas of current or potential inbound foreign investment[74]
- Any limitations on taxing rights (for example, limits on withholding taxes and incentive provisions, such as tax holidays for new investment) under domestic law[75]
- Regional rules on tax competition or coordination/harmonization of domestic tax policy
- The presence of a regional tax treaty
- The ability of members' tax administrations to comply with treaty obligations.

Regional Model Tax Treaty

Once regional economic community members have agreed on a regional tax treaty policy framework, they should develop a regional model tax treaty based on the preferred positions of the policy framework. As discussed, it may be desirable for a regional economic community of developing countries to use the provisions of the UN Model, unless members have clear and strong reasons to deviate from them.

Any national model treaty maintained by an individual member country should conform to the regional model to the extent possible. Most importantly, national model treaties should not envision lower source-country taxing rights than those in the regional model.

4. Group Treaty Negotiations

How Group Treaty Negotiations Work

Group tax treaty negotiations can be defined as joint negotiations of a bundle of bilateral tax treaties by a single negotiating team. As such, group treaty negotiations differ from multilateral tax treaty negotiations. In a group negotiation, the regional tax treaty policy framework and any available regional model treaty serve as the basis for negotiating positions.

Benefits of Group Negotiations

Group tax treaty negotiations can be of substantial practical assistance to members of a regional economic community in several ways, whether or not the regional economic community has a regional tax treaty.

First, group negotiations can give member countries more bargaining power than they would have in one-on-one negotiations. Group negotiations would enable countries to better resist the pressures of tax competition between themselves and might increase the chance of preserving, for example, desired levels of withholding taxes. One of the main purposes of group treaty negotiations is to reduce the likelihood of differences among treaties that might facilitate base erosion.

Second, countries with little or no experience in tax treaty negotiations could benefit from group negotiations through the pooling of their personnel resources. Group treaty negotiations could provide a valuable opportunity for capacity-building in ministries of finance and revenue administrations. In addition, the process of group treaty negotiations could facilitate cooperation of revenue administrations in other areas, such as the exchange of information and collection assistance, because members of a joint negotiation

[70]It is also likely to require concessions on other issues that are not bottom-line positions.

[71]IMF (2014), 25–27.

[72]The minimum withholding rates should not be zero.

[73]There are many papers on this issue. The latest one focusing on Africa is Quak and Timmis (2018).

[74]If, for example, a developing country has significant natural resources such as oil reserves, it may wish to ensure that its tax treaties do not unduly restrict its ability to tax the income from activities relating to the exploitation of such resources. Similarly, if there are significant road or rail transport activities between two neighboring countries, those countries may wish to extend the operation of Article 8 (Shipping, inland waterways transport and air transport) to those forms of transport (Pickering (2013)).

[75]Even if a country's current tax law does not provide taxing rights on certain type of income, the country can include such taxing rights in its bottom lines if it believes it may wish in future to change tax laws.

Table 3. Population and GDP of East African Community Members, 2019

Country	Population (millions)	GDP (nominal, billions, US$)	GDP per capita (US$)	Tax treaties in force*
Burundi	11.7	3.2**	274	0
Kenya	47.8	87.9	1,839	14
Rwanda	12.1	9.5	785	5
South Sudan	12.3	4.7	382	0
Tanzania	54.2	57.3	1,057	9
Uganda	39.0	31.1	797	10
Total	177.1	193.7	856 (unweighted average of 6 countries)	38

Source: EAC homepage (https://www.eac.int/eac-partner-states).
* = number of bilateral tax treaties in force as of November 2019.
** = 2018.

team could learn from one another's tax systems and tax administrations and could solidify personal relationships. The process would also increase the consistency of the application and interpretation of tax treaties.

Third, where relatively small developing countries, particularly those without large natural resource endowments or wealthy consumer markets, need to conclude a bilateral tax treaty with an advanced country for legitimate reasons, these countries may not individually be attractive as treaty negotiating partners to other countries, which inevitably face limitations on resources available for treaty negotiations. The prospect of entering into a single negotiation with multiple counterparties may appear to potential counterparties to be a more efficient and cost-effective prospect. For example, the members of the East African Community (EAC) have a total population of 177 million (2019) and GDP of US$194 billion (2019). Potential negotiating partners might find it preferable to deal with the community as a whole rather than with member countries individually (Table 3).

Even if member countries conducting group negotiations agree to a regional tax treaty policy framework and a regional model tax treaty, there may be a need for special provisions to accommodate an individual member's tax system or policy objectives. Group negotiations do not require participating member countries to agree on identical provisions. Special provisions could be included in a treaty or a protocol based on individual negotiation, as long as such provisions do not compromise bottom-line positions.[76] For example, if one member has a branch profit tax, the member can add a special provision that allows the member to apply the branch profit tax.

In some cases, particular community members may be unable to participate in group negotiations because they have bilateral treaties with the counterparty countries which they, or the non-community member, do not wish to renegotiate because the existing treaty includes a provision that a member wishes to keep, such as one for tax sparing, or one that the non-community member wishes to keep such as waiver or low withholding taxes on investment income. This situation should not, however, preclude other members of the community from engaging in group negotiation, because significant benefits may be available, even if not all community members participate.

A joint negotiation team could benefit from technical assistance from international organizations that draw expertise from both advanced and developing countries.[77] Although such assistance should be limited to advice on international norms, treaty precedents, and tax laws of a counterpart country of the group negotiation, it could provide significant benefits, including capacity building, to those involved in the negotiations.

[76]As group negotiations are joint negotiations of a bundle of bilateral tax treaties by a single negotiating team, the decision to ratify signed treaties is up to each member.

[77]Such international organizations have no conflict of interest in providing advice and can draw expertise from both advanced and developing countries, for example providing simulated negotiation exercises using former treaty negotiators of advanced and developing countries and retired tax practitioners. There are some lawyers who provide such assistance pro bono.

5. Conclusion

Developing countries do not necessarily need to conclude tax treaties, regional or bilateral, to attract foreign investment at any expense.

When a regional economic community of developing countries decides to conclude a regional tax treaty, the community members should carefully design and negotiate the regional tax treaty to mitigate the spillover effects and reduce the risk of erosion of the revenue base. The regional tax treaty should at least include provisions on minimum withholding taxes on investment income and technical service fees, capital gains from indirect offshore transfer, and anti-treaty shopping.

A tax treaty policy framework that specifies the main policy outcomes intended to be achieved by tax treaties before negotiations commence would enable a developing country with less expertise and capacity for negotiation to avoid concluding problematic tax treaties. When a developing country is a member of a regional economic community and that community aims to coordinate/harmonize its members' tax policies, a regional tax treaty policy framework can help community members' efforts for regional coordination/harmonization of tax policies and reduce the risk of erosion of revenue base of members and noncommunity members.

A regional tax treaty policy framework and a regional model tax treaty—which set out agreed preferred positions to be pursued in negotiations—can enable members of a regional economic community of developing countries to negotiate a bundle of bilateral tax treaties as a group with a third-party country. This group negotiation provides member countries more bargaining power than they would have in one-on-one negotiations, as well as other benefits such as enabling uniform interpretation and application of tax treaties among member countries. A joint negotiation team could benefit from technical assistance from international organizations.

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