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SUGGESTIONS
REGARDING THE PRINCIPLES WHICH MAY BE
ADOPTED BY THE CARIBBEAN COUNTRIES IN
NEGOTIATING AGREEMENTS FOR THE AVOIDANCE OF
DOUBLE TAXATION
WITH DEVELOPED COUNTRIES

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PART I

Introduction

The purpose of this Paper is to invite the attention of the members of the Joint Consultative Committee on Double Taxation to certain points concerning the subject matter of discussion (viz. the framing of suitable double taxation principles which should be borne in mind by Commonwealth Caribbean countries while negotiating tax treaties with Metropolitan countries) for stimulating consideration of this very important question. To be specific, this meeting has been convened in pursuance of the directive of the Heads of Government assembled at their Sixth Conference contained in the following Resolution:-

"Resolved that -

the Caribbean Secretariat take immediate steps to arrange joint consultation to frame suitable double taxation principles which represent the fundamental views of the Commonwealth Caribbean Countries to enable Governments to negotiate such principles with Metropolitan countries as a basis for concluding suitable Double Taxation Treaties bearing in mind the need to protect the interest of those non-independent Countries where the Metropolitan power has been determining external treaties".



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Shorn of all embellishments, the main purpose of a double taxation treaty is to promote the establishment of good commercial and trade relations between the contracting States. The balance of advantage may vary depending on the level of development and the political relationship between the two countries. Looked at from the developing countries' point of view, the most important purpose of a tax treaty is to attract foreign investment to help meet their development expenditure. Investment decision in the case of foreign investment depends upon several considerations, such as -

- (a) Criteria and practices employed by developing countries for the acceptance and promotion of foreign investment;
- (b) Developing countries' policies governing relative shares of foreign and host country investors in capital investment;
- (c) The forms of foreign equity participation such as cash investment, supply of machinery and equipment, provision of technological services and know-how;
- (d) Policies and practices governing foreign participation in management and training of management Personnel in developing countries;
- (e) Investment opportunities and fields of investment for foreign enterprises;
- (f) Policies and measures of developing countries with regard to the use of patents and licences supplied by foreign enterprises;

- (g) Adequacy of existing business practices for transfer of technology to developing countries through patents and licences by foreign enterprises;
- (h) Policies applied by foreign enterprises with respect to goods and services produced by these firms;
- (i) Tax treatment of foreign investment, both in capital importing and capital exporting countries;
- (j) Practices of foreign enterprises as regards exports of products resulting from foreign investment and/or grant of patents and licences;
- (k) Reinvestment undertaken by foreign enterprises from income earned in developing countries;
- (l) Policies applied by the developed countries with regard to the flow of private capital to developing countries and by developing countries with regard to the repatriation of capital and earnings;
- (m) The introduction of incentives by the developing and developed countries to encourage such flows; and
- (n) Policy of developing countries towards employment of foreign personnel and imports of machinery and equipment.

The important role which private foreign investment can play in the economic development of developing countries by providing capital, managerial skills and technological know-how is being recognised in developing countries. This is also true in the case of the Caribbean countries as may be seen from the following extracts from the Trinidad and Tobago's Third Five-Year Plan (1969-73), the Budget Speech (1970) and the Prime Minister's Press Conference. Although, the reference is,

obviously, to Trinidad and Tobago, the observations are of general application in the context of the Commonwealth Caribbean countries.

".....foreign private investment has a very useful role to play in the economy of nearly all countries" ^{1/}

".....If by an "open economy is meant a situation in which the local Government and local producers abdicate to foreign firms and individuals the making of crucial decisions on new investment, technology, production, retrenchment, domestic credit conditions, the buying and selling of land and other assets of the country, the images and messages of the communications media, tastes in goods and even ideas of proper national economic and social goals and instruments, then the maintenance of such policies and institutions would be inimical to the development of a truly national economy; and the country might as well opt for absorption as a satellite into another dominant economy. ^{2/}

"This argument suggests that to create the conditions for internally propelled growth in Trinidad and Tobago in the 1970's is not to close off the economy from foreign trade, from the inflow of foreign private capital or from relatively free foreign "invisible" transactions. Rather, it suggests the necessity for more positive steps to promote tastes for local goodslocal enterprise (both public and private) and the mobilisation of local capital" ^{3/}

^{1/} Para. 21, p.36, Third Five-Year Plan (1969-73)/(T&T).

^{2/} Para. 22, p.36, ibid.

^{3/} Para. 23, pp. 36-37, ibid.

"Economic development policies of the country in the years ahead must rest on clearly defined respective roles for national and foreign private investment. Accordingly, it is appropriate to end this chapter with the following formal statement of Government's policy towards foreign investment.

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7. The country needs foreign direct investment not so much because of the finance involved as because of the access that this type of investment provides to management, know-how, training in skills, technology and, in certain cases, overseas markets.

8. The Government will not only continue to tap traditional sources of foreign direct investment but will seek to diversify such sources by making approaches to other areas.

9. Branches and subsidiaries of foreign companies will be encouraged to re-investment locally a minimum or a certain percentage of their after-tax profits. When they do not wish to invest in their own line of business, they will be encouraged to invest their funds in locally controlled public companies or in the proposed Development Finance Company in such a manner that they do not acquire controlling or dominant interest in these enterprises." ^{4/}

^{4/} Para. 50, pp. 54-55, Third Five-Year Plan (1969-73).

"The Government has on many occasions declared that it welcomes foreign investment, and has taken concrete steps to ensure that it plays its part in our development within the framework of our national objectives". ^{5/}

"The contribution of foreign investment both to the national economy and to the balance of payments is clearly maximised when branches and subsidiaries of foreign companies operating here re-invest locally a high percentage of their after-tax profits. In future, these firms will be encouraged to undertake the maximum feasible amount of re-investment. When they do not wish to re-invest in their own line of business, they will be encouraged to invest their funds in locally controlled public companies or in the proposed Development Finance Company in such a manner that they do not acquire controlling or dominant interest in these enterprises". ^{6/}

"There is no opposition in Trinidad and Tobago to foreign investment. The opposition is to foreign domination of the economy. And this is a horse of a different colour". ^{7/}

^{5/} Budget Speech, 1970 28 November 1969.

^{6/} Para. 10, p. 43, Third Five-Year Plan - 1969-73 and Budget Speech 1970, 28 November 1969.

^{7/} Press Conference, dated 31 July 1970 - Trinidad Guardian dated 1 August 1970.

"Under the present system, foreign investors were welcome, once they would agree to local decision-making".

"The foreign investment policy was an essential part of nation-building". 7/

The problem is a long-range one and has to be viewed on that basis. 8/

7/ Press Conference, dated 31 July 1970 - Trinidad Guardian dated 1 August 1970.

8/ The following news-item may be read with interest in this connection:-

Speaking for the first time about his present job while in London with the CARIFTA European Mission, Mr. Demas observed, "I intend to keep pointing out to CARIFTA Governments that they must look at developments in the long-term". 7 Sunday Guardian 16 November 1969. 7

PART II

Suggestions regarding the principles which
may be adopted by the Caribbean Countries
in negotiating Agreements for the Avoidance
of Double Taxation with Developed countries

It is axiomatic that international double or multiple taxation is one of the important factors hindering the development of trade and commerce and the establishment of closer economic relations between different countries.

It is also axiomatic that the developing countries do need large capital investment for development.

There is already a very big gap between the developing and developed countries. According to the Industrial Development Survey,^{9/} if the average annual growth rate of even 7 per cent (which was achieved in the early sixties but could not be maintained in the later part of the decade) were to continue, it would take between 35 and 40 years to reach only the present aggregate level of manufacturing output of developed market economies. In the meantime, of course, the developed world would have advanced far beyond the present level.

Capital investment for development can be derived from two main sources - domestic savings and foreign investments.

The level and volume of domestic savings in the Caribbean countries (in common with other developing countries) falls very much short of the over-all developmental requirements.

^{9/} ID CONF. I/46

To meet their increasing developmental requirements and the growing menace of unemployment and under-employment, the developing countries have, therefore, to depend on foreign loans and investments (institutional and private).

There is nothing wrong with foreign investments as such. The most earnest consideration has, however, to be given to the nature of the 'strings' attached to such investment and the most advantageous utilisation of such investments.

The effort should, therefore, be, to achieve, apart from proper utilisation, the most suitable terms.

Foreign investments are competitive and investment decisions are taken by prospective investors on the basis of several considerations. Two such considerations, which are quite important, are:

- (a) the security of investment; and
- (b) the return on such investment.

The first concerns the general industrial policy of the Government, political stability, etc.

The second consideration is dependent on the taxation policy and a suitable agreement for the avoidance of double taxation plays an important part in this field.

The existing tax treaties between the Caribbean countries and other Governments outside the region fall into three broad categories -

- (a) treaties or "arrangements" between the metropolitan Governments and the erstwhile "colonies" or "possessions";
- (b) treaties entered into by the metropolitan countries with other countries and "extended" to the "colonies"; and

(c) treaties negotiated between the Caribbean countries, after independence, and the metropolitan and other countries.

For obvious reasons, treaties belonging to the first two categories, conceived and concluded in different conditions and circumstances do need revision or abrogation and re-negotiation. The same may also apply to some of the treaties falling in the first subcategory of the third category (viz. category (c)). Indeed, all the treaties in category (c) do need a second look.

The main objective which should, it appears, be kept in view while negotiating new Agreements for the Avoidance of Double Taxation is that the Agreement should enable the developing country to keep its tax sacrifices to the minimum while making, at the same time, the investment worthwhile for the prospective investors.

In particular, the effect should be -

- (a) to promote the establishment of joint ventures between local and foreign investors and the participation and employment of 'nationals' at different levels, - especially the decision-making levels;
- (b) to encourage the retention of profits for ploughing back in the same enterprise or investment in another approved enterprise.

The actual negotiations would, however, proceed on the basis of "give-and-take" and in the circumstances of a particular case. For example, a concession involving a slight deviation of a non-fundamental character in favour of a particular country may have to be made as a quid-pro-quo for a substantial advantage.

Apparently, neither the Mexico and London Model Conventions nor the OEEC/OECD Draft Convention would provide a suitable basis for negotiation, the former inter alia being too-antiquated and the latter having been "especially designed to meet the present-day needs of member countries". ^{10/}

It is felt that for the sake of both clarity and convenience the Draft Treaty ^{11/} prepared by the writer in connection with avoidance of double taxation in the Caribbean may be adopted as a basis for purposes of discussing the various principles involved.

The following further suggestions are made in this regard in brief:-

- (1) "Industrial and commercial profits" and "permanent establishment" - These terms will have to be defined so as to ensure, as far as possible, the taxation of profits derived from Caribbean sources by the Caribbean countries and their outright exemption or grant of relief by the country through credit provision, including, where necessary, credit for tax 'foregone'.
- (2) Industrial and commercial profits - These should be taxable in the country of source on the "permanent establishment" principle.
- (3) Associated enterprises - The general principle should apply.
- (4) Shipping and aircraft profits - These should be dealt with in accordance with the general international practice.

^{10/} Report of OECD Fiscal Committee (1963).

^{11/} ECLA/POS 70/13.

- (5) Inter-corporate profits and dividends - A suitable rebate will have to be allowed but (i) its quantum should be kept as low as possible and (ii) it should, as far as possible, be restricted to companies having substantial foreign investment and engaged in enterprises of special benefit to the country.
- (6) Interest and income from real property - These should be taxed by the country of source.
- (7) Salaries, Annuities and Pensions - The general principle may apply.
- (8) Royalties - The general principle may apply except for royalties on mass-media information projects.
- (9) Temporary residents - The general principle may apply, except in the case of public entertainers, etc.
- (10) Professors and teachers - The general principle may apply.
- (11) Students and trainees - The principle adopted in Article XIII of the Draft Treaty may apply.
- (12) Tax credit - This will require very careful attention. The principle adopted in Article XIV, may, as far as possible, be applied.
- (13) Diplomatic Officers - The general principle may apply.
- (14) The other provisions may follow on the lines of the corresponding provisions contained in the Draft Treaty. ^{12/}