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How to Conduct Tax Treaty Negotiations

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How to Conduct Tax Treaty Negotiation

Odd Hengsle

1. Introduction

The object of a tax treaty negotiation is to achieve a treaty that is beneficial to both countries and meets the interests of each side as far as possible. A treaty that favours only one country will not be beneficial in the long run. If one country feels that it has been overwhelmed and possibly cheated that country may resist applying the treaty, or may not apply it in the way intended, and may create a bad relationship between the competent authorities. The treaty may even be terminated, or that country may ask for renegotiations.

It is important that the negotiations are conducted in a co-operative atmosphere with a willingness from both teams to achieve the best result for both countries. Consequently it is important that both teams negotiate in good faith.

The treaty needs to work smoothly in practice and should be effective and not create undue difficulties in compliance issues. As a tax treaty will in most cases last for many years, it is important that it is drafted to stand the test of time.

Reaching a good agreement is dependent on many factors, including research, planning and preparations, the conduct of the negotiations and the management of the process. Preparations are very important.[1]

When the two teams meet for the first time, the first issue to decide is which draft model should be used as the working document. It is always an advantage to have one's own draft model accepted as the working document because any change to that model has to be argued and explained by the other team and in many cases less important differences will be accepted without difficulty.

The host team will usually ask for its draft to be the working document. In many cases, the visiting team will accept this request. However, both drafts will be on the table and should be taken into consideration during the discussions. It is advisable to use a projector to display the working draft on a screen. If possible a merged document which shows the text of both drafts could be screened to facilitate a full discussion. This is then updated to make it easier to see what is actually agreed.

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1 See Odd Hengsle, Preparing for Tax Treaty Negotiation, Paper 3-N of this collection.

When the two teams have solved all outstanding issues there are two articles that have to be drafted, i.e. the "Entry into force" and the "Termination" articles. These two Articles are important since there should be no doubt as to which income year the treaty should be applied for the first time, or if terminated, which income year would be the last year in which it should be applied. However, these articles are discussed in the paper on Post–negotiation Activities. [2]

2. Negotiation Style

Negotiation style is very important. The style can vary from soft to aggressive.

A soft negotiator may have as his objective to reach agreement on all articles as soon as possible. He may search for solutions that are acceptable to the other side and try to avoid conflicts. However, a soft negotiator may easily make unnecessary concessions.

An aggressive negotiator will have as his objective to defeat the other side on all issues. He will insist on his proposals and demand concessions. However, such an aggressive style will easily create an unfriendly atmosphere and should be avoided. In the worst case the other team will feel offended or bullied and may react by ending the discussions without further negotiation, or by insisting that the other team use a different leader.

A negotiation style somewhere in between is obviously desirable. A negotiator should be consistent in his approach, but always polite. He should be prepared for the negotiation knowing what is important for his country and proposing and explaining his preferred solutions without being aggressive.

Whatever his or her approach, a negotiator must remember that his or her style should take into account the goal of the negotiations, which is to achieve a mutually beneficial treaty. It is important to have in mind that you have to look at the overall balance of the treaty and not be blinded by specific issues.

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[2] See Odd Hengsle, Post-negotiations Activities, Paper 5-N of this collection.

3. Trust

To achieve a productive atmosphere during the negotiation process, it is necessary to gain the trust of the other team. Losing credibility may lead to negotiating difficulties if the other team does not trust the validity of arguments put forward and becomes sceptical of everything said.

It is important that what a team explains is correct. If a team is asked to explain its domestic legislation or its position on a certain issue, the answer should be truthful. If the leader is not familiar with the issue, there may be others in the team that can give a satisfactory explanation. If the team cannot respond immediately, or is in doubt, it is advisable to say so and promise to find out and provide an answer. On the other hand, it is not always necessary to give more information than is asked for.

One should always be transparent and never lie. The other team may already know the answer, but may be checking if the answers received are correct. The other team may also check the explanation it has received after returning home. For example, it is easily ascertainable if a team is giving incorrect information in relation to what has been accepted with third countries.

Poor disclosure can be very harmful. It is wise to remember that negotiators are a small group and form a closed circle. If you spoil your reputation with one party, that will soon be known to others and may put you at a disadvantage in relation to later negotiations with other countries. One should always be aware that it is easier to lose than to gain credibility.

4. Building a relationship

If the negotiation is with a country that you are not familiar with, it is advisable to check whether there are issues to be aware of and to take into consideration. They could be related to food, alcohol, religious beliefs or what is considered to be bad behaviour. The timing of the negotiations is one example. Do not propose negotiations during important religious holidays of the other country. Awareness of the dress code when visiting the other country is another example. This may relate to the way women dress, but also to how men should be dressed. Never dress too informally unless there is a special reason for doing so.

At the negotiation table, formality is appropriate even if you already know the members of the other team. However, remember that informal discussions or contacts taking place during a break, at

lunches or dinners also play a part in building a good relationship and perhaps make negotiations more fruitful. It is important to remember that all interaction, formal or informal, plays a part in the negotiations. The way any member of the team behaves during the meeting or after hours may have an influence on the relationship you are trying to build.

Remember always to meet on time. Nothing can be more irritating than wasting time waiting for the other team to arrive. If you are late for some reason, excuse yourself and give an explanation.

The two team-leaders lead the negotiation. To prevent confusion or offence, no other member of the team should take the floor without being invited to by the leader. It is the leader who decides what to say and by whom it should be said. If any member of the team feels he has a valuable contribution, he should address his leader. When speaking, always address and look at the other party's leader unless it is obvious that it is correct to address someone else.

When the leader (or someone else from the other team) is presenting his arguments, listen and show respect for the arguments put forward - even if you disagree. It is bad behaviour to interrupt, shake your head or tell the other team that they are wrong. It is important to be polite in explaining to the other team why you are of a different opinion or prefer a different solution. It is your argument that should convince the other team and not by way of obvious disrespect.

5. Discussion

When time and place for negotiations are agreed, a list with the names and titles of the participants of the two teams should be exchanged, also naming the leader. In addition, when the two teams meet for the first time, both leaders should introduce themselves and their team so that both teams know who is present and what the role of each team member is. For example the leader might introduce a team member as "Peter Smith from the revenue agency" or "Linda Jones, who is a member of the Treaties team in the Ministry of Finance". This will also be the time to hand over business cards. This makes it easier to identify the members of the team. Most countries provide business cards for their negotiators. And it shows good manners to provide them when the two teams meet for the first time.

The leader of the host country should also ask if the proposed agenda is acceptable.

Who leads the discussion may vary. Usually it will be the leader from the host country, but there are no set rules. Sometimes it will be the leader from the stronger team that would lead. It may also vary from one article to another depending on whose proposal is being discussed.

From time to time the question of naming the treaty a “Convention” or an “Agreement” arises. Most countries will use the word “Convention” throughout the treaty. However, to some countries there is a difference between an “Agreement” and a “Convention”. These countries use “Agreement” in relation to a bilateral treaty and “Convention” in the context of a multilateral treaty. It is wise to check with the Ministry of Foreign Affairs if they have any preference. However, this is a minor issue and should be solved easily. If one country has a preference to use the term “Agreement”, the other team should agree where possible and move on.

It is wise to agree on the process of the discussions. If it is the first round of negotiation between the two teams, one can agree to work through all the articles one by one without a deep discussion on each article. In this way issues of less importance to both parties can be settled. However, some countries prefer to deal with linked provisions at the same time, e.g. the taxation of shipping in paragraph 3 b of Article 3 (Definitions), Article 8 (Shipping), paragraph 3 of Article 13 (Capital gains) and paragraph 3 of Article 22 (Capital).

By working through all the articles one by one it will be easy to ascertain where the difficult issues are and to identify the most important issues for one or both countries. It is also important to understand the value of the issue under discussion. What is important to one country may not be important to the other. Understanding the value of the issues both to you and to the other side is essential when trying to reach a compromise or doing a trade-off.

When all the articles have been worked through, it is time to concentrate on solving the remaining difficult issues. This may be done during the first round of negotiation but, depending on time, may be postponed to a second round.

Another way to begin negotiations is to initially identify which items are most important to the teams and begin by discussing them. However, this method is probably best used after the teams have had their first round of discussion of the draft as such. Deciding to begin with the two country’ s important issues when the teams meet for the first time may prove a disadvantage for the teams. It is not always wise to identify very early in the negotiations what are the most important issues to each of the teams. Even if the other team has no serious objections to a proposal, e.g. because the item is

not important for them, they may defer acceptance of the proposal in the hope of achieving something in return at a later stage in the negotiations.

If a provision mostly relates to one of the countries or is a clarification of the wording of an article, it may be better to include the provision in a protocol rather than trying to draft wording to that effect in the treaty itself. This might simplify the reading of the treaty text. However, if a protocol is used, it is important to draw attention to the protocol in an explanatory note to the treaty. Otherwise the provision in the protocol can be easily overlooked.

Negotiators should remember that even if the issues, which are not agreed, are important, it is not necessarily difficult to find solutions. It may be that the two teams identify the same issues as important. In such cases it may be easy to find common solutions if both teams can reach agreement on what solution is preferable or at least acceptable. However, if both teams regard an issue as important, but disagree on the solution, a compromise may be difficult (but not impossible) to find. It may also be that an issue, which is regarded as important to only one of the teams, is not contrary to what can be accepted by the other team provided the arguments advanced are satisfactory.

For an effective discussion to take place one should introduce the item and present one's position clearly. It is not necessary to present all arguments at once. In fact it may be wise to hold some arguments back, to be used if the other team does not agree and has explained why.

After the arguments for a position have been presented it is wise to note carefully the reactions from other team. Sometimes it may be difficult to understand the response. In such a case one should always ask for clarification, and continue to ask until the response is clearly understood. By listening carefully to the arguments put forward by the other team, you will from time to time find that the proposal they are making is actually advantageous and better than your own proposal. If this is the case, accept the proposal and make the necessary amendments to improve your own model.

A team may resist a proposal and the arguments used in its favour. When this team is arguing for a different solution, listen, and be prepared to counter. It is for this reason that is not wise to present all the arguments at the first presentation, but use them as the discussion continues. If it seems difficult to get acceptance for the proposal that is being discussed, it is time to look for alternatives, which may have been prepared before the negotiations, or may be developed during the negotiation. Alternatives may also be found in the Commentaries to the United Nations Model Double Taxation Convention between Developed and Developing Countries ("UN Model Convention") - and the

Organisation for Economic Co-operation and Development's Model Tax Convention on Income and on Capital ("OECD Model Convention") or in the OECD officials' website, where commonly used alternative provisions may be found. Such alternatives may easier be accepted since they indicate internationally accepted solutions. Alternatives may also be found in one of the countries' treaties with other countries. Careful preparation before the meeting may enable the teams to settle their differences more quickly and effectively.

One way to try to solve a difficult issue is to propose a *"most favoured nation clause"* (MFN). The purpose of such a clause is to ensure that if a team accepts a less satisfactory proposal put forward by the team from the other country, and that country at a later stage agrees to a more favourable provision with a third country, the latter provision should also be applied in relation to them. MFN-clauses can for instance be found in relation to withholding taxes on interest and royalties. In relation to royalties, such provision may be drafted, for example, as follows:

> *"2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed X per cent of the gross amount of the royalties. For the purpose of this paragraph, if a lower rate of State A tax is agreed upon with any other State than State B after the entry into force of this Convention such rate shall automatically be applied."*

A MFN-clause may also be included in a protocol to the treaty and may be further restricted to treaties entered into with a group of countries, such as an OECD member country or a country within a region. Such a provision might read:

> *"Protocol.*
>
> *If after the date of signature of the Convention State A conclude a double taxation Convention with a State that is a member country of the Organization for Economic Co-operation and Development which limits the taxation in State A of dividends as referred to in Article 10, interest as referred to in Article 11 or royalties as referred to in Article 12, the lower rate shall automatically apply for the purposes of this Convention from the date of entry into force of the first-mentioned Convention."*

If a negotiation is preferred to an automatic entry into force, a third alternative might be to introduce the following provision into a protocol:

For the purpose of Articles 11 and 12 if a lower rate of State A tax is agreed upon with any other State than State B after the entry into force of this Convention, State A shall without undue delay inform the Government of State B in writing through diplomatic channels and shall enter into negotiations with the Government of State B with a view to include a similar provision in the present Convention."

A different way to deal with difficult issues is to propose a *"sunset clause"*. Such a provision can for instance be found in relation to tax sparing provisions in the article on the elimination of double taxation. A sunset clause will then usually be inserted as a last sentence in the tax sparing provision and may for instance be drafted as follows:

"……..This provision shall apply for the first ten years for which the Convention is effective, but the competent authorities may consult each other to determine whether this period shall be extended."

A third proposal to deal with difficult issues may be a *"grandfathering clause*". Such a clause can be a solution when renegotiation of a treaty takes place. If the existing treaty gives a more favorable treatment for a person than the one proposed in the new draft treaty, a solution might be to let the old provision apply to persons already benefiting from the existing provision. Such a clause can be applied without limitation, or limited to a certain period of time. Grandfathering clauses can be inserted in a protocol to the treaty or in the termination article. A drafting example is to insert a paragraph in the termination article reading as follows:

"2. Notwithstanding the termination of this Convention in accordance with paragraph 1 of this Article, this Convention shall in any event continue to apply to persons receiving income as mentioned in Article X. However, this provision shall only apply to persons receiving such income at the time this Convention becomes effective."

A fourth proposal to deal with difficult issues may be to agree that a provision or an article shall become effective, not at the same time as the rest of the treaty, but at a later age to be agreed between the competent authorities.

One country may be prepared to accept a proposal from the other country, but at the time of negotiations does not have the legislative instruments in place to give effect to the provisions. An example could be where the government is considering the introduction into its treaties of an article on the assistance in the collection of taxes as that proposed in Article 27 of the UN and OECD

Model Conventions. However, since the necessary legislation has not been passed by the parliament at the time of negotiations, an article on the assistance in collection of taxes could not become effective until the necessary legislation has been approved. If the legislation is expected to be in place within a reasonable period of time a solution might be to accept the article but defer its entry into force. This avoids the time consuming work of introducing the article in the treaty through an amending protocol to the treaty at a later stage. To achieve a deferral, one solution is to add a paragraph or sub-paragraph in the article on the entry into force reading:

> *"Article 29*
>
> **Entry into force**
>
> 1. The Contracting States shall notify each other in writing, through diplomatic channels, that the legal requirements for the entry into force have been complied with.
>
> 2. This Convention shall enter into force upon the later of these notifications and shall thereupon have effect:
>
> a. In State A in respect of taxes on income for any year of income beginning on or after …… (date and month) next following that in which this Convention enters into force;
> b. In State B in respect of taxes on income relating to any calendar year next following that in which the Convention enters into force;
> *c. For the purposes of Article 27 (Assistance in the collection of taxes), from a date to be agreed in an exchange of notes through the diplomatic channels."*

Even if a team does not accept a proposal at once, it does not mean that it will not be accepted at a later stage during the negotiations. The team may have understood that the solution argued for is of great importance to the other team and is holding back to see what it may receive in return. If a team during the discussions indicates in its response that it may be willing to accept a proposal if certain conditions are met, try to establish what conditions the other team have in mind. If the conditions are not quite clear, try to clarify them.

During the discussions, compromises will often be suggested. Unless the compromises represent well-known positions and drafting, it is advisable to be very careful. Compromises drafted across the table are not always of the best quality. They may lead to unexpected results and can in worst cases

scenarios be harmful to one or both countries. Unless one is very experienced, it can be difficult to foresee all implications of an unfamiliar wording. Even if the proposed wording seems to solve a problem, the best way to handle such compromises is to put them in brackets for further consideration. If the issue is not too important and the wording not too difficult it may be enough to have studied the wording during a break or in the evening after that day's session has ended. Depending on the importance of the issue, it may also be prudent to take it home for consultation with qualified persons.

During the discussions a team may realise that the other team has misunderstood the effect of a proposal that is made. Due to that misunderstanding, the other team may have accepted a proposal they otherwise would not have agreed to. It may also be that, during the discussions, a team realises that the other team has a different understanding of its own proposal than what is the general international understanding or that their proposal will not give the intended result.

For example, a country is of the opinion that its domestic legislation regarding the taxation of money transmitted from a branch of a foreign company to its headquarters in the other country (branch profit tax) is not in conflict with its obligations under the non-discrimination article. The other country may be of a different opinion. In such cases it will be wise to deal with the problem either in the relevant article or in a protocol. One way to solve the problem mentioned in the example above is to clarify the common understanding in the non-discrimination article itself:

> *"3. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. However, branch profits tax levied on income repatriated by a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be regarded as being contrary to the provisions of this paragraph. This provision shall not be construed……..."*

If one team believes that the other team has misunderstood the meaning or effect of a proposal, the issue should be raised. If the issue is important to the other team and that other team realises later in the negotiation that they have misunderstood a proposal to which they have agreed, they may feel misled and want to reopen the issue. They may even lose faith in the integrity of the other team and therefore be reluctant to agree on new issues. If the misunderstanding is not realised during the

negotiations, but before signature, a delicate situation may arise when the country refuses to sign the treaty or insists on renegotiation.

If a team at any time during the negotiation wishes to clarify issues or discuss arguments within the team, they should do so and ask for a time-out. It is better to take a time-out than make a wrong decision. All countries, developed as well as developing, have been in situations where a time-out has been necessary.

If an issue is agreed, accept it and move forward. It is not advisable to restate the issue by informing the other team how important the solution was, or to begin repeating the arguments. Restating the issue may result in the other team changing its mind or asking for further reflection before deciding.

To avoid unnecessary misunderstanding it is important that both teams send correct signals on their attitude to the proposals put forward. One should avoid a situation when a team at the end of a discussion has got the understanding that an agreement has been reached, but the other team at a later stage claims that it never had meant to agree, but had just signalled a positive attitude to agree provided that all other issues in the treaty had been resolved acceptably.

One should always take notes during the meeting. Notes are extremely important if a second round of negotiations is needed. Some time usually elapses between the first and the second round of negotiations. Members of the team during the first round of negotiations may have left or moved to other positions. The team preparing for the second round will therefore often be dependent on what they can read from the notes. The notes are also useful when drafting compromises, discussing positions with qualified persons or producing proposals for approval.

The notes are also important when preparing the treaty for signature or explaining the solutions agreed upon to your minister or at a hearing in the parliament. They can also be of great interest when the competent authority at a later stage may need to interpret issues arising from the treaty.

6. Arguments

During the discussion the teams should be prepared to present relevant arguments to explain the proposal put forward in the different articles of the draft it has presented. This is true of all articles, but essential where the wording of an article deviates from what is common wording in international models such as the UN Model Convention, the OECD Model Convention or any commonly used

regional models. This is why preparations are so important. Without having done the "homework" before the negotiations take place, a team may not be able to convince the other team why special wording is an improvement on recognised international models. Special wording may be considered necessary to take care of certain economic activities, such as mining or the extraction of natural resources. It may also be related to activities in the financial sector like banks or drafted to remove uncertainty in relation to the use of new financial instruments.

Different wording from the international models can often be found in the Commentaries to those models. In such a case the Commentaries will usually explain the wording and relevant arguments can be found there. However, the team should be able to explain where the wording can be found and why that wording is the preferred approach. With respect to the OECD Model Convention such wording can for instance be found in relation to the taxation of services, pensions or the taxation of dependent personal services.

There are different kinds of arguments commonly used such as policy, protection of revenue, precedent, anti-abuse, not effective or firm policy.

The policy argument plays on reason and sound policy. It is often based on *economic arguments* and closely linked to *a revenue argument*. In many cases it will be difficult to tell which it is.

An example is the situation where a foreign company, for bona fide reasons, establishes a branch in your country through which it performs all its economic activities in your country. Any profit made will be taxed according to Article 7 (Business profits). However, any transfer of money (after tax) to the headquarters will be transferred without further taxation in your country. If the foreign company instead had established a daughter company (subsidiary company) in your country, any transfer of money after tax would have been in the form of dividends and taxed in accordance with the provisions of Article 10 (Dividends). To avoid such different treatment a country may wish to tax the transfer of money from the branch in the same way as taxing a dividend distribution (Branch profits tax). The argument for the introduction of a branch profits tax will be based on both the economic and the revenue arguments.

Another example is the taxation of royalties. For the same reason as for interest payments, a country that imports a lot of know-how from abroad may use similar explanations to argue for a withholding tax, or to widen the definition of royalties to include for instance fees for technical services.

A third example may be that a certain economic activity in a country is of such economic importance to that country that special provisions have to be introduced in the treaty to prevent revenue losses. To achieve this, a country may want to introduce provisions enabling that country to tax any activity performed there by a foreign enterprise no matter the length of their stay. Such provisions will often be linked to mining or the extraction of natural resources.

A further example is when a country has a lot of building or renovation activities taking place and is dependent on services performed by foreign enterprises. To avoid having loss of revenue, such services rendered by foreign enterprises may necessitate the introduction of a provision on the rendering of services. Examples of such provisions can be found in the UN Model Convention as well as in the Commentaries to both the UN and the OECD Model Conventions.

The policy argument can also be based on *mutual benefit* reasoning e.g. to introduce provisions to prevent abuse or tax avoidance or evasion. It may be also be an argument for having an article on assistance in collection of taxes.

A different reason often used in support of a proposal is the *precedent argument*.

Alone or in addition to other arguments a team may show that other countries have accepted the wording of an article. For a developing country negotiating with a developed country, such an argument will be of greater value if they can show that other developed countries have accepted the wording.

It may also be the other way around. The team of one country may be asking for wording the other country has accepted in treaties with third countries. They may point to those treaties and ask the other team why such wording is no longer acceptable.

A further argument in this regard arises when the other country has accepted a certain provision with a country to which you prefer to be compared, business in your country will be disadvantaged unless you get the same benefits. This will often be the case when discussing the rates in the dividend, interest and royalties articles.

It will always give your argument increased value if you can show that your provision is found in the UN or OECD Model Conventions or proposed as an alternative in the commentaries to the respective models.

In several cases a provision may be asked for to *prevent abuse*.

When negotiating a tax treaty it is important to have in mind that the purpose of a treaty is to avoid double taxation and to stimulate cross border activities. The purpose is never to create a situation of double non-taxation. It is also important for a country to be aware of provisions in a treaty that business can misuse to avoid taxation in the country of source or even in the country of residence.

In the Commentary to Article 1 in the UN Model Convention there is a chapter on the improper use of tax treaties, which discusses the use of legislative anti-abuse rules found in domestic legislation. A similar chapter is found in the Commentary to Article 1 in the OECD Model Convention. In both models it is argued that anti-abuse rules found in domestic legislation are generally not contrary to tax treaty provisions and could be used to combat improper use of tax treaties.

However, despite the good arguments in the UN and OECD Model Conventions for using domestic legislation to combat the improper use of tax treaties, it may in certain cases be advisable to introduce specific anti-abuse provision in these treaties. Both the UN and the OECD Model Conventions discuss the use of specific anti-abuse rules found in tax treaties.

When prevention of abuse is used as an argument, it is important to use examples to illustrate why a certain wording is necessary.

An example could be the introduction of thin capitalisation rules in domestic legislation. Depending on the wording of such legislation, the rules could be argued to be contrary to the non-discrimination article in the tax treaty. To avoid a discussion of legislation to combat the use of excessive debt capital instead of equity capital to finance the establishment of a daughter company in your country, it might be useful to propose a sentence either in the non-discrimination article or in a protocol to the treaty that such provision is not in breach of the provisions of non-discrimination article.

If your domestic legislation contains other provisions that could be argued to be contrary to the article on non-discrimination, it could be wise, after you have carefully explained the domestic law provision, to propose a provision in a protocol to the treaty reading as follows:

> *" Ad Article…*
>
> *Nothing in the domestic legislation in State A at the time of the entering into force of this Convention shall be regarded as being contrary to the article on non-discrimination."*

Another example may be that a country may want to include a paragraph in the article on dependent personal services to deal with international hiring out of labour. Such a provision could be introduced to prevent the situation whereby a local company, in order to avoid taxation of its employees, hires them through a foreign company. Such wording and an explanation can be found in the Commentaries to that article both in the UN and the OECD Model Conventions.

A third example could be a provision added as a new paragraph in the articles on dividends, interest and royalties, stating that the provisions of those articles should not apply if a dividend, interest or a royalty payment was created mainly for the purpose of taking advantage of the respective articles and not created for bona fide reasons. An example of such a paragraph in Article 11 might be:

> "The provisions of this Article shall not apply if the debt-claim in respect of which the interest is paid was created or assigned mainly for the purpose of taking advantage of this Article and not for bona fide commercial reasons."

Similar provisions could be inserted in the articles on dividends and royalties.

Another possibility could be to add an article on the limitation on benefits. An example of such drafting might be:

> *"Article ……..*
>
> ***Limitation of benefits***
>
> *Benefits of this Convention shall not be available to a resident of a Contracting State, or with respect to any transaction undertaken by such a resident, if the main purpose or one of the main purposes of the creation or existence of such a resident or of the transaction undertaken by him, was to obtain the benefits under this Convention that would not otherwise be available."*

An argument one frequently meets is that a proposal is based on *firm policy*. However, the question is how firm is firm?

A country may have found that a certain provision is not effective in relation to what they have tried to achieve. However, an argument based on this kind of experience should be illustrated by examples.

Some countries have non-negotiable provisions in their model. That can be due to certain business activities or industries such as mining or extraction of natural resources. It may also be related to incentive legislation or other areas of great importance, or it may be for policy reasons such as exchange of information.

It is, however, important to distinguish between provisions that are really non-negotiable and provisions which are only strongly preferred. Provisions that are only strongly preferred should not be presented as non-negotiable.

When an argument of firm policy is used, it does not mean that the provision in question is not negotiable. The argument should be understood to mean that a provision or a wording is regarded as of great importance, but which, under certain circumstances may be open for discussion. However, it will not easily be given up and you may in return be prepared to accept something that is of importance to the other team. It may be a provision to be put in brackets and dealt with in the final bargaining process. However, it is never advisable to use the argument of firm policy too often. Doing so will weaken the argument or make the whole negotiation more difficult. It may even encourage the other team to use the same argument in cases where they otherwise would not. It may in many cases be better to tell the other team that an issue is important, rather than based on firm policy.

When using the argument of firm policy, it is advisable to remember that by looking at other treaties that the country has entered into, it can easily be ascertained how firm that policy really is. If other treaties show that a firm policy argument is not sustained, that country would need to give a good explanation as to why the policy does not seem as firm as has been claimed. One possible explanation may be that a change of domestic legislation has taken place or that experience from earlier treaties has made a change of policy necessary.

There are at least two arguments that are of little or no value unless they are substantiated. One is “We need this wording because we are a developing country”. Another argument is “We need this wording because we have such a provision in our domestic legislation”. It may be true that a country is a developing country and because of that needs a special provision. It may also be true that a special provision in domestic legislation necessitates a special provision in a treaty. But in both cases it is important to explain clearly why a special provision is needed.

7. Records of discussions

During the discussions it is advisable to have the working draft electronically projected on a screen that is visible to both teams. One team member needs to be made responsible for maintaining the agreed text. In this way everybody can check that the changes made are correct. When going through the working draft, article by article, all wording that is not agreed should be put in brackets. One way of doing this is to use colours. The preferred wording for both teams should be put in brackets using different colours. This would make it easier to identify where agreement is not achieved and what the position is for each of the teams. By using brackets it will also be clear to both teams what is agreed and what is not. What is not put in brackets should be regarded as agreed and closed. If there is no screen it is important to read the text before moving on to the next issue. One example of using brackets and colours might be:

> (3. Gains derived by an enterprise of a Contracting State from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in that the Contracting State in which the place of effective management of the enterprise is situated.)

Alternatively:

> (3. Gains derived by an enterprise of a Contracting State from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in that the Contracting State in which the place of effective management of the enterprise is situated.), or
>
> (1. Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.
>
> (2. Notwithstanding the provisions of paragraph 1, profits of an enterprise of a Contracting State derived from the operation of ships or aircraft may be taxed in the other Contracting State to the extent that they are profits derived directly or indirectly from ship or aircraft operations confined solely to places in that other State.)

The black letters will be the same for both countries while one colour will be the proposal for country A and the other colour will be the proposal for country B.

If no colours are used letters should be used to mark the different proposals:

> *(3. Gains (AP derived by an enterprise of a Contracting State) from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in (AP that) (BP the Contracting) State (BP in which the place of effective management of the enterprise is situated.).*

However, the last example should clearly indicate that the use of colours simplifies the understanding of the differences.

If colours are not used, it will in many cases be a better solution to present the two proposals this way:

> *(*AP*: 3. Gains derived by an enterprise of a Contzracting State from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in that State.)*
>
> *(BP: 3. Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.)*

At the end of the meeting it is important to ensure that there is agreement on which issues have been resolved, and which are postponed for a second or subsequent round of negotiations. Both teams should have a printed version of the working draft as it stands at the end of discussion and one should always leave enough time to read it and check for mistakes. When the draft is based on a merged text that has been on a screen, there will be fewer possibilities for serious mistakes. Misprints can always be corrected in later correspondence between the two teams.

If it is not possible to have the working draft projected on a screen, accurate paper drafts need to be kept. This requires very careful organisation. All paper drafts should be dated so that it is clear which text is the latest.

When the two teams have agreed that the working draft is in accordance with what has been agreed, the two leaders should initial each page of the draft. Even if there are still brackets and a second round is necessary, initialling the working draft is advisable. Since several drafts may have been on the table, an initialled draft proves what has been agreed and which draft is the correct one.

When initialling a draft, begin by initialling on the left side of the page. Your initials should be found just below the last line on each page, which is not necessarily on the bottom of the page. The theory behind this is to avoid that anything should be added or removed in the text without being discovered. When all pages are initialled, exchange draft and initial on the right side. When both leaders have initialled the two drafts there will be one initialled draft for each country. The copy to bring home is the one where your initials are found first. (Initials on the left side of the page). However, if the initialling is done differently, it is of no importance as long as the two leaders have a draft that shows what has been agreed. The initialling of the draft has no binding effect on the countries. It shows what the two leaders have agreed and are prepared to take home to be presented for approval by the relevant authority.

Before ending the meeting it is advisable to produce an Agreed Minute. In this document all major outstanding issues should be noted. In Annexes 1 and 2 there are examples on the drafting of such Minutes.

If the understanding of a provision has been discussed and agreed on during the meeting or one of the teams has stated how it will interpret a provision, this understanding or interpretation should be noted.

If there is to be a second round of negotiation, the open issues should be in brackets, indicating either in colours or otherwise, the positions of the two countries. It is also wise to agree on a (tentative) date for future negotiations and note this date in the minute. That date should not be too far into the future. If it takes too long between the first and second round of negotiations the members of the teams from the first round of negotiations may not be present for the second round. The result could be that issues agreed during the first round will be reopened by a new leader, which may harm the process of finalizing the treaty and create irritation and confusion.

8. Conclusion

It is during the discussions you will realise how important preparations are. Be aware of your country's policy and your own model. It is essential to meet prepared and be ready to explain your proposals and the reasoning behind. Behave respectfully and listen carefully to arguments put forward. Be careful to take notes during the discussions. To achieve a treaty that is beneficial to your country, it is important to be patient and be prepared to propose alternatives and compromises to solve what may seem as a deadlock. If necessary, be prepared for a second round of negotiations.

Annex 1

AGREED MINUTE

A first round of negotiations of a Convention between State A and State B for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income was held in ….. from …. through…..Date and Year. The delegation from State A was headed by Mr ……., Director in the Ministry of Finance. The delegation from State B was headed by Mr……. Director in the Ministry of Finance. A list of both delegations is attached as Annex I.

The negotiations were conducted in a friendly atmosphere of mutual understanding and cordiality. While most Articles of the Convention were discussed in depth and agreed, some provisions were left pending and these are indicated in brackets and marked in colour. Yellow for State A and green for State B. The pending issues include Article 5, paragraph 3, Article 8, Article 11, Article 12, Article 13, Article 19, Article 21 and Article 26. These pending issues are set out in the joint draft text attached as Annex II which will be used in the future negotiations to be held in …….., at a date to be agreed.

Done in State A on Date and Year.

For the delegation from State A: For the delegation from State B:

Mr …….. Mr ……..

(Head of delegation) (Head of delegation)

Annex 2

AGREED MINUTE

A second round of negotiations for the conclusion of a Convention between State A and State B for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income was held in ……. from … through … Month and Year. The delegation from State A was headed by Mr…… Director, Ministry of Finance, while the delegation from State B was headed by Mr. …….., Director, Ministry of Finance. A list of both delegations is attached herewith as Annex I.

The negotiations were conducted in a friendly atmosphere of mutual understanding and cordiality. The provisions of the Convention that were left open after the first round of discussions in ….., as well as a number of other provisions previously accepted, were discussed in depth. The discussions led to an agreement at official's level on all issues and an agreed text was initialled on .. Month and Year. The agreed text is attached herewith as Annex 2.

Done in …. on … Month and Year

For the delegation from State A:

Mr ……..

(Head of delegation)

For the delegation from State B:

Mr ……..

(Head of delegation)