Centre International pour la Fiscalité et le Développement
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Working Paper 102

Review of Tax Treaty Practices and Policy Framework in Africa

Catherine Ngina Mutava

December 2019

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ICTD Working Paper 102
First published by the Institute of Development Studies in December 2019

ISBN: 978-1-78118-603-9

Available from:
The International Centre for Tax and Development at the Institute of Development Studies, Brighton BN1 9RE, UK
Tel: +44 (0) 1273 606261
Email: info@ictd.ac
Web: www.ictd.ac/publication

IDS is a charitable company limited by guarantee and registered in England
Charity Registration Number 306371
Charitable Company Number 877338

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Catherine Ngina Mutava

Summary

In recent years, tax treaties concluded by sub-Saharan African countries have become more residence-based with fewer provisions allocating taxing rights to the source countries. This trend is observed in treaties signed with OECD countries in particular. For countries which are capital importers, as is the case with most African countries, this means that these countries have been slowly ceding their taxing rights over income earned within their jurisdiction. This could be deliberate as the countries try to attract foreign direct investment, or it could be the result of a lack of policy to guide treaty negotiations. In the countries we reviewed, the latter reason seemed to prevail.

From this study, it is apparent that many sub-Saharan African countries do not have a treaty policy in place. The lack of a policy creates ambiguity on matters such as who should be involved in negotiating and concluding tax treaties, which countries are viable treaty partners, and the minimum tax treaty terms that a country should contend for. This provides room for political and elite capture of the negotiation process and leads to the conclusion of treaties without adequate consideration of their technical implications, which could therefore be detrimental to the country.

A well-crafted and properly implemented treaty policy could go a long way in resolving most of the issues faced by sub-Saharan African countries in concluding tax treaties. The lack of capacity and technical understanding of tax treaties makes development of such treaty policy and model treaties an uphill task for most sub-Saharan African countries. Thus, there is need for training and capacity building in the area of tax treaties, and help in the formulation of a tax treaty policy and model. This training and help can come both from experts within the countries themselves and through external support from other countries.

Keywords: tax treaties; tax treaty policy; tax base; source; resident; treaty negotiations.

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Contents

Acknowledgements

Linda, what would I do without you? To Sol Picciotto for being a patient wealth of information. For ICTD for giving me the opportunity to carry out this research. I am especially grateful to the various government officials who took time to speak to me. Rosa, for taking control of the ship while I was away. And to Mark for taking the graveyard shift so I could write.

Acronyms

ATAF	African Tax Administration Forum
BEPS	Base erosion and profit shifting
DTA	Double taxation arrangement
FDI	Foreign direct investment
MC-BEPS	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
MFN	Most favoured nation
MNE	Multinational entities
OECD	Organization for Economic Co-operation and Development
PE	Permanent establishment
UN	United Nations

Introduction

Tax treaties are agreements through which two countries agree to assign and restrict taxing rights on economic activities that span two countries (Hearson and Kangave 2016). Tax treaties have been a feature of tax law for over 100 years with the first form of tax treaty being traced back to 1899 when Prussia and Austria concluded a tax treaty (Holmes 2014).

Traditionally, tax treaties were concluded mainly for the purpose of avoiding double taxation, as indicated in the preamble of both the Organization for Economic Co-operation and Development (OECD) and United Nations (UN) model tax conventions (OECD 2019a and UN 2018). Both conventions acknowledge in their introductory section the primary role of tax treaties in creating a favourable investment climate by eliminating double taxation.

Treaties create a favourable environment by establishing rules that assign taxing rights on cross-border income between contracting states. Generally, they assign the right to tax income earned through active business to the source country (where the activities take place) and the rights to tax passive income (dividends, interest, royalties, fees for services) to the state of residence of the providers of capital, intellectual property or services. Where the income is taxable in both countries, treaties offer relief either through the credit method or the exemption method. The credit method allows the taxpayer to credit any tax he or she paid in the source country against the tax due in the resident state. The exemption method exempts any income that has already been taxed in the source state from being taxed in the residency state (Holmes 2014).

The necessity of tax treaties for eliminating double taxation has been questioned. Tsilly Dagan argues that the assumption that, in the absence of tax treaties, double taxation would be inevitable is not entirely accurate. She avers that, even in the absence of a tax treaty, capital-exporting countries will always have an incentive to relieve double taxation unilaterally (Dagan 2003). According to her, many of the capital-exporting countries already offer unilateral relief in their domestic laws and as such, tax treaties are not necessary for alleviating double taxation. She captures it best when she states:

> Rather, they [double taxation treaties] serve much less heroic goals, such as easing bureaucratic hassles and coordinating tax terms between the contracting countries, and much more cynical goals, particularly redistributing tax revenues from the poorer to the richer signatory countries. (Dagan 2003: 939)

Thus, whereas tax treaties may play a role in eliminating double taxation, the same could be achieved through domestic law, with the added benefit that the source country would not have to give up its taxing rights.

1 The importance of negotiating appropriate treaties

Where the contracting parties are equal partners with balanced economic relations, tax treaties are easier to negotiate, since the income lost by limiting source taxing rights on passive income can be offset by tax revenue from incoming flows as a resident state. However, where there is an economic asymmetry, as in the case of a rich, capital-exporting country (developed country) and a poor, capital-importing country (developing country), then tax treaties are unbalanced, with the treaty provisions resulting in greater tax revenue shifting to the capital-exporting country to the detriment of the capital-importing country (Zolt 2018). As such, unlike the case of a tax treaty between two developed states, the developing country that signs a tax treaty with a developed one has little or no hope of offsetting the tax revenue loss that arises from ceding taxing rights on economic activity that takes place in their jurisdiction.

Tax treaties are often associated with investment promotion in African countries. Even though a tax treaty is likely to result in some loss of tax revenues, especially for the capital-importing countries, these countries assume that these losses will be offset by the investment inflows that result (Van de Poel 2016). Increased foreign direct investment (FDI), it is argued, results in increased technological transfer resulting in increased trade and a wider tax base (Osano and Koine 2016; Barthel, Busse and Neumayer 2009). Where attracting FDI is one of the key objectives, the tax policy should embody this objective and provide guidance on how this should be achieved.

For some countries, this may entail adopting a policy of lowering withholding tax rates to avoid excessive source taxation of income, while in other cases, countries may opt to cede their rights to tax a particular type of income. For others, it may mean signing tax treaties to send a signal of their willingness to apply internationally accepted taxation norms in their taxation of foreign investors (Pickering 2014). Almost all tax treaties for example, contain an article that provides for non-discrimination of non-resident persons and in so doing, offer legal defence to foreign investors against any punitive tax laws that the government may pass against them (IMF 2014: 25). The increased certainty and lighter taxation is supposed to signal an attractive investment environment for potential investors (OECD 2015, Ch. 5).

Sub-Saharan African countries should be careful not to conclude tax treaties with the sole objective of attracting FDI. This is especially so in light of studies which indicate that the link between FDI and tax treaties is far from clear (IMF 2014). Notably, Baker's recent study covering the period 1991-2006 shows that treaties have no effect on FDI (Baker 2014). Even where the treaty results in increased FDI inflows, the benefits accruing to the developing country may be offset by the revenue losses as a result of concessions in taxing rights since the net FDI flows from the developing countries can be greater than the FDI inflows. As the tax treaties limit the tax imposed on the outflows, the revenue loss can be much greater than the gains on the inflows (Baker 2014).

Further, the role of treaties in signalling stability is trivial compared to other measures that a developing country could take in improving investment fundamentals (Brooks and Krever 2015). Such measures include enforcing robust laws that are consistent with the rule of law as well as establishing an effective tax administration.

Additionally, treaties may not be effective at signalling stability, and therefore attracting investment, due to the regional approach of most investors in relation to developing countries in sub-Saharan Africa. Most investors do not view sub-Saharan African countries individually but rather have a regional view of the countries (Christians 2006). In discussing this, Christians states:

> The potential for signalling a stable investment climate through tax treaties with less developed countries (LDCs) in Sub-Saharan Africa is especially hampered by the persistence of negative perceptions about this region's investment climate. Foreign investors in LDCs often take a regional, rather than national, approach to investment, attributing the negative aspects of one country to others in the vicinity.
> (Christians 2006: 707)

For example, if the countries neighbouring Rwanda are unstable, investors are unlikely to be greatly influenced by any tax treaties Rwanda has as the investors are likely to view Rwanda as part of an unstable region and thus be less likely to invest in the country. In addition, a country's history in honouring international agreements is more likely to signal its stability as opposed to its signing of a tax treaty. Thus, a tax treaty cannot overcome the challenges of a poor investment climate to attract investors to that country.

It is therefore important for developing countries to have a broader objective for concluding tax treaties, away from the traditional roles of eliminating double taxation and giving away taxing rights to attract FDI since both of these can be achieved through other means.

Although the main purpose of tax treaties is to prevent double taxation, the role of tax treaties has evolved over the years. One of the purposes of modern-day tax treaties is to prevent tax avoidance and evasion by blocking loopholes, adding anti-abuse provisions, and enhancing cooperation among tax administrations (OECD 2017). Yet despite this being touted as one of the main purposes served by tax treaties, treaties can contain legal loopholes that have made aggressive tax planning possible, resulting in base erosion and shifting of profits from high tax areas to low-tax areas, as well as double non-taxation (Lamers, Mcharo and Nakajima 2014). Tax treaties fail to take into account inconsistent definitions and characterisations of income by the contracting states, which creates room for tax arbitrage (Brooks and Krever 2015). By applying tax treaties and using complex tax structures that include hybrids, multinational entities (MNEs) have been able to avoid or drastically reduce the tax paid to source countries (Brooks and Krever 2015). The reduced tax revenues have a negative impact on governments, and especially those of developing countries, which leads to underfunding of public resources such as education which are critical for social and economic development. To try to meet the resultant deficit, governments in developing countries are forced to shift the burden to labour and consumption and in so doing increase the burden on the individual taxpayers.

More recently, there has been research and debate on the effectiveness of tax treaties for both residence and source taxation. All countries have become increasingly concerned about tax avoidance and aggressive tax planning, including the role of tax treaties in facilitating such abuses. These concerns led to the major initiative to reform international tax rules, the project on base erosion and profit shifting (BEPS), launched by the OECD in 2013 and supported by the G20 world leaders. The resulting package of recommendations delivered in 2015 included a multilateral convention on BEPS (MC-BEPS) to implement treaty-related BEPS measures.

At the same time, the net impact of tax treaties on capital-importing states, especially developing countries, has increasingly been questioned. A study carried out by ICTD and ActionAid, for instance, highlighted that some of the treaties concluded between developing and developed countries assigned substantial taxing rights on income generated in the source country to the country of residence, resulting in considerable losses of potential tax revenues by the developing country, while the possible beneficial effects on inward investment were at best doubtful (ActionAid 2016; Hearson 2016). The study revealed that treaties signed by lower-income countries with OECD countries were particularly unfavourable to the low-income countries. Reduced aid and increases in population have increased pressure on sub-Saharan African governments to generate revenue to fund their development needs. Taxation provides one of the key sources of domestic revenue for these countries and as such their tax bases must be safeguarded and expanded.

If sub-Saharan African countries are to succeed in safeguarding their tax bases, they must rethink their approach towards the negotiation of tax treaties. They must first determine if tax treaties are necessary. They must further insist on mutually beneficial outcomes, and only treaties whose benefits outweigh the costs should be concluded. A tax treaty policy would go a long way in ensuring this is achieved.

2 Objectives of this research paper

This paper is a build-up on an already existing body of literature which indicates that tax treaties have resulted in significant loss of revenue, especially for developing countries, and that the revenue loss is not comparable to the expected benefits from foreign investment. Increased awareness of the impact of unfavourable tax treaties on the revenues of a state has seen some sub-Saharan African countries such as Zambia, Malawi, Uganda and South Africa cancel, suspend and or renegotiate some of their tax treaties seeking more favourable terms (Brooks and Krever 2015).

This paper proposes that sub-Saharan African countries need to develop and implement a tax treaty policy framework to ensure that they safeguard their interests when concluding tax treaties.

This paper seeks to:

- understand the process of concluding tax treaties carried out by sub-Saharan African countries and, specifically, whether these countries tend to have a framework in place to guide tax treaty negotiations;
- discuss the objectives of a tax treaty policy for developing countries; and
- make recommendations on how to formulate a tax treaty policy.

3 Methodology and findings

3.1 Process

The process entailed a desktop review of the existing body of literature on the history of tax treaties and their impact on developing countries in Africa. A sample of tax treaties was reviewed, concluded by a sample of sub-Saharan African countries with developed countries and tax havens. The tax treaty review helped establish whether the countries follow a particular model convention, and the rights given up under such treaties. The ICTD/ActionAid treaty dataset aided in the analysis and the comparison of the treaties vis-à-vis the UN and OECD Model Conventions.

To understand what informs the tax treaty negotiation process, key stakeholders in the treaty negotiation and implementation process were interviewed. The interviewees included government officials drawn from the revenue authorities as well as the ministries of finance and treasuries in Kenya, Uganda, Tanzania, Rwanda, Ghana, South Africa and Mauritius. A total of 15 persons were interviewed. The choice of the interviewees was based on their involvement in negotiating tax treaties for their respective countries, with only persons who are/have been involved being interviewed. The interviews were semi-structured to guide the conversation, with a focus on the whole treaty negotiation process, starting from the formulation of policies that inform the treaties, the choice of treaty partners, the selection of the team involved in the negotiations, how the negotiations are conducted, as well as the country's involvement in the BEPs process. This was to give room to the interviewees to express themselves on the challenges they faced in negotiations. The interviews were carried out from May 2017 to April 2018. Some interviews were carried out in person while others were carried out via telephone conversations. Additional information was provided during a seminar organised by ICTD and held at Strathmore University in April 2018 to discuss tax treaties in sub-Saharan Africa. The seminar drew participants from various countries in sub-Saharan Africa including but not limited to the countries that are the subject of this study.

3.2 Findings on tax treaty negotiations – the experience of selected sub-Saharan African countries

Of the countries reviewed, South Africa, Mauritius and Ghana currently have a tax treaty policy in place that guides their treaty negotiations. At the time that this research was conducted, Kenya, Uganda, Tanzania and Rwanda did not have such a policy but were in the process of developing their treaty policies. Two countries proved to be distinct: South Africa and Mauritius. South Africa's choice of model varies according to the treaty partner. South Africa is a capital exporter to African countries and thus, according to the official we interviewed, will mostly rely on the OECD Model when negotiating with other African countries, with a few deviations on permanent establishment (PE) and pension provisions.[1] When negotiating with OECD countries, in relation to which it is a capital importer, South Africa will normally demand certain provisions contained in the UN Model.

Mauritius has a wide treaty network and has over the years sought to market itself as a 'treaty hub' intermediary jurisdiction for investors, first into India and more recently into Africa. A review of its treaties suggests that these are informed by this need rather than the need to protect its tax base. Mauritius is thus not consistent in the model it uses but rather this is determined by its treaty partner. The review further indicates that Mauritius is keen to retain the right to tax capital gains, notably by excluding any treaty provision allowing source country taxation of the disposal of shares in companies owning immovable assets.

The other countries reviewed showed little consistency on the choice of the model, with most accepting both the OECD and UN Models as their negotiation starting point (Dauver and Krever 2014).

Analysis of the ICTD/ActionAid treaty dataset by Hearson has shown that over recent years, treaties concluded by sub-Saharan African countries with OECD members have become more residence-based, with fewer provisions allocating taxing rights to the source countries (Hearson 2016). For countries which are capital importers, as is the case with most sub-Saharan African countries, this means that they have been slowly ceding their taxing rights over income earned within their jurisdiction. This could be deliberate as the countries try to attract FDI, or it could be the result of a lack of policy to guide treaty negotiations. In the countries reviewed for this paper, the latter reason seemed to prevail.

Interviewees from countries that did not have a treaty policy in place observed that lack of a policy created ambiguity on matters such as who should be involved in negotiating and concluding tax treaties, which countries are viable treaty partners, and the minimum tax treaty terms that a country should contend for.[2] In some of the countries that do not have a treaty policy, it is unclear who can or should be involved in the treaty negotiation process. Some of the interviewees who work in the treaty departments of the revenue authorities, which are responsible for applying the treaties, stated there were instances where treaties were negotiated and concluded without them even being aware that such a process had commenced.[3] They only found out once the treaty was made public.[4] Such secrecy, they argued, provides room for elite capture of the negotiation process and leads to the conclusion of treaties without adequate consideration of their technical implications, which

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[1] Interview with official from South Africa Ministry of Finance.

[2] Interviews with officials from country A. In some of the cases mentioned in this section, there was one interview with each official; in others, there were multiple interviews with more than one official.

[3] Interviews with officials from country A.

[4] Interview with revenue officials from country A

could therefore be detrimental to the country.[5] This is especially so in many sub-Saharan African countries where politics and the elite are closely linked and as such the elite can use their political influence to protect their interests. The officials further opined that the lack of a written policy allowed for elite influence in treaty negotiations resulting, in some cases, in countries negotiating treaties with tax havens or with countries with which they had few or no economic ties. This, according to the interviewees, arose where politicians had economic interests that would benefit if a treaty was concluded with a particular country.[6] Due to political influence, some tax treaty negotiations are conducted very speedily, not allowing enough time for consultation with relevant experts and without a tax policy document to guide on acceptable minimum standards. Hence, the treaties end up being quite unfavourable to the country.

The officials interviewed were of the view that tax treaties were used, in some instances, as tools for cementing diplomatic ties, without considering the economic impact of the treaties on the tax base.[7] In many instances, the treaties were used as a tool to attract FDI despite the lack of evidence directly linking tax treaties with the level of FDI. The lack of understanding by some of the negotiators on the impact of tax treaties on the tax base and their overall impact on the economy was further compounded in some of the countries by the exclusion of the tax administration from the negotiation process, with a number of the countries only involving officials from the treasury and the ministry of foreign affairs.

Furthermore, the lack of a policy document made oversight on treaty negotiation processes an almost impossible task as there were no criteria which parliament or any other oversight authority could use to check if the correct process was followed or if the treaty is beneficial for the country.

In countries where tax treaty policies existed, implementation was cited to be a big challenge.[8] In some countries, for instance, the treaty policy document is not readily available even to some parties who are involved in the treaty negotiation process, making it impossible for those involved in the process to know how and with whom to negotiate treaties.[9]

From the findings, the officials felt that they needed more guidance on how and what to negotiate for. They also felt they needed protection from the whims of the executive as well as greater negotiating power. The interviewees indicated that sometimes, due to political reasons, they had been forced to negotiate treaties at short notice and within a very short period. An interviewee expressed frustration at having been required to negotiate and conclude a treaty within days despite not having been given time to carry out research on the treaty partner. In such instances, he said, a negotiator can only do their best to get the bare minimum and not cede all taxing rights.[10]

This paper proposes that in order for sub-Saharan African countries to safeguard their interests when concluding tax treaties, they must put in place mechanisms to guide and direct the entire tax treaty negotiation process. Such mechanisms include:

(i) a tax treaty policy;
(ii) a country model tax treaty; and
(iii) a tax treaty negotiating strategy.

[5] Interview with ministry officials from country B.
[6] Interviews with officials from countries A, B, C, D and E.
[7] Interviews with officials from countries A, B and E.
[8] Interviews with officials from countries A and B.
[9] Interview with officials from country A.
[10] Interview with official from country B.

4 Tax treaty policy: its role

As already discussed, since tax treaties shift taxing rights and can erode the tax base, developing countries should take pause before concluding any. They should first determine whether tax treaties are necessary for them and which countries they should sign with. Brumby and Keen (2016) report that Stephen Shay, senior lecturer at Harvard Law School, recommended that:

> Developing economies should be sceptical as to whether benefits of a bilateral income tax treaty program outweigh costs, and any one treaty should be considered 'a potential treaty with the world': if a country has ten treaties… investors will take advantage of the 'worst' one.

A tax treaty policy is a critical document that ensures a country's interests are protected. It provides guidance and gives clarity to the treaty negotiators on how to conduct the process. The treaty policy should have as its foundation the reasons why the country seeks to expand its treaty network. Each country has motives for doing so, which may be both political and economic. Based on the country's objectives for concluding tax treaties, the policy should also stipulate how the intended objectives will be achieved (Brumby and Keen 2016).

This section discusses in detail the critical role of a tax treaty policy in addressing the challenges encountered by sub-Saharan African countries when negotiating treaties, which often result in unfavourable outcomes.

4.1 Protecting the domestic tax base

One of the main objectives of a tax treaty policy is to ensure that a country's tax and economic interests are protected. Although the prevention of tax avoidance and evasion is now stated to be one of the main purposes served by tax treaties, treaties still contain legal loopholes that have made aggressive tax planning possible, resulting in base erosion and shifting of profits as well as double non-taxation (Lamers *et al.* 2014). If the interaction with the domestic tax system is not taken into account at the negotiation stage, the conclusion of tax treaties can result in inconsistent definitions and characterisations of income by the contracting states, thereby creating room for tax arbitrage (Brooks and Krever 2015). By exploiting these inconsistencies and using complex tax structures, for example using hybrid entities or instruments, MNEs can avoid or drastically reduce the tax paid to source countries.[11] For example, where treaties are signed with low-tax jurisdictions and lack adequate provisions limiting benefits to genuine residents of the partner state, it may result in 'round-tripping' and treaty shopping. Round-tripping arises where local investors route their investments through the low-tax jurisdiction in order to avoid tax and in so doing erode the domestic tax base. Treaty shopping on the other hand arises where a person who is not a resident of either contracting state to a treaty establishes an entity in one of the contracting states for purposes of obtaining the treaty benefits. A study by the IMF indicates that treaties signed with investment hubs such as Mauritius and the Netherlands result in treaty shopping and in investments being re-routed through the hubs in order to take advantage of the treaty benefits. These investment hubs have wide treaty networks, do not levy withholding taxes on outflow of income, have few substance requirements and have low taxes on income. This, the study finds, attracts intermediate holding companies that make use of debt, intellectual property and other schemes to shift profits to the low-tax jurisdictions. Such re-routing, the

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11 A hybrid entity is one that is treated as transparent in one jurisdiction and non-transparent in another jurisdiction. For example, Holdco would be treated as a partnership and therefore transparent in country A and as a corporation and therefore non-transparent in country B. A hybrid instrument on the other hand is one that is treated differently in different jurisdictions. For example, it may be treated as equity in one jurisdiction and as debt in another jurisdiction (OECD 2012).

study finds, often results in tax avoidance, with sub-Saharan countries estimated to suffer losses of 15 per cent of corporate income tax (Beer and Loeprick 2018).

A lack of appreciation of the impact of tax treaties on a country's tax revenues and overall economy was noted as a leading cause in the conclusion of politically motivated treaties. A well-crafted treaty policy can address this by setting out the rationale for concluding treaties and requiring an analysis of the impact of tax treaties not only on domestic revenue mobilisation but also on the economy (Lang and Owens 2014). An assessment of the impact of tax treaties on the economy is useful in creating awareness among government officials as well as parliament of what the country stands to lose when they agree to unfavourable treaties. It thus ensures that only treaties whose benefits outweigh the cost are concluded.

A good treaty policy will seek to ensure that treaties are concluded where the country retains as wide source taxing rights as possible. A treaty policy outlines the main policy outcomes that a country aims to achieve from tax treaties by establishing targets that are (i) optimal for the country; (ii) an acceptable compromise; and (iii) outcomes that must be achieved in every negotiation (Pickering 2014).

In determining which terms to include in the treaty, due regard must be given to sectors that are key to a country's economy and to whether the country has the capacity to administer the treaty. For example, a country that is a net importer of technical services, as is the case with most sub-Saharan African countries, can provide in the treaty policy that an article on taxation of technical services must be contained in the treaty.

By providing for negotiable and non-negotiable terms in the treaties, the policy empowers and guides the negotiators in concluding treaties that protect the tax base of the country. Where a non-negotiable term is rejected by the other state, negotiators have the confidence and authority to walk away from the negotiations. Most of the interviewees from the countries that did not have a tax treaty policy cited frustration at not having the confidence to reject terms that were not beneficial to their countries. A tax policy would go a long way to giving the negotiators the much-needed authority to do so.

Tax treaties are generally expected to be long-term binding agreements. Withdrawal from an existing tax treaty may negatively impact investors who have already factored the treaty terms into their business models. However, there are instances where a country should renegotiate or even withdraw a tax treaty to safeguard its interests. A treaty policy stipulates instances where a country may withdraw or seek to renegotiate a tax treaty.

4.2 Provide a framework for developing a country model tax treaty

The treaty policy further provides a basis for developing a country's model tax treaty which reflects its preferences with respect to provisions on the various clauses contained in the tax treaties. While countries are encouraged to adhere to the provisions of international model conventions as much as possible (the UN Model in the case of developing countries), a country's model treaty reflects its own preference on treaty provisions, which is especially important where the intended policy outcomes vary from those envisaged in the international treaty model (Pickering 2014).

The UN Model is recommended as a reference model for developing countries since it provides for greater taxing rights in source countries. However, depending on the rights that a country is keen to protect, the country can make additional changes to the UN Model to protect such rights. Though preferred by most developing countries, the UN Model should be viewed as a preferred outcome rather than a start point for treaty negotiations. Since negotiations often result in concessions and the UN Model is already a compromise position, if used as a start point for negotiations, it is likely to result in developing countries ceding more taxing rights than is desirable. Thus, it would be better for developing countries to prepare their own model capturing what they consider to be most important to them. In developing the model, the countries can be guided by the UN Model and the African Tax Administration Forum (ATAF) Model.

4.3 How to identify treaty partners

Sub-Saharan African countries tend to be reactive in their choice of treaty partners, with most negotiating with the countries that request a treaty rather than choosing a treaty partner that meets a pre-determined criterion. A number of the interviewees indicated that their countries would conclude a treaty with any country that requested one. According to the officials of most countries interviewed, when the officials of another state came into the country for an official visit and requested a treaty, one would almost certainly be concluded.

The treaty policy can remedy this by establishing the criteria that must be met for a country to qualify as a treaty partner. The criteria set out in the policy empowers government officials to decline negotiations with a country that does not meet the required conditions. Treaties should only be concluded where there are sufficient economic partnerships. The assessment is also useful in identifying challenges that are likely to arise from the investment and trade between the two countries. If these can be solved under domestic legislation, then there may not be a need to conclude a tax treaty (Thuronyi 2010). Countries should consider concluding agreements that address specific issues not covered in domestic legislation, e.g. agreements for exchange of information and cooperation in tax matters.

4.4 Provide clarity on who should negotiate treaties

Some of the interviewees indicated a lack of consistency in the persons allowed to negotiate tax treaties. In some cases, it was treasury officials, while in others it was revenue authority officials.[12] A change in negotiators creates room for inconsistencies in the negotiation process and makes the process opaque, making it difficult to ensure that those with relevant knowledge and experience are involved. A tax policy would go a long way in clarifying this and ensuring there is transparency in the process.

The treaty policy should specify which government department (negotiating authority) will have the power to authorise treaty negotiations.[13] The UN recommends inclusion of tax administrators in the tax treaty negotiating process (where domestic legislation permits). As implementers of the treaty, they can advise on problems experienced in administering some treaty provisions (United Nations 2019). South Africa, for example, requires both the revenue authority and the treasury to be involved in treaty negotiations. Due to the diplomatic importance of treaties, it may be prudent to involve the ministry of foreign affairs in order to ensure that the negotiations align with the country’s foreign policy (United Nations 2019).

Developing countries are advised to consider seeking technical advice from consultants who are treaty experts if such skills are lacking in government and where the domestic law permits it (United Nations 2019). The final team that is mandated to negotiate tax treaties can then be divided into those who will do the actual negotiations and those who will provide technical support through research such as research on the potential partner’s tax system, economic position, and investment flows, among others.

12 Interview with officials from country A.
13 *Ibid.*

4.5 Ensure transparency and guard against sectional/political interests

By providing guidance on key aspects of treaty negotiations, a tax treaty policy creates transparency and consistency in the process and in so doing prevents capture by sectional interests. A number of interviewees gave examples of times they have been forced to negotiate a treaty with leaders from another country who have come into the country for a state visit. In such cases, the negotiators were unaware of the visit and, as such, ill-prepared for the negotiations.[14]

These negotiations, they added, had to be concluded in less than a week, giving them little time to carry out the requisite research and consultation.[15] To prevent situations where the executive demands, for political reasons, the conclusion of a treaty within a short period, the treaty policy can contain as part of the framework the need to carry out research on the potential treaty partner, their tax system and the expected impact of the treaty on the tax base.

Transparency in treaty negotiations, both internally as well as externally, is important for sub-Saharan African states. Internally, a tax treaty policy provides a means for parliament or any other oversight body to exercise oversight and ensure that the negotiation process has been conducted in line with the treaty policy and that the minimum specified outcomes were achieved. Government officials who do not adhere to the treaty policy guidelines can be held accountable.

Externally, a treaty policy can provide transparency for the negotiating partners as it allows the negotiators to communicate the non-negotiable terms in advance (United Nations 2019). This reduces the amount of time spent negotiating about such terms.

5 What should inform a tax treaty policy?

As stated, tax treaty policies are of great import in guiding countries in their treaty negotiations. These policies contain the justification for negotiating and concluding tax treaties. Sub- Saharan African countries need to take into account various factors when designing their treaty policies. These include economic circumstances, existing domestic policies and available technical capacity, as further discussed below.

5.1 The country's economic status

A tax treaty policy should take into account a country's economic circumstances, particularly the key economic sectors which contribute significantly to domestic revenue as well as those with potential for growth, and the nature and levels of inbound and outbound investments and trade. Due consideration must be given to the country's main revenue sources and how the same can be protected (Pickering 2014). The African Development Bank estimates that Africa holds 30 per cent of global mineral reserves, eight per cent of oil reserves and seven per cent of natural gas reserves (African Development Bank 2016). In view of this, sub-Saharan African countries should ensure that they safeguard taxing rights on the income and capital gains from immovable property.

An assessment of the country's level of investment and trade flows (inbound and outbound) is also an important policy consideration as it helps determine the economic relevance of concluding a tax treaty with a particular country. Assessment of trade flows also informs the

[14] Interviews with officials from countries A, B and D.
[15] Interviews with officials from countries A, B, D and E.

treaty provisions to negotiate for. For instance, since Ghana is a net importer, it insists that a technical service clause is mandatory in all its treaties. In the case of South Africa, the choice of model is determined by the country it is negotiating with. It adopts the OECD guidelines when negotiating treaties with sub-Saharan African countries (since it is a net exporter to Africa) and adopts UN terms when negotiating with developing countries (since it is a net importer from developed countries).

5.2 The country's tax policy

The domestic tax policy and the tax treaty policy must be aligned to ensure that they work in tandem, do not conflict, and that treaty terms are enforceable under domestic laws. Where the domestic tax policy seeks to promote a certain sector, the tax treaty policy should take this into account and not provide treaty terms that give undue advantages to foreign firms over local firms. For instance, failing to tax fees paid to foreign providers of technical services may disadvantage local providers of similar services. It is also recommended that while drafting the treaty policy, a country should be forward-looking by taking into account taxation that is currently not in place but is likely to be enacted in future e.g. although a country may not currently be exploiting natural resources, it should seek to retain appropriate source country taxing rights on immovable property to protect future revenue. These forward-looking treaties can be achieved by ensuring that treaty negotiators are technically equipped and are up-to-date on emerging tax issues in other markets and globally.

5.3 The objectives of other existing policies

Tax treaties are not purely economic instruments. The tax treaty policy should be aligned with other key objectives such as diplomatic policy and the country's economic policy. Although it is not recommended, tax treaties can be concluded for political reasons. For example, during the apartheid era South Africa had a policy of signing a tax treaty with any country that would allow them to open an embassy.[16] This was a case of foreign policy determining the treaty partner. Care should be taken even in such instances that the treaty concluded is consistent with the overall objective of the treaty policy and does not cede too many taxing rights to the other state.

5.4 The main stakeholders

At present, the process of negotiating tax treaties in many countries reviewed is opaque and in some instances news about a concluded treaty is received from the media. It is important to involve key stakeholders in the formulation of the policy so as to ensure that the policy reflects the interests of the country, and in so doing prevent elite capture of the process (Moerland 2017). Though treaties have a direct impact on all the citizens in the country, it is unlikely that most will have the technical capacity to actively engage in discussions on treaty policy. The main stakeholders that can be consulted include corporate players making cross-border investments. They can help determine the type of investment being made and therefore the type of taxes likely to be levied.[17] Other stakeholders include the revenue authority, since they are the main implementors of the treaties and are likely to have an understanding of the impact of a treaty on the country's revenues. Civil society also plays a key role as they are likely to represent the interests of the public and to prevent state capture. Technical experts in the area can provide technical expertise on the subject. Some revenue officials noted that one of the main sources of disputes with respect to treaties is differences in technical interpretation of certain treaty provisions between the authority itself and corporate taxpayers and tax advisors.[18] Engagement of these stakeholders in policy

[16] This was discussed during ICTD Tax Treaties Seminar held at Strathmore University in 2018.
[17] Lutando Mvovo, presentation at the ICTD Tax Treaties Seminar, Strathmore University, 2018.
[18] Discussions during the ICTD Tax Treaties Seminar, Strathmore University, 2018

formulation will ensure that the tax treaty policy is enriched, that ambiguity is eliminated when drafting treaties, and that treaties will gain legitimacy.

5.5 The cost of treaty negotiation and implementation

The cost of tax collection as a proportion of total tax revenue is high in sub-Saharan Africa with countries such as Swaziland and Zimbabwe reporting at 5.2 per cent and four per cent respectively in 2016 (African Tax Outlook 2018). Tax treaties require resources to negotiate and implement in addition to potential revenue lost from giving up taxing rights, and from the abuse of treaties. Such costs include building the capacity of treaty negotiators and revenue authorities, the administrative costs of enforcing some treaty provisions such as exchange of information, the collection of taxes pursuant to the cooperation in tax matters agreement, and the cost of resolving disputes through the mutual agreement procedure (Pickering 2014).

It is important for sub-Saharan African countries to evaluate the associated costs of negotiating and implementing a tax treaty against the expected benefits. This may, for instance, raise the bar when establishing the criteria for choosing a treaty partner. It may also inform when other alternative agreements, such as exchange of information agreements, should be considered, as well as what terms are administratively feasible to implement.

6 Negotiating strategy

Sub-Saharan African countries need to design a negotiating strategy to enable them to achieve their treaty policy objectives. To begin with, the negotiators must understand the country's objectives and expected outcomes as outlined in the treaty policy (Pickering 2014; United Nations 2019).

Most negotiations between developed and developing countries often result in unequal exchange, with developing countries giving more concessions. Several reasons have been cited for such outcomes, ranging from inadequate resources (lack of experienced negotiators and of crucial information in developing countries) coupled with aggressive demands by the developed countries (Nkot 2014). An example is tax treaty negotiation with a number of developed countries that demand the inclusion of a 'most favoured nation' (MFN) clause. The MFN clause provides that should the country agree on a lower rate with a third country that is similar to the existing treaty partner, it must provide similar treatment to the existing trade partner (United Nations 2019).

While some scholars hold that perceptions of power between the negotiating parties significantly impact negotiation outcomes (with the perceived powerful party prevailing over the weak), other scholars believe that since negotiations are about specific issues and interests, negotiations conducted with skill and tact can significantly reduce disparities in the outcomes, regardless of the powers involved (Salacuse 2003). A well-crafted negotiating strategy is crucial, especially for developing countries, which are often perceived as the weaker party in negotiations with developed countries. The negotiating strategy provides practical guidance to treaty negotiators on how to conduct the negotiations in order to achieve the intended treaty outcomes.

6.1 Pre-negotiation

The preparations made prior to commencement of the negotiations form an important part of the negotiation strategy. Once it is determined which section of government has the authority to negotiate treaties, the country should set out to build capacity among the negotiators.

Technical as well as soft skills training is key in helping the negotiators represent the country's best interests. Technical skills include knowledge of tax and of treaty terms, and some understanding of the economic implications of the treaty, the domestic legislative processes in concluding treaties, the interaction of the tax treaty with domestic tax legislation, among others. Soft skills may include negotiation and drafting skills. It might be worthwhile for the country to build capacity in the area of drafting. This skill is useful in capturing what was agreed during the negotiations and reducing this into the technical treaty terms.

The negotiating team should carry out an analysis of the economic importance and impact of a tax treaty with a prospective partner. This should be guided by the tax treaty policy which helps in determining the selection of treaty partners. Such analysis may include an examination of the investment flows between the prospective treaty partners to determine if a treaty is indeed required and would be beneficial. The analysis should extend to the likely impact of the treaty on revenue flows as well as on the economy. Similarly, there should be consultation with the business community on the tax challenges they are currently facing in trading with the prospective treaty partner. Based on the analysis and the consultations, the negotiating authority should determine if indeed a treaty is necessary or if the domestic law is sufficient to address these challenges. A brief should be prepared on why the treaty is necessary and how it will address the challenges. This information is useful in helping the negotiating team determine the aims of the negotiation (Salacuse 2003).

If the analysis indicates that a treaty is desirable, the negotiators should research the tax system of the potential treaty partner as well as the treaties it has signed to gain an understanding of what the other country is likely to ask for during negotiations. As stated above, it would be helpful for countries to prepare their own model to guide the treaty negotiations. Based on this model, the negotiation team can produce a draft text and agree on the terms that are negotiable, those that are non-negotiable, and those that are not particularly important to the country. Where the team decides to deviate from the model, they should set out in advance the alternatives that they will be requesting in the negotiations.

The negotiating team should then select the individuals who will carry out the negotiations and assign the roles to be played by each team member (United Nations 2019). The team should be comprised of members with the requisite technical knowledge and experience in all stages of the negotiation process (Nogues 2004). At a minimum, the negotiating team should have a technical expert in international tax matters who is also experienced in tax treaty negotiations (Nogues 2004). Where possible, the team should include a less experienced member so as to build capacity (Mann 2015). The negotiating team should prepare adequately for each negotiation. They should for instance be well informed about their country's circumstances (such as the country's key resources and what it has to offer the treaty partner) (Nogues 2004), and the relevant tax legislations and economic policies. They should also understand the content and basis of their country's draft/model treaty provisions, the justification for treaty provisions which diverge from the international norms, treaty terms concluded with other countries, and any justification for exceptionally beneficial clauses with a particular country (Pickering 2014).

The team should be sensitised on the culture of the other country (Pickering 2014). The team leader should be experienced and command the respect of the rest of the team. She or he should have a good understanding of her or his team as well as their strengths and areas of expertise (Pickering 2014).

6.2 Negotiations

The two countries should agree on how, where and when to carry out the negotiations. Details of the place and time of the negotiations, as well as the language to be used to carry out the negotiations, should be agreed at the beginning. Once these details are agreed, the negotiating team should seek to be disciplined and adhere to these rules. To increase their negotiating power, the team should have limited negotiating autonomy. Their autonomy is limited by the preferences of their country, as documented in the treaty policy. The clearer the intended goal of the country is, the less autonomy the negotiator has and therefore the less likely they are to concede on an issue that is against the preferences of their country.

It is argued that all treaty negotiations take place at two levels: at the domestic level and at the international level (with the foreign counterpart) (Moerland 2017). For a treaty to be concluded, there must be an intersection between the domestic preferences and the demands of the foreign counterpart (Clark, Duchesne and Meunier 2000). Thus, the domestic preferences of a country (defined as what will make the constituents happy) (Putnam 1988), where clearly determined, guide and bind the negotiator, leaving little room for the perceived stronger state to impose its position on the negotiator and the perceived weaker state. Where, however, the negotiator is given wide negotiating autonomy, they can be easily pushed into conceding terms that may not be preferable to their country. When negotiating with countries where there is economic asymmetry, as with developed states, developing countries can employ a ‘tied hands’ strategy. This involves hiding behind domestic preferences as the reason for not conceding (Fearon 1997). In this case, the tax treaty policy document could act as the source of the constraint and in so doing limit the autonomy of the negotiators. An independent impact assessment of the effects of the treaty if concluded could also act as a constraint and build up on the tied hands negotiation strategy (Moerland 2017).

6.3 Post-negotiations

To prevent abuse of the treaty-making process by politicians and the elite, the draft treaty agreed upon by the two countries should be submitted for comments to an oversight body such as parliament and/or to a committee of experts which has authority from parliament to review treaties (United Nations 2019). This ensures accountability in the negotiation process and acts as a measure to ensure that only treaties whose benefits outweigh the costs are signed. Where the oversight body raises legitimate questions on the benefit of the draft treaty to the country, the process of ratification can be stopped, and the negotiators can go back to the table to discuss the same. South Africa for example, submits such drafts to its parliamentary finance committee and only upon this committee being satisfied as to the benefits of the treaty, is the treaty signed. This prevents the need for renegotiation after the treaty has come into effect which is often a difficult and expensive process. Since most members of parliament in most countries do not have the requisite technical knowledge on tax matters, it may be worthwhile for the government to consider setting up a technical tax committee that advises parliament on treaty matters.

Box 1

Parliamentary oversight of treaties in Kenya

Recently, the constitutionality of the Kenya-Mauritius tax treaty was challenged for, among other reasons, lack of public participation. In its judgment, the High Court of Kenya held that double taxation arrangements (DTAs) are not treaties and therefore need not be subjected to the ratification process that involves the tabling of DTAs before Parliament. However, the Legal Notice that brings into effect the DTA itself should be laid before Parliament. This distinction between the treatment of the DTA itself and of the Legal Notice effectively gives the executive greater leeway to conclude DTAs without much scrutiny since the ruling affirms that any such scrutiny can only be at the tail end after the treaty has been concluded, as that is when the Legal Notice is tabled before Parliament. By that point, the DTA has already been signed and it is unlikely that much in the DTA can or will be changed by Parliament. By requiring the Legal Notice to be tabled before Parliament, the judgment is a win, albeit a small one, for accountability in the area of DTAs. However, the DTA itself is not subject to the same kind of scrutiny, and much more still needs to be done to place checks on the powers of the executive to conclude treaties that can have an adverse impact on the country's tax base.

7 Conclusion

The general lack of consistency in treaties concluded by sub-Saharan African countries, whether with OECD or non-OECD countries, reveals that most of these countries do not have a tax treaty policy that informs their treaty negotiation. As such, the actual text adopted is sometimes determined not by the needs of the country but by the partner with whom they are negotiating and the terms that it dictates. This is especially so when the negotiators are under pressure to conclude a treaty due to political reasons. It is essential that sub-Saharan African countries develop a treaty policy and a negotiating strategy that outline their minimum acceptable treaty terms which should be applicable in all treaties to safeguard their interests. This should provide guidance for negotiators that ensures consistency and accountability in the negotiation and conclusion of tax treaties. Further, the policy should indicate the factors to consider in the choice of a treaty partner. These countries should bear in mind that tax is not the greatest motivator for location of businesses. Rather, other factors such as markets, legal protection, economic and political stability among others rank higher, and so they should focus on improving these areas rather than concluding lopsided treaties that have an adverse impact on their tax base.

Further, there is need to build capacity among tax treaty negotiators in sub-Saharan African countries. The interviews conducted revealed that in some cases there was only one person in the relevant ministry or revenue authority who was knowledgeable on matters relating to tax treaties. The treaty negotiations were unbalanced, with the teams from developed countries having far greater knowledge and understanding of tax treaties, placing the developing country at a great disadvantage. Sub-Saharan African countries seeking to negotiate tax treaties should ensure that their negotiation teams are well trained and have the authority to walk away if the treaty terms are not favourable to the country. Further, oversight bodies should be empowered to review tax treaties and they should be well trained if they are to play their role well. This can be achieved if there is a treaty policy which takes into account the peculiar circumstances of the country as well as an analysis of the potential impact of treaties on tax revenue.

Finally, it has been argued that sub-Saharan African countries lack bargaining power in negotiating tax treaties. In light of this, these countries should take advantage of the current global efforts to reduce incidences of BEPS by signing on to the MC-BEPS. As of 30 October 2019, 12 African countries had signed the MC-BEPS with more expected to sign in the near future (OECD 2019b). From interviews conducted for this study, the MC-BEPS is seen by most of the countries under review as a welcome initiative as it will provide a faster and more efficient means of amending existing treaties. The officials noted that the normal process of amending an existing treaty is often lengthy and expensive. In any case, most treaty partners, especially OECD countries, are unwilling to engage in bilateral negotiations due to the number of treaty partners involved and the stringent timelines within which they must comply with the OECD BEPS minimum standards. Consequently, sub-Saharan African countries seeking to amend treaties which they deem to be unfavourable, especially treaties made with OECD countries, should take advantage and sign the MC-BEPS. The MC-BEPS deals with the treaty abuse that has become rampant. A number of the measures contained in the MC-BEPS were included in the amended UN and OECD Models. However, while the Models are effective in dealing with future negotiations, the MC-BEPS offers countries a chance to seal loopholes contained in already concluded treaties. The MC-BEPS provides various anti-abuse measures.

Sub-Saharan African countries must realise that it is not only important to have a wide treaty network, but vital that the treaties they conclude do not erode their tax base and that their interests are always protected. Thus, it is imperative that prior to commencing negotiations, the country must know what they want and what they are willing to cede (Pickering 2014). To ensure consistency and accountability, this knowledge must be documented in a policy document that provides guidance on all matters pertaining to treaty negotiations.

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