Double Taxation Treaties in Uganda

Impact and Policy Implications

July 2014

SEATINI
Strengthening Africa in World Trade

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Table of Contents

List of boxes and tables

List of abbreviations

CGT	Capital Gains Tax
DTA(s)	Double Taxation Agreement(s)
DTT(s)	Double Taxation Treaty (Treaties)
EAC	East African Community
FDI	Foreign Direct Investment
ITA	Income Tax Act, 1997
LDC	Least Developed Country (Countries)
MNC	Multinational Companies
MDG	Millennium Development Goals
MU	Mauritius
NL	The Netherlands
OECD	Organisation for Economic Cooperation and Development
PE	Permanent Establishment
RSA	Republic of South Africa
UAE	United Arab Emirates
UIA	Uganda Investment Authority
URA	Uganda Revenue Authority

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Front page photo: ActionAid

Executive Summary

Tax provides the much needed revenue for Governments to fund public services for its citizens. It pays for schools and teachers, health centers and health care workers; for roads and infrastructure and major public expenditure in the budgets. But who is the major taxpayer in Uganda? The majority of taxes are collected from consumers and citizens through Value Added Tax, Excise Duty and Pay As You Earn (PAYE). All the while, very few taxes are collected from the growing business community and large flock of multinational companies that operate in Uganda.

Along with other countries all across Africa and other developing countries, multinational companies and investors have found ways to dodge taxes. Countries across Africa are losing $50-60 billion every year to illicit financial flows, with two-thirds of this being lost to manipulation of commercial transactions. The UN High Level Panel on Illicit Financial Flows further estimates that $39 billion are lost to tax evasion and avoidance mechanisms. **The network of double taxation treaties is one of the mechanisms used by companies to avoid paying taxes, leading to illicit financial flows and tax losses for Uganda.**

Double taxation treaties determine which country has the right to tax corporate profit when a company has subsidiaries in two or more countries. When a company invests in Uganda, and generates outputs and profits from this business in Uganda, you might think that Uganda would be the country to tax these profits. However, double taxation treaties can be a way that a company ensures that it is either taxed in a country where the taxation rate is lower, or that it is not taxed anywhere. The effect of double taxation treaties is therefore sometimes referred to as **double non-taxation.**

Uganda should be commended for the recent decision to suspend negotiations of new tax treaties until there are clearer guidelines on how the country should benefit from such agreements. As well as developing these guidelines for new negotiations, Uganda should review its existing DTTs, particularly those with so-called conduit jurisdictions, often used by MNCs in their tax avoidance schemes. The guidelines under development should speak both to new negotiations and to the review, assessment and renegotiation of existing DTTs.

Some countries operate as conduit countries where multinational companies will set up a subsidiary only to avoid being taxed in the country of operation. Instead, by using such conduit countries, profits end up in developed countries, with minimal taxes paid in the countries where production happens. This is known as **profit shifting,** where profits are moved to where they will be taxed the least.

This paper analyses the double taxation treaties Uganda has signed with two known conduit countries, Mauritius and the Netherlands; both countries where incidents of various types of treaty abuses have been exposed, such as **treaty shopping** and **round tripping,** popular names for some of the tax dodging schemes that multinational companies have developed to avoid paying taxes in developing countries.

By analyzing key provisions in these treaties, this paper shows that Uganda has signed treaties that in some instances favor the developed countries and the multinational companies rather than ensuring that Uganda retains the right to tax corporate profits generated in Uganda. Many African countries have successfully renegotiated their double taxation treaties e.g. Mauritius and ended up with a much better result. It would be wise for the Government of Uganda to thoroughly investigate and consider whether existing treaties are actually benefitting Uganda, or simply exist to the benefit of the companies and the other contracting country.

According to Uganda's Commissioner Tax Policy Department in the Ministry of Finance Mr Moses Kaggwa, the model that is eventually adopted to guide Uganda's negotiation of DTTs will take into consideration other best practices that have been tried and tested elsewhere. Many treaties have been signed following a model treaty that was developed by the OECD countries, which favors exactly those countries, i.e. developed countries. Some provisions of the treaties analyzed in this paper, are based on, or are even worse, than the provisions in this OECD model treaty. This model was never intended to be used by developing countries. Instead, another model developed by the UN is a more appropriate basis for a treaty between an OECD country and a developing country like Uganda.

Some of the provisions of the treaties examined in this paper do follow the UN or more progressive models. **However, key provisions of the treaties under review are even more regressive than the OECD model, restricting Uganda's ability to raise revenue and to tackle tax dodging by multinational companies.**

In developing the new policy on negotiation of DTTs, Uganda should draw on examples of treaties that have gone beyond the UN model, as Uganda's DTTs already do in some instances. These options include taking the UN model as a point of departure, and incorporating provisions from more progressive models that have been developed in the Andean region in Latin America to ensure optimal taxing rights in the country where profits are generated and productive activities take place.

We urge the Government to ensure that the proposed policy framework for negotiation of DTTs will also be a step toward a shift from the current tax policy that continuously adds more taxes to the ordinary citizens who struggle to make ends meet. As the country has successfully invited more investors into the country than even neighboring EAC countries, it is also timely that Uganda puts in place the mechanisms to ensure that such investment works for Ugandan citizens by generating taxes needed to pay for the public services they rely on.

Uganda is in most cases the source country for international and foreign direct investments, meaning that this is where profits are generated. Uganda should therefore not sign off their taxing rights by signing lopsided double taxation treaties that lead to treaty abuse with profit shifting and non-taxation as a result. The Government of Uganda is urged to thoroughly investigate and consider whether existing treaties are actually benefitting Uganda, or simply exist to the benefit of the companies and the other contracting country, while Uganda loses out on much needed tax revenues.

Introduction

Countries enter into Double Taxation Treaties (DTTs) or Agreements (DTAs) to facilitate investment and to create fiscal certainty for investors to inform location decisions. In theory, the purpose of DTTs is to eliminate double taxation of cross-border flows by determining which treaty partner can tax different categories of income generated in one treaty state by a resident of the other The prevalence of DTTs is attributed to a deepening globalization that has led to greater economic interdependence among countries and increased growing cross-border investments, international financial flows, and migration or flows of labor (Fischer, 2003).

Each state has the right to tax income arising in their territory, but where this income is generated by an investor resident in another state and subsequently repatriated to the investor's state of residence, this can lead to double taxation, or the imposition of tax in two or more countries on the same taxpayer in respect of the same income and for identical periods. The income is taxed in both the investor's home state (usually referred to as the residence state) and in the state where the investment is made (the source state) (Kofler & Mason, 2007).

DTTs are a commonly used basis by which any two countries can divide up taxing rights over income generated by companies and persons who have a connection with both countries, on the basis of **residence of the taxpayers or source of income** (Miller & Oats, 2006). The DTTs are also given effect in the domestic tax law but cannot create a right to tax, which does not already exist in the country's domestic tax law (Miller & Oats, 2006).

Uganda is a signatory to ten DTTs, having entered into agreements with developing countries like Zambia, transition countries like Mauritius and India, and developed countries such as the Netherlands and the United Kingdom. Five others are pending ratification or final negotiation, including with secrecy jurisdictions or tax havens such as the Seychelles.[1]

North-South DTTs have traditionally operated to shift taxing rights from capital-importing nations to capital-exporting nations (Barthel, Busse, Krever & Neumayer, 2010), with most specific DTTs closely modelled on the OECD model convention. As such, DTTs have benefitted developed countries more than developing countries because cross-border trade and investments are predominated by Multi-National Companies (MNCs) which are largely from developed countries and control more than 60%-65% of global trade (Global Financial Integrity, 2011).

DTTs, as well as preventing double taxation, can lead to double non-taxation. One of the key challenges exists in the exploitation of loopholes in the global DTT network, known as treaty abuse. Routing financial flows through a number of different tax jurisdictions allows companies to avoid withholding tax on cross-border transfers whether or not there is a bilateral treaty between the country in which the income is generated and the final destination country; this is known as **treaty shopping.**

This diversion of inward FDI from non-treaty countries through treaty countries affects the apparent origin of investments. The objective is to reduce source taxation – typically on dividends,

1 http://thehill.com/policy/finance/191166-oecd-releases-list-tax-havens

interest, royalties and business income not connected to a permanent establishment. Treaty shopping typically involves three features:

(a) The beneficial owner of the treaty shopping entity does not reside in the country where the entity is created;

(b) The conduit has minimal economic activity in the jurisdiction in which it is located; and

(c) The income is subject to minimal (if any) tax in the country of residence.

Box 1: The cost of treaty shopping to Zambia

ActionAid's exposé of tax avoidance by the international food giant Associated British Foods (ABF) demonstrates treaty shopping in practice (ActionAid, 2013a). Zambia Sugar, ABF Zambian subsidiary, took a loan from a UK bank to finance their operations. Under normal circumstances, interest payments of 17% would have been subject to 10% WHT on leaving Zambia for the UK. However, on paper, the loan was routed through an Irish subsidiary, which meant that, under the terms of the Zambia-Ireland DTT, no WHT was liable. ActionAid estimates that the strategy of routing the loan through Ireland may have deprived the Zambian exchequer of up to US$3 million (ZK13.5 billion) in withholding taxes.

Another common strategy is for domestic companies to avoid tax by re-registering in the jurisdiction of a treaty partner, presenting themselves as if they are external investors; this is known as **round tripping.** These investors can benefit from advantageous treaty terms, e.g. exclusion of source taxation on capital gains from the alienation of shares. This is particularly appealing if the other country has a low tax regime. For example, Ugandan companies can register and then send their profits to Mauritius to take advantage of personal tax of 22.5% as compared to Uganda's 30%, or corporate tax of 15% as compared to 30%, respectively. Round-tripping also allows domestic companies to take advantage of incentives their country of origin only offers to foreign investors.

Box 2: Indian round tripping through Mauritius

For the period 2008 to 2013, Mauritius contributed just above 40% all inward FDI to India. Far more than traditional sources such as Singapore, UK, US, Japan and the Netherlands, whose combined FDI contribution still only amounted to 35%; lower than what Mauritius channeled to India.2

The India-Mauritius DTT provides for taxation of capital gains arising from alienation of shares only in the country of residence of the investor. Since capital gains are fully exempt from taxation in Mauritius, an investor routing his investment through Mauritius into India does not pay capital gains tax either in India or Mauritius.

Many commentators believe that this high level of investment from Mauritius is not FDI but rather domestic Indian investment which is routed through Mauritius (round tripping) to avoid capital gains tax on the alienation of shares and to benefit from Indian tax incentives only available to foreign investment, and not to domestic investment.3

2 Reserve Bank of India: http://www.rbi.org.in/Scripts/AnnualReportPublications.aspx?Id=1110

3 See: http://articles.economictimes.indiatimes.com/2013-04-05/news/38306811_1_tax-residency-certificate-tax-evaders-tax-benefits & http://www.equitymaster.com/5minWrapUp/charts/index.asp?date=05/05/2012&story=1&title=Does-this-indicate-FDI-inflows-from-Mauritius-are-set-to-decline

Comparing the UN and OECD Double Taxation Conventions[4]

The United Nations (UN) and Organisation for Economic Cooperation and Development (OECD) provide the two most prominent model tax treaties that are followed in designing specific DTTs. The OECD model, originally designed to determine taxing rights between OECD countries, has increasingly permeated development and implementation of international income tax law and practice among OECD countries and between OECD and non-OECD countries (Pistone, 2011). The UN model, in contrast, has been widely used in treaties among non-OECD countries. The two models are accordingly the source of international tax rules and have formed the normative dimension in most bilateral tax treaties.

The underlying way in which the two models differ is related to how taxing rights are assigned between signatories. The OECD Model Tax Convention favors the residence principle, i.e. the income is taxed where the company is tax resident. The UN Model Tax Convention favors the source principle, and hence taxing rights belong to the country where production is carried out or where profit is accrued. The former favors developed OECD countries as most MNCs and FDI originate from the OECD, whereas the UN model is slightly more beneficial for developing countries, giving them more rights to tax what is produced and earned from business carried out in the developing country.

Given that up to 74% of the existing DTTs involve a developed country (Barthel, Busse and Neumayer, 2010), it is no wonder that the OECD model has been so influential and is still used when non-OECD countries enter into DTT negotiations. Conversely, only a few tax treaties between non-OECD countries are modelled on the UN Model Tax Convention (UN model). It is more common for treaties modelled on the OECD treaty to incorporate specific clauses modelled on the UN version.[5]

Many OECD countries use the UN treaty in their negotiations with net capital-importing countries, in order to foster the economic development of such countries. **However, rather than relying on OECD countries to do this, countries like Uganda should start from either the UN model position or even apply more progressive outsets to negotiate from in order to safeguard their taxing right of profits made in the country.** Some capital importing countries, e.g. Ghana, have managed to convince their OECD treaty partners to include provisions that go beyond the UN model.[6]

4 In considering the comparison between the UN and OECD models, substantial reference can be made to Lennard M (2009): The UN Model Tax Convention as Compared with the OECD Model Tax Convention – Current Points of Difference and Recent Developments, Asia-Pacific Tax Bulletin January/February 2009; Lennard M (2011) The United Nations Model Tax Convention and Related UN Work, Presentation to Asian Development Bank Institute, 2-10 October 2011; McIntyre M: Model Tax Treaties; Pistone P. (2011): General Report Explaining the different articles of Double Taxation Treaties.

5 For example, delivery operations, stock maintenance and certain insurance activities carried out in the source country, all of which are included within the UN model's definition of a PE, but excluded from that of the OECD. Each of these provisions appears in only around 25 to 35 per cent of treaties signed by non-OECD developing countries since 1980.

6 For example, Ghana has succeeded in including the right apply withholding tax to technical service fees in most of its tax treaties in force: in those with Germany, Switzerland and the Netherlands, article 12 incorporates royalties and technical service fees; in those with Italy and France there is a separate article 13 on management fees.

The UN model is based on the OECD model but is primarily designed to address the unique interests of developing countries. Unlike the OECD model which is presented as the *"Model Tax Convention on Income and Capital"*, the UN model, which is produced by a committee with a mandate "to have regard to the special needs of developing countries", is presented as *"United Nations Model Double Taxation Convention between Developed and Developing Countries".* While most taxing rights are still retained by the residence country, the UN model allocates a greater share of taxing rights to the source country in comparison to the OECD model. The UN model would therefore allow developing countries to retain more taxing rights on income generated by foreign investments in their territories.

The objective of increasing the tax revenue of developing countries is receiving increasing attention in financing for development debates, but this is rarely reflected in the division of taxing rights in treaties between OECD and non-OECD countries. The impact of different tax treaty provisions on developing countries' ability to raise revenue will be considered in light of two DTTs that Uganda has entered into: the treaty with Mauritius and the treaty with the Netherlands.

Double Taxation Treaties in Uganda

Treaties with Mauritius and the Netherlands

This paper will compare the treaties Uganda has signed with Mauritius and the Netherlands, analyzing the extent to which the DTTs are in conformity with either or both the UN and OECD model conventions. The analysis will include suggestions for even more progressive clauses that would be to Uganda's advantage to negotiate. A general and contextual analysis aimed at understanding the nature of the two treaty partners will precede this section and subsequently, general risks will be flagged out.

Mauritius

Mauritius, in contrast to other African countries, has achieved a relatively high level of development and governance. The country has an extensive treaty network, with 38 existing DTTs already in force, 13 of which are with African countries, and with more under negotiation.[7] It has a network of 36 Investment Promotion Protection Agreements (IPPA), under which Mauritius offers full protection of foreign investments, including with 18 African countries. The country is a low tax jurisdiction, with tax rates ranging from 0%-20%, compared to Uganda's 6%-30%. Though OECD classified Mauritius as a jurisdiction that has substantially implemented internationally agreed tax and transparency standards in April 2009, the country is still widely considered a tax haven (Gravelle, 2013).

7 Details correct as of 18 July 2014. See further: http://www.mra.mu/index.php/taxation/double-taxation-agreements

Whereas most investment from Mauritius used to go to India, currently, up to 50.9% of the outward FDI from Mauritius is directed towards Africa (Randall, 2013). This indicates a shift in focus by Mauritius, which is rebranding itself as the point of entry for investment into Africa. In 2012, Mauritius held outward FDI stock[8] amounting to 681 million US$, an increase of more than 500% since 2000.[9]

Records from the Uganda Investment Authority (UIA) shows that the top FDI sources to Uganda for the period 1990-2010 were United Kingdom (US$ 1,018 million), India (US$ 947 million), Kenya (US$ 858 million), and China (US$506 million). In 2011, Mauritius appears on the list, bringing in FDI amounting to slightly below US$ 20 million (with 8 projects). It was 7th on the list of investing countries, which was headed by Kenya (US$87 million), Norway (US$78 million), India (US$50 million) and China (US$ 42 million). United Kingdom had dropped to 8th on the list (UIA, 2011).

These changing dynamics could mean that Mauritius is overtaking the traditional sources of FDI to Uganda. **However, given Mauritius' reputation as a conduit jurisdiction, it is more likely that traditional investors are beginning to channel investment through Mauritius, taking advantage of the Uganda-Mauritius DTT, effective since 1 July 2005.**

8 Outward FDI stock is the value of capital and reserves in another economy attributable to a parent enterprise in the economy.
9 unctadstat.unctad.org, as of June 18 2014.

The DTTs entered into by Mauritius generally reduce the withholding taxes that investors pay as they move income out of the source country through Mauritius and on to the final destination. In addition, one of the most striking advantages offered to investors interested in using Mauritius as the country through which they invest in African countries involves taxation of the sale of shares. Most African governments impose Capital Gains Tax (CGT) on the sale of shares at rates ranging from 30-35%. Many of the DTTs that are in force with Mauritius restrict taxing rights of capital gains on sale of shares to the country of residence of the seller of those shares, which will be Mauritius in most investment cases (ActionAid, 2013b). Since there is no CGT in Mauritius, the potential tax savings for the Mauritius registered entity are therefore very profitable, being taxed 0% instead of 35%.

This analysis **highlights the significance of the Uganda-Mauritius DTT,** and suggests that the Government of Uganda needs to carefully assess who is benefitting from the Mauritius DTT.

The Netherlands

The Netherlands is also a conduit jurisdiction, with low rates of tax for certain types of income, e.g. royalties. Weyzig refers to the double taxation treaties the Netherlands has signed as one key mechanism in which diversion of FDI and equity funding takes place for tax reasons using the Netherlands as a conduit (Weyzig, 2013). This can take place to eliminate withholding taxes on interest payments and on dividends (ibid.). Recent high profile cases in United Kingdom of tax avoidance by Starbucks, which paid no corporate tax over 3 years despite sales of £1.2 billion, and Google, which paid only £3.4 million over sales of £2.5 billion, used schemes rooted through the Netherlands (McGauran, 2013). The tax dodging scheme used to avoid tax in Zambia by international food giant Associated British Foods, exposed by ActionAid in 2013, also relied on the routing of profits through the Netherlands.[10]

Using the 2010 statistics, the Netherlands was ranked the 6th country in receiving Ugandan exports at a value of US$ 90 million; whereas Uganda imported goods worth US$ 133 million and was ranked 9th as a source of imports. There is no doubt that the Netherlands is an important trading partner with Uganda but currently having a negative trade deficit from this relationship. Notably, two of the major companies in the oil sector, Tullow Oil and Total, are also both operating with and through subsidiaries in the Netherlands.

The Dutch Parliament is pressing the Government to improve the terms of DTTs with developing countries like Uganda (McGauran, 2013). This suggests that there might be political space for Uganda to engage pro-actively with the Dutch and improve the terms of the treaty through renegotiation.

10 Lewis, M. (2013): Sweet Nothings. Available at: http://www.actionaid.org/sites/files/actionaid/sweet_nothings.pdf

Analyses of selected clauses of the two treaties

This paper has selected some key clauses from both DTTs in scope in order to draw out the key challenges that exist with the treaties signed. These clauses are some of the most used to lower tax payments in developing countries, thus scrutinized here. Some of the key aspects are summarized in a table format representing a continuum from a worst case scenario towards alternative possibilities that Uganda could look to for inspiration in improving their negotiation position when discussing DTTs with other countries.

This section will look at three key elements that are likely to expand or restrict Uganda's ability to raise tax revenue:

1. Definition of Permanent Establishment
2. Withholding Tax rates
3. Taxation of Capital Gains

1. Definition of Permanent Establishment (Article 5) and Taxation of Business Profits (Article 7)

A country is generally entitled to tax a subsidiary of a foreign multinational company as a tax resident in its own right. In cases where a MNC generates income without incorporating a subsidiary, DTTs permit countries to tax the operations of foreign multinational companies if their presence falls within the thresholds set by the treaty's definition of 'permanent establishment' (PE). This is normally a point of departure between the OECD and UN double taxation conventions, with the UN model drawing a wider set of circumstances in which a developing country would be able to tax a multinational company's presence in its borders. The definition of Permanent Establishment largely covers the same ground in both the Uganda-Mauritius and Uganda-Netherlands DTTs. Both treaties include some provisions that follow the UN model and some provisions that follow the OECD model. On balance, the PE definition included in these treaties remains narrow and limits Uganda's ability to tackle tax avoidance.

Provisions following the UN model treaty

Treatment of services (Article 5.3b)

This is one of the most critical provisions that developing countries need to pay attention to, given the registration of service provision in low-tax jurisdictions is a particularly common tactic used in tax avoidance schemes. If a developing country can define services provision in their country as a 'permanent establishment', then the artificial registration of those services abroad does not prevent the developing country from taxing profits associated with that service provision.

Both the Uganda-Mauritius and Uganda-Netherlands DTTs seem to have been inspired by the UN model convention and include a services permanent establishment. This provision does not exist in the OECD model. Under the UN model, as long as the services are delivered for a period of more than six months within any twelve-month period in the aggregate, this is defined as a permanent establishment and the source country gets the taxing rights. Both Uganda-Mauritius and Uganda-Netherlands DTTs are in fact more generous than the UN model, providing for a services permanent establishment after a period of just four months. The OECD model convention has no special provisions for services, and the commentary on this model has echoed that services provision is treated in the same way as provision of goods. The UN model convention recognizes that provision of services has unique characteristics, and cannot be treated as the provision of goods if source countries are to be treated fairly and equitably.

Building sites (Article 5.3a)

Both the Uganda-Mauritius and Uganda-Netherlands DTTs are in conformity with the UN model, defining a building/construction site as a permanent establishment after six months, rather than requiring Uganda to wait twelve months to tax related activities as provided for under the OECD model.

Provisions following the OECD model treaty

Delivery and insurance (Article 5.5b)

Both the Uganda-Mauritius and the Uganda-Netherlands DTTs do not follow the UN model in all respects. The maintenance of stock for the purposes of delivery and certain insurance activities carried out in the source country are all included within the UN model's definition of a PE, but excluded from that of the OECD. On *delivery*, the rationale is that the presence of a stock of goods for prompt delivery facilitates sales of the product and earning of profit in the host country and represents a continuous connection with the source country, and as such may constitute a PE. On *insurance*, in case the insurance agent collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status, this will also constitute a PE. The Uganda-Mauritius treaty includes delivery activities within the definition of a PE, but excludes insurance activities. The Uganda-Netherlands DTT excludes both, which means that Uganda has signed away the right to tax these activities.

Attribution of profits (Article 7.1)

The UN model contains what is known as a 'limited force of attraction' rule, which applies in a scenario where a multinational investor has a PE in a source country, that country can bundle together all the profits made by that multinational from activities that are "of the same or similar kind" to those undertaken directly by the PE, and tax them. Without this rule – i.e. under the OECD model – a developing country would only be able to tax the activities formally undertaken by the PE. The limited force of attraction rule is desirable because it makes administration easier and prevents potential abuse, and consequently, it expands a developing country's taxing rights. The 'full force of attraction' rule could also be applicable in a situation where all the activities of a multinational in a country can be bundled together with a PE in the same country. Neither of the DTTs under review, in line with the OECD model, allows taxation of business profits beyond what is formally attributable to the activities of a PE, i.e. neither includes a full force of attraction rule. This is restrictive and not appropriate for developing countries that are failing to meet their Millennium Development Goals (MDGs) due to lack of appropriate funding.

Table 1: Permanent Establishment Continuum

Worse than OECD position	OECD position	UN position	Better than UN position	Theoretical possibilities
Longer time threshold than OECD model	UG-NL DTT excludes delivery from PE definition Both DTTs exclude insurance from PE definition	Both DTTs provide for building site PE after 6 months UG-MU DTT includes delivery from PE definition	Both DTTs provide for services PE after just 4 months	Andean model does not restrict taxing rights to presence of a PE
	UG-NL and UG-MU DTTs do not include a force of attraction rule	Limited force of attraction		Full force of attraction

A review of both DTTs shows a position spread across the continuum with some elements that are more generous than the UN model. The inclusion of a services PE corresponds with the modern reality of running businesses which do not always require a physical structure in Uganda, but can rely on online and telephone communication. However, there are still aspects of both treaties that could be improved. A wide PE definition is not just about maximizing taxing rights, it is also about the prevention of tax avoidance: managing 'PE risk' is an important component of tax planning, and some aggressive schemes, most notably the controversial sales structure used by Google in the UK, have exploited the fine detail of these definitions.

The proposed '*full force of attraction'* principle embedded in the model treaty developed in the Andean region in South America, where taxing rights are not restricted to the presence of a PE, is suggested as a more progressive milestone for Uganda to achieve in a round of (re)negotiations.

2. Withholding Tax rates on overseas payments under Article 10 (Dividends), Article 11 (Interest), Article 12 (Royalties) and Article 13 UG-MU DTT (Technical Fees)

Withholding taxes (WHTs) in this context are taxes levied by a source country government on certain types of overseas payments. Technically they are levied on the foreign company that receives the payment, but 'withheld' by the local company sending it. WHTs are probably the most visible part of a tax treaty, constituting the most clear-cut impact of the negotiations between treaty partners. Tax treaties set maximum thresholds on the level of WHTs that a country can levy on dividends, interest payments, royalties and technical service fees. The OECD model only provides for WHTs on the first two categories, while the UN model also includes royalties; a number of tax treaties signed by developing countries also contain provisions for WHTs on technical services. It is not uncommon that developing countries (source countries) actually end up having lower rates than provided for in the model conventions. Uganda has succeeded in negotiating reasonable rates, although still following the more restrictive OECD model.

WHTs are both a means of dividing up the taxing rights between source and residence country, and a first line of defense against transfer pricing abuse through payments for services and intangibles, which may be difficult to prevent through transfer pricing enforcement. These types of payments can often be manipulated through treaty shopping, just one treaty with lower WHTs – especially with low tax jurisdictions such as Mauritius and the Netherlands – can undercut all existing treaties, and hence negotiators must be very careful.

While the levels of taxation in these provisions are important, the definitions also matter. Treaties generally provide for lower WHTs on portfolio investment than on FDI, and article 10 in the UN model includes the threshold of ownership at which the lower ceiling kicks in.

The Withholding Tax rates under the two DTTs are as follows:

Table 2: Withholding Tax Rates

Item	Uganda-Mauritius DTT	Uganda-Netherlands DTT
Dividend	10%	FDI: 15% Portfolio: 0%, 5%*
Interest	10%	10%
Royalties	10%	10%
Technical fees	10%	n.a.

*No withholding tax is due on dividends paid by a company in Uganda where a company resident in the Netherlands is the beneficial owner of *' at least 50 per cent of the capital of the company paying the dividends with respect to investments… made after the entry into force of this convention'*. Where a company in the Netherlands is the beneficial owner of less than 50 per cent of the capital, 5% withholding tax is payable.

The continuum below positions the DTTs in respect of the different models.

Table 3: Withholding Tax Rate Continuum

Worse than OECD position	OECD position	UN position	Better than UN position	Alternative possibilities
UG-NL DTT excludes WHT on portfolio income where the beneficial owner holds 25%-50% of the capital	Both DTTs include WHT on interest and dividends but at low maximum rates	Both DTTs include WHT on royalties, but at low maximum rates UG-MU DTT includes WHT on portfolio investment regardless of the share held by the beneficial owner, at a higher rate than the OECD model	DTT with Mauritius include WHT on technical fees, but at low maximum rate	Andean model does not set any restrictions, and gives taxing right to country in which services are rendered

3. Taxation of capital gains on sale of shares - Article 13 in UG-NL DTT/Article 14 in UG-MU DTT

Capital gains tax (CGT) may be the most overlooked aspect of tax treaties signed by developing countries, despite being at the heart of some of the most prominent examples of treaty abuse, particularly when one of the treaty partners is a low-tax jurisdiction. Interestingly, in both the Netherlands and Mauritius, capital gains are generally exempt from tax (Ernst & Young, 2013)[11].

On taxing source capital gains, both DTTs follow the OECD model in providing that capital gains on the sale of immovable property, moveable property owned by a permanent establishment, and ships and aircraft can be taxed in the source country.

Alienation of shares

The UN model and, since 2003, the OECD model also include a provision that covers the sale of shares in property rich companies that have been formed as vehicles to own real property. This is excluded by the Uganda-Mauritius treaty. Without this provision, it is quite easy to structure the ownership of, say, a mine or large business in such a way as to avoid capital gains tax entirely when it is sold. The Uganda-Mauritius treaty also omits a provision found in the UN model, article 13(5), which permits a country to levy CGT on sale of shares when a foreign resident sells its stake in a domestic company if that stake exceeds a certain threshold. Without this provision, investors are free to structure FDI so as to be immune from CGT if they pull out

11 The only exceptions in the Netherlands are profits derived from sale of business assets, liquidation of companies, and sale of substantial interest in company, in excess of 5% of issued share capital.

or sell their investment.[12] This can constitute a revenue loss of many millions of dollars' revenue forgone on a single transaction. The absence of this provision has been the basis for numerous disputes between Mauritius and its treaty partners (ActionAid, 2013b), notably related to the enormous tax losses to India through 'round-tripping' of investment between Mauritius and India, which the Indian government has estimated costs the Indian exchequer some $600m annually.[13] The Rwanda-Mauritius DTT was recently renegotiated to correct this omission, allowing Rwanda to collect capital gains tax on the sale of shares by a Mauritius-based company, and Uganda should consider doing the same.

In contrast, the Uganda-Netherlands treaty (Article 13.5) provides for source taxation of capital gains on the alienation of shares, in line with the UN model.

Below we consider the performance of these DTTs on the continuum of source taxation of capital gains:

Table 4: Capital Gains Continuum

Worse than OECD position	OECD position	UN position	Better than UN position	Alternative possibilities
UG-MU DTT excludes source CGT on shares even where more than 50% of their value is derived from immovable property	Both DTTs include source CGT on immovable and certain types of movable property UG-NL DTT excludes source CGT on alienation of property associated with a fixed base for providing independent personal services	UG-MU DTT includes source CGT on alienation of property associated with a fixed base for providing independent personal services	UG-NL DTT includes source CGT on alienation of shares without ownership threshold (but with residency requirement)	Andean model gives exclusive source taxing rights over capital gains.

12 See, for example, 'The Nowhere Deal' in ActionAid UK, How Tax Havens Plunder the Poor (May 2013).
13 David Cay Johnston, 'Tax gateways to India', Reuters, 9 August 2011, http://blogs.reuters.com/david-cay-johnston/2011/08/09/tax-gateways-to-india

Treaty abuses can lead to major tax losses

The major risks involved in DTTs need to be thoroughly considered and digested by policy makers to ensure that the treaties do not foster treaty abuse by taxpayers, both individuals and MNCs. As shown above, specific provisions of DTTs can seriously restrict developing countries' ability to collect tax revenue. While there are some progressive provisions in Uganda's treaties with Netherlands and Mauritius, some key provisions are reasons for caution; including low withholding taxes on portfolio investment in the treaty with Netherlands, and residence taxation of capital gains on sale of shares in the treaty with Mauritius, which create clear opportunities for tax dodging.

The need for tax treaties to eliminate double taxation has diminished in importance since the early 20th century: in most developed countries, double taxation is eliminated unilaterally by the capital-exporting country, either by offering a credit against a multinational's worldwide bill in its home state for the tax it has already paid abroad, or by the exemption of overseas income from taxes in the home state altogether. More often, tax treaties can facilitate double non-taxation. Low withholding tax rates allow double taxation treaties to act as a conduit for profit shifting; the artificial movement of income to avoid tax goes unchecked by source taxation.

Capital exporting countries are perpetually pressing the Least Developed Countries (LDCs) as recipients of the FDI or capital importing countries to give the owners of the capital, who are their residents, a favourable tax dispensation that will not only give the investors reasonable income but will also give the capital exporting countries the right to tax their profits. African countries have tended to compete against each other to offer generous tax incentives; this race to the bottom means that not only do they forfeit potential tax revenue; research suggests that these incentives are not needed to attract Foreign Direct Investments (FDI) (ActionAid 2013c). Similarly, evidence that tax treaties attract foreign investment is inconclusive, but emerging evidence suggests that provisions like those highlighted above operate like tax incentives for multinationals from, or investing through, a specific jurisdiction.[14]

Uganda as an LDC is placed in this precarious situation, needing to attract FDI to raise tax revenues, but at the same time offering such generous incentives in a misinformed attempt to attract FDI while it can end up losing the same in tax revenues. Some of the countries with the highest inward FDI to Uganda in 2011, including USA, Canada, Turkey, Sri Lanka and Iran have no DTT with Uganda. Uganda needs to make an objective analysis to establish the impact of DTTs on both FDI and revenue mobilisation. To take part in a race to the bottom, simply lowering taxes to compete with other developing countries also in need of revenue, will only benefit the investors, with the competing countries, and their citizens, losing out.

14 See further: http://martinhearson.wordpress.com/2014/06/19/do-tax-treaties-affect-foreign-investment-the-plot-thickens/ and http://martinhearson.wordpress.com/2014/07/02/time-we-scrutinised-chinas-tax-treaty-practice-too/

Successes with renegotiations and cancellations

Uganda should be commended for the recent decision to suspend negotiations of new tax treaties until there are clearer guidelines on how the country should benefit from such agreements. The potential impact of such agreements on the country's ability to achieve national socio-economic objectives, including attainment of the goals set out in the National Development Plan, as well as the MDGs and post-2015 goals, should be considered as part of these guidelines.

As well as developing these guidelines for new negotiations, Uganda should review its existing DTTs, including these with the two countries, Mauritius and the Netherlands, which are known conduit jurisdictions, often used by MNCs in their tax avoidance schemes. The guidelines under development should speak both to new negotiations and to the review, assessment and renegotiation of existing DTTs.

Rwanda and South Africa provide interesting examples and set precedents in terms of reviewing and successfully renegotiating DTTs with Mauritius.

In renegotiating their treaty with Mauritius, South Africa successfully introduced a 10 percent withholding tax on interest flows as well as a provision that allows South Africa, in certain circumstances, to collect capital gains tax on shares sold by a Mauritius-based company, neither of which was possible under the previous treaty. This will have a major impact on capturing due taxes from property-rich companies and dual residency. Key changes after renegotiation include:

(a) The new agreement stipulates that if more than 50% of the value of shares held by a Mauritian tax resident company is derived from immovable property in South Africa, then Capital Gains Tax will arise on the sale of those shares. The amendment has diluted the impact of the practice of some foreign firms using a Mauritian holding company to hold shares in South African mining or property companies that have interposed jurisdiction through Mauritius.

(b) For companies with dual residence, the place of effective management will no longer be used to determine the source country, but will be determined by mutual agreement between the South African and Mauritian Revenue Authorities.

(c) Withholding tax on interest payable to a Mauritian company will, generally, be subject to a 10% South African withholding tax; and royalties paid to a Mauritian company will, generally, be subject to a 5% South African withholding tax.

In the case of Rwanda, the renegotiation was prompted by the recognition that the exceedingly generous tax regime to the benefit of companies and to Mauritius was disadvantaging them. Notably, the treaty encouraged treaty shopping, as MNCs could create a holding company in Mauritius and repatriate their profits through Mauritius without payment of withholding taxes or capital gains tax.

The Commissioner General of the Rwanda Revenue Authority (RRA) stated the challenge that necessitated the renegotiation of the 2001 DTT between Rwanda and Mauritius:

> *It [the DTT] is meant to discourage treaty shopping; with an agreement like the one we had before, where Mauritius had all the rights of taxation, people would go and register there because it is a low tax economy — sometimes businesses pay no taxes at all. Then they would invest here, and repatriate all their income and profits without paying taxes here.*

The renegotiated DTT, which is before Parliament for ratification, introduces a 10 per cent withholding tax on dividends, royalty and interest, and 12 per cent for management fees for investors between the two countries. It also allows Rwanda to collect capital gains on shares sold by a Mauritius-based company. The review resulted in a DTT that seems more mutually beneficial to both contracting countries.

Conclusion

Developing countries like Uganda face the challenge of ensuring that the different economic measures chosen to support economic development through mobilization of revenue, promotion of trade and investment are efficacious in promoting investment and preventing both tax avoidance and double non-taxation.

This paper has analyzed two specific DTTs; that with the Netherlands and that with Mauritius. Both countries are conduit jurisdictions, often used in the complex tax avoidance schemes developed by MNCs. It would be wise for the Government of Uganda to thoroughly investigate and consider whether existing treaties are actually benefitting Uganda, or simply exist to the benefit of the companies and the other contracting country, while Uganda loses out on much needed tax revenues.[15]

Uganda is currently developing a national policy framework to articulate the minimum standards and benchmarks for negotiating DTTs to ensure that they are 'good for the country'. According to the Tax Policy Commissioner, Mr. Kaggwa, this new policy 'will not only offer guidelines but give clear priorities of what our interests and objectives are'.[16] This framework must ensure that any DTTs concluded by Uganda are well positioned to support the attainment of economic development without compromising Uganda's ability to collect tax revenues needed to invest in development for its citizens.

According to Commissioner Kaggwa, the model that is eventually adopted will take into consideration other best practices that have been tried and tested elsewhere. While the UN model treaty includes some provisions that are advantageous to developing countries, unfortunately it is the OECD model, developed as a model for DTTs between OECD countries, which has been most influential in the design of specific treaties signed by developing countries. In three key areas, namely: definition and taxation of permanent establishments, withholding taxes, and taxation of capital gains; this paper has highlighted the continuum of potential measures, from the most regressive to the most progressive approaches. Some of the provisions of the treaties examined in this paper follow the UN or more progressive models. However, key provisions of both treaties are even more regressive than the OECD model, restricting Uganda's ability to raise revenue and to tackle tax dodging by MNCs.

The UN model, while more progressive than the OECD model, is a template for a development-orientated compromise between an OECD country and a developing country. In contrast to what many believe, the OECD model is not a model where the developing country gets it to their benefit. OECD countries, which are in similar economic positions relative to developing countries, have negotiated among themselves a common position that is clearly articulated in the OECD model treaty, which cannot be applied to the relationship between a developed and developing country. Uganda and developing countries need to agree on a position that works to their benefit, which is better based in the UN model or even more progressive models, and apply this during negotiations.

15 As of 1 June 2011, Uganda had DTTs with: Belgium, Denmark, India, Italy, Mauritius, the Netherlands, Norway, South Africa, the UK and Zambia. http://unctad.org/Sections/dite_pcbb/docs/dtt_Uganda.PDF

16 http://www.monitor.co.ug/Business/Govt-suspends-Double-Taxation-pacts/-/688322/2338432/-/qc4jofz/-/index.html

In developing such a position, Uganda could draw on examples of treaties that have gone beyond the UN model, as Uganda's DTTs already do in some instances. The most radical point of view is set out in the 1971 Andean model treaty, which formed the basis of some treaties between Latin American countries. In contrast to the UN and OECD models, the Andean model started from the assumption that the right to tax income rested with the source country, and then outlined the (limited) circumstances in which the residence country had taxing rights.

Uganda's tax policy should increasingly allow the state to collect tax revenues from production and profits generated in Uganda. The network of double taxation treaties is one of the mechanisms used by companies to avoid paying taxes, leading to illicit financial flows and tax losses for Uganda. Reviewing double taxation treaties is therefore one key step to ensure that Ugandan citizens benefit from investment into Uganda, and the profits that those investors make.

Policy recommendations for renegotiating positions

1. DTT Policy Framework

In order for the Government of Uganda to achieve favorable results in DTT negotiations and renegotiations of existing ones, it would be beneficial to develop a DTT policy framework and a model treaty. This should define what policy outcomes that are most beneficial to Uganda, and include outcomes that must be achieved in any negotiation.

The Government of Uganda needs to urgently put in place a **formal DTT Policy Framework** that will be used to guide the country in the development, negotiation, and signing of new DTTs, and in the review and renegotiation of the existing DTTs. Lack of a formal policy framework under which Government manages and monitors the DTTs in which it is signatory, is a hindrance for the Government to properly negotiate with a clear mandate of strengthening the economy of Uganda through these highly important legislative instruments for trade and taxation.
The framework should include the following elements:

(a) Articulation of the objectives and benefits to be pursued from the DTTs, including domestic revenue mobilization, and how these will be aligned to the national socio-economic objectives.

(b) Statement of the minimum standards and benchmarks; following the existing Double Tax Conventions, such as the UN or Andean models, or other alternative, progressive models, highlighted in the 'alternative possibilities' in the continuum tables above.

(c) A clear rejection from the most regressive provisions as highlighted in the 'worse than OECD positions' in the continuum tables above.

(d) Development of a clear mechanism for protecting the country's sovereign taxing rights and ensuring that the tax revenue and other benefits to be received from the DTTs are commensurate revenue with the expectations.

(e) A definition of the criteria to be followed in choosing potential contracting states for DTTs by Government. Uganda needs to articulate a clear position in relation to entering into treaty negotiations with countries that are known to be FDI conduit countries, or are facilitating treaty abuses such as treaty shopping and round tripping. In respect to countries that are conduits for FDI, Government needs to consider whether the most viable option is to cancel and reject these DTTs, or a renegotiation to protect the country from such glaring abuses.

(f) The procedural roadmap to be followed in developing and negotiating DTTs, including a strong negotiation framework, budget framework, need for consultation with key stakeholders and level of supporting research.

(g) The policy framework should include an analysis whether it is simply more useful to sign an agreement with certain countries only on exchange of information rather than a full-fledged DTT.

(h) Given the cross-cutting nature of DTTs, Government should institute a consultative and participatory mechanism in developing and agreeing both the Policy Framework and the development and monitoring of DTTs. This should include involvement of key sectors like trade, investment and other key government agencies such as Uganda Revenue Authority, Uganda Investment Authority as well as the legislative, judiciary, and of civil society and private sector.

2. Economic efficiency of DTTs

There is need for Government to undertake an analysis and audit of all the existing DTTs to confirm whether they are meeting the expected objectives, including promotion of investments, cross-border trade and elimination of double taxation, mobilization of tax revenue and stemming fiscal evasion and promoting investments. The exercise would indicate evidence in terms of tax revenue deficit or surplus and impact on trade balance; and consideration of the potential benefits or disadvantages in terms of FDI, trade and tax revenue to be derived from the audited DTTs.

3. Renegotiate or cancellation the DTTs that prevent due tax revenue collection

The Government of Uganda needs to review its DTTs on the following counts, considering whether cancellation or renegotiation is the best option ahead:

(a) The conscious formulation of a Policy Framework on DTT should lead to new and more relevant benchmarks against which DTT will be constructed and negotiated.

(b) There have been recent reviews, amendments and improvements in the Double Tax Conventions effected by both the OECD and UN, which are as recent as 2011. Yet all Uganda DTTs were contracted before 2008. It would accordingly be prudent for the Government of Uganda to make a general review of the DTTs to ensure that they meet the new progressive standards and added knowledge in the field of international taxation.

(c) Considering both the preparation for oil extraction and the actual production once it kicks off, it is crucial that the Government puts measures in place to close any gaps that may be exploited by multinational oil companies and service providers in the sector, as it is expected that the money flow will only increase. In this situation, it is very likely, as in other places, that the oil sector companies will have strong ties to countries through which they can obtain tax benefits harmful to Uganda.

(d) Knowing that various types of treaty abuse have taken place, such as round tripping and treaty shopping, through the use of DTTs with countries that Uganda has also signed treaties, it is prudent that Uganda considers the risk of similar practices by abusing treaties Uganda has signed.

4. Standardization of incentives towards foreign investors

Incentives should be equally applied to domestic and foreign investors to avoid that domestic investors might be inclined to undertake round tripping to benefit from incentives awarded to foreign investors.

Government should develop a standard framework for taxation of foreign investors, and should refrain from negotiations with individual investors and provide them special terms on tax exemptions, tax holidays and other incentives offered.
Rather, the Government should cultivate a culture of referring investors to a standard national benchmark, with equal treatment between domestic and foreign investors. Having a multiplicity of tax regimes for individual taxpayers results in a weird and expensive programme for the tax

administration to monitor tax compliance; while the tax loss for Uganda stemming from incentives is high and neither commensurate to the investments received, nor a necessary attraction factor for investors.

5. Competence of the negotiators

The Government of Uganda needs to strengthen the competence of the representatives in the DTT negotiations so that they extract treaties from the other contracting countries that meet the country's interests and expectations. This is premised on the consideration that the quality of DTTs is largely influenced by the competence of the bureaucrats.

6. EAC Model DTT

Uganda needs to ensure that the existing, non-ratified, EAC Model Treaty does not solely follow OECD model provisions, and in fact will foster economic development in the EAC and in the participating countries. Government should include this in their Policy Framework and have a pro-active agenda in the EAC to ensure benefits to the countries, and not aspire to foster tax competition within the EAC to the sole benefit of MNCs.

It is furthermore imperative to weigh whether it still makes economic sense for each member country of EAC to go alone in negotiating DTTs, or whether they need to negotiate as one group. This needs to be worked out systematically, and is critical in focusing EAC to the bigger picture and avoid the self-defeating measures such as tax competition which only accelerates the "race to the bottom" in the EAC.

Government should therefore promote a regional approach to developing the policy framework and negotiating the DDTs given the strides in the regional integration process and the fact that other EAC partner states are reviewing some of the DTTs they have signed.

The EAC member countries should act as a block in relation to DTTs, inspired by the Andean region that have succeeded in formulating the best practice treaty model.

7. Exchange of Information and supporting in Tax Administration

In negotiation of DTTs, Government needs to focus on strengthening the clause on exchange of information to ensure full collaboration with other tax authorities. The clause would be extended to cover supporting tax administration in collection of revenue and stemming tax avoidance and tax evasion.

However, the Government of Uganda should be reminded that if the sole purpose of DTTs is information exchange, there are other options to achieve this purpose, such as signing simpler agreements on sharing of information.
In aspects of information in tax administration, it is more acceptable to be burdened by information overload than lack information which can lead to tax losses due to poor assessment possibilities.

8. Combatting Illicit Financial Flows

The UN High Level Panel on Illicit Financial Flows, chaired by former South African President Thabo Mbeki, will be submitting their final analysis and report on the illicit financial flows out of African countries to the African Union Heads of State summit in June 2014.

The Government of Uganda should endorse the report and pay particular attention to the proposed mechanisms to embark on combating these murky schemes that remove taxable profits out of Uganda. The potential tax revenue that could be generated would be able to remove the more socially unfair tax collection solutions (consumption taxes) that are being introduced these years to increase the tax to GDP ratio for Uganda.

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