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Tax Treaties For Investment And Aid To Sub-Saharan Africa: A Case Study

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Abstract

Tax treaties are believed to increase cross-border trade and investment by reducing international tax burdens. The pursuit of tax treaties is therefore advanced as an integral component of U.S. foreign aid policy, which increasingly favors indirect assistance in the form of fostering trade and investment over traditional direct assistance in the form of donor funding. The importance of tax treaties is especially advanced in the context of U.S. relations with Sub-Saharan Africa, where poverty-related conditions are extreme and foreign trade and investment minimal. Yet despite many years of consistent promotion there are currently no tax treaties between the United States and the developing countries of Sub-Saharan Africa. This article explains the apparent contradiction by presenting as a test case a hypothetical tax treaty between the U.S. and Ghana. The case study illustrates that in today's global commercial climate, traditional tax treaties provide few tax benefits to and indeed may negatively impact private investors. Consequently, the continuing absence of tax treaties can be explained by the lack of incentives for private investors to pressure the U.S. government to conclude these agreements. This article concludes that means other than increasing the international network of tax treaties must be pursued if the goal to increase trade and investment to developing countries is to be achieved.

TAX TREATIES FOR INVESTMENT AND AID TO SUB-SAHARAN AFRICA: A CASE STUDY

Allison D. Christians[*]

I. INTRODUCTION

The U.S. is committed to increasing trade and investment to less developed countries (LDCs),[1] particularly those in Sub-Saharan Africa,

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[1] There is no uniform convention for the designation of a country as "less developed." The term is generally used to reflect a country's economic status or growth potential. In the context of taxation, these labels may be used to distinguish "in a general way between countries with highly developed, sophisticated tax systems and those whose tax systems are

where poverty-related conditions are extreme and foreign trade and investment minimal.[2] This commitment is demonstrated in U.S. efforts to negotiate agreements to eliminate trade barriers such as tariffs and quotas with many of these countries.[3] U.S. officials also consistently proclaim a commitment to enter into tax treaties with LDCs,[4] on the theory that tax treaties can eliminate excessive taxation and therefore help to increase trade

at an earlier stage of development." VICTOR THURONYI, TAX LAW DESIGN AND DRAFTING, xxvii (1996). In the United States, the Central Intelligence Agency (CIA) delineates three categories in a hierarchy, consisting of 35 "developed countries," 27 "former USSR/Eastern Europe," and 172 "less developed countries" (all other recognized countries, including all of Sub-Saharan Africa except South Africa). *See* CENTRAL INTELLIGENCE AGENCY, THE WORLD FACTBOOK 2004 (hereinafter WORLD FACTBOOK 2004), *at* http://www.cia.gov/cia/publications/factbook/ (LDCs defined in Appendix B). As a rough guide to U.S. foreign policy, this article incorporates these terms. For a discussion of the arbitrary and often unyielding nature of these designations despite changes in a particular country's economic status or prospects, *see What's in a name?,* THE ECONOMIST, January 17th 2004.

[2] Since the late 1980s, increasing trade with and investment in LDCs has become a preferred means of providing aid to such countries. *See, e.g.*, Paul B. Thompson, THE ETHICS OF TRADE AND AID 2 (1992); *see also* Bruce Zagaris, *The Procedural Aspects of U.S. Tax Policy Towards Developing Countries: Too Many Sticks and No Carrots?*, 35 G. W. INT'L L. REV. 331, 384 (2003) (the "official policies" of the U.S. are "to mobilize private capital rather than foreign aid"). For an overview of poverty conditions and foreign investment in African nations, *see, e.g.*, UNCTAD, FOREIGN DIRECT INVESTMENT IN AFRICA: PERFORMANCE AND POTENTIAL 1, 2, 21 (United Nations 1999) (foreign investors typically associate Africa with "pictures of civil unrest, starvation, deadly diseases and economic disorder," and foreign investment "inflows into Africa have increased only modestly" since the 1980s).

[3] The main agreement is the African Growth and Opportunity Act (AGOA), a trade preference agreement, discussed *infra* at note 18. The U.S. is also currently negotiating a free trade agreement with the South African Customs Union (comprised of South Africa, Botswana, Lesotho, Namibia, and Swaziland). *See* United States Trade Representative, *Background Information on the U.S.-SACU FTA, at* http://www.ustr.gov/Trade_Agreements/Bilateral/Southern_Africa_FTA/Background_Information_on_the_U.S.-SACU_FTA.html.

[4] *See, e.g.*, U.S. Treasury Dept. Press Rel. JS-1809, Treasury Welcomes Entry into Force of U.S.-Sri Lanka Income Tax Treaty (July 22, 2004) ("The Treasury Department is committed to continuing to extend and broaden the U.S. tax treaty network, including new agreements with emerging economies"), SENATE FOREIGN RELATIONS COMMITTEE, 108TH CONG., HEARING ON JAPANESE AND THE SRI LANKA TAX PROTOCOL (February 25, 2004), 2004 WL 363565 (F.D.C.H.) ("we are trying to expand the scope of these treaties to developing countries"), and Joseph H. Guttentag, *An Overview of International Tax Issues,* 50 U. MIAMI L. REV. 445, 450 (1996) ("tax treaty expansion in this area is a high Treasury priority"). The U.S. currently has 16 tax treaties with LDCs: Barbados, China, Cyprus, Egypt, India, Indonesia, Jamaica, Korea, Morocco, Pakistan, Philippines, Sri Lanka, Thailand, Trinidad and Tobago, Tunisia, and Venezuela.

and investment between the partner countries.[5] As such, tax treaties appear to be a perfect complement to trade agreements in furthering U.S. efforts to increase trade and investment to LDCs. Yet there are currently no tax treaties in force between the U.S. and any of the LDCs in Sub-Saharan Africa.[6]

The lack of tax treaties between the U.S. and the LDCs of Sub-Saharan Africa cannot be explained by disinterest or lack of support on the part of academics, practitioners, or lawmakers. Representatives from all sectors have urged the importance of concluding these agreements.[7] Neither can the omission be attributed to disinterest on the part of the LDCs in Sub-

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[5] This theory has been officially propounded since the first independent U.S.-LDC treaty was contemplated. *See* John F. Dulles, Letter of Transmittal to the President, July 9, 1956, *reprinted in* STAFF OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION, LEGISLATIVE HISTORY OF UNITED STATES TAX CONVENTIONS 1445 (1962) (Proclaiming that a treaty with Honduras would increase U.S. investment in that country because "by eliminating double taxation….[tax treaties] have contributed much to the trade and investment flowing between [partner] countries and the United States"). For a recent restatement of the theory, *see* Barbara Angus, International Tax Counsel, before the Senate Committee on Foreign Relations on Pending Income Tax Agreements, February 25, 2004 (in regards to a proposed treaty with Sri Lanka, "[t]he goal of the tax treaty is to increase the amount and efficiency of economic activity" between the partner countries).

[6] The U.S. tax treaty network at one time included ten LDCs in Sub-Saharan Africa, pursuant to extensions of existing tax treaties with the U.K. and Belgium. All of these treaties were subsequently terminated. Treasury Dept. News Rel. (R-2222, July 1, 1983). Today, the only Sub-Saharan African country with a U.S. tax treaty is South Africa, which is considered to be a developed country. *See supra,* note 1. Ethiopia, Ghana, and Liberia each have a treaty with the U.S. that deals solely with the taxation of income from shipping and aircraft activity; these agreements are largely unnecessary due to parallel provisions in U.S. domestic tax law. *See* Internal Revenue Code of 1986 as amended (hereinafter, IRC) § 883.

[7] *See, e.g.*, Karen B. Brown, *Missing Africa: Should U.S. International Tax Rules Accommodate Investment in Developing Countries?* 23 U. PA. J. INT'L ECON. L. 45, 46 (2002) (arguing for tax treaties between the U.S. and countries in Sub-Saharan Africa); Calvin J. Allen, *United States Should Expand Tax Treaty Network in Sub-Saharan Africa,* 34 TAX NOTES INT'L 20 (March 19, 2004) (same); Statement by Michael A. Samuels, House Ways and Means (August 1, 1996), 1996 WL 433282 (F.D.C.H.) ("Given the vital role that investment must play in the development of African countries…the new policy must contain several key investment-related priorities, including an emphasis on bilateral investment and tax treaties."); Richard G. Lugar, Senate Foreign Relations Committee Hearing (March 25, 2004), 2004 WL 623421 (F.D.C.H.) (supporting legislation that "directs the Secretary of the Treasury to seek negotiations regarding tax treaties with [AGOA] eligible countries"); and Charles B. Rangel, The State of Africa: The Benefits of The African Growth and Opportunity Act—Next Steps, 149 CONG. REC. E1464-01, 2003 WL 21643348 (July 14, 2003) (stating that the U.S. should negotiate tax treaties with AGOA countries).

Saharan Africa themselves.[8] Many of these nations have long pursued tax treaties with the U.S,[9] and a few have gone so far as to formally and publicly express their interest in commencing negotiations with the U.S.[10]

Finally, the lack of tax treaties cannot be charged to a lack of real commitment on the part of the U.S. to conclude agreements that will increase trade and investment to and assist in the economic growth of the countries of Sub-Saharan Africa.[11] This commitment has already been demonstrated through the making of significant concessions, including the foregoing of revenue in the form of direct aid as well as reduced tariffs, in the context of trade and aid agreements with these countries.[12]

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[8] All of the LDCs in Sub-Saharan Africa are in urgent if not desperate need for foreign capital, and most are responding to the need by implementing measures to make their countries more attractive to foreign investors. Given the powers ascribed to tax treaties in increasing trade and investment between partner countries, most LDCs would pursue the opportunity to commence negotiations with the U.S. (provided that the concessions required to secure such agreements are not too great).

[9] For example, Nigeria began pursuing a tax treaty with the United States in 1978, after it unilaterally withdrew from its coverage under an extension of the 1945 tax treaty between the U.K. and the U.S (as a former U.K. territory). *See supra* note 6 (discussing the treaty extension), and Announcement 78-147, 1978-41 I.R.B. 20 (Oct. 10, 1978) (terminating the treaty). Although it was apparently negotiated at length, the tax treaty was never completed.

[10] Calvin J. Allen, *Botswana, Burundi Wish to Negotiate Tax Treaties with United States,* 26 TAX NOTES INT'L 1264 (2002). This is a rather unusual event, since tax treaties are generally commenced and negotiated in secret. Their existence is usually made public after negotiations have concluded and the treaty has been signed by the respective countries, pending ratification. RICHARD E. ANDERSEN & PETER H. BLESSING, ANALYSIS OF UNITED STATES INCOME TAX TREATIES, ¶ 1.04[1][a][i], [ii], 1998 WL 1038746. Thus, countries don't usually issue public proclamations regarding their desire to enter into tax treaties. Similarly, since there is little public disclosure regarding progress in treaty-making by the U.S. Treasury Department, there is little means to determine the reaction, if any, Treasury has had to these or other requests to initiate negotiations.

[11] *See* Miranda Stewart, *Global Trajectories of Tax Reform: The Discourse of Tax Reform in Developing and Transition Countries,* 44 HARV. INT'L L. J. 139, 148-149 (2003) (pointing to the number of U.S. treaties with other emerging economies as evidence that "the lack of U.S. treaty-making with [LDCs in Sub-Saharan Africa] cannot be explained solely by a general reluctance to enter into tax treaties with less developed or non-capitalist countries"); Richard Mitchell, *United States-Brazil Bilateral Income Tax Treaty Negotiations,* 21 HASTINGS INT'L & COMP. L. REV. 209, 225 (1997) ("the United States displays eagerness to enter into tax treaties with developing nations").

[12] The main agreements are the African Growth and Opportunity Act (AGOA), a preferential trade regime, discussed *infra* at note 18, and the recently introduced Millennium Challenge Act, an aid package tied to countries' demonstrated commitment to growth through investment and trade, discussed *infra* at note 19 .

That the lack of tax treaties cannot be explained by disinterest, lack of support, or lack of commitment on the part of individuals or governments suggests that there must be some other reason or reasons that tax treaties have not been concluded between the U.S. and the LDCs of Sub-Saharan Africa. This article explores some of these reasons by presenting as a test case a hypothetical tax treaty between the U.S. and Ghana, one of the LDCs of Sub-Saharan Africa.[13] Hypothesizing the structure and operation of a tax treaty between these two countries provides a vehicle for measuring the potential effect of such a treaty on international commerce. The case study demonstrates that in today's global tax climate, a typical tax treaty would not provide significant tax benefits to current or potential investors. Consequently, there is little incentive for these investors to pressure the U.S. government to conclude tax treaties with many LDCs.

There are of course any number of other reasons why tax treaties may not be concluded between the U.S. and the LDCs of Sub-Saharan Africa, including competing priorities, either for tax treaties with other countries or for other domestic or international tax matters. Undoubtedly, socio-political factors play an important role as well.[14] However, this article argues that since tax treaties with LDCs like Ghana would not provide major tax benefits to the private sector, two results occur.

First, not surprisingly, there is likely to be little private sector demand or support for the conclusion of these agreements. Second, there is little reason to believe that, even if concluded, tax treaties between the U.S. and Sub-Saharan Africa could ever have the significant impact on cross-border investment and trade so consistently proclaimed by treaty proponents. This article concludes from these observations that if the U.S. is truly committed to increasing investment and trade to the LDCs of Sub-Saharan Africa, an examination of how the global tax climate has changed is in order. We must acknowledge that tax treaties cannot deliver the promised benefits, and examine the factors that prevent them from so doing.

An overview of the background and function of tax treaties and their proclaimed benefits are discussed in Part II of this article. Part III presents the case study of a hypothetical tax treaty between the U.S. and Ghana and shows that such a treaty would produce few tax benefits to current or

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[13] Ghana was chosen as a subject for this case study for several reasons, including its existing commercial ties to the U.S., as described in Part III.

[14] For example, there may be national interests at stake, such as security, defense, or energy supply issues, that may contribute to the prioritization of concluding tax treaties with LDCs in other areas of the world, such as Sri Lanka (concluded in 2004) and Bangladesh (currently pending ratification). The various foreign policy goals that motivate the agenda for treaty-making is a subject that deserves much attention, but is beyond the scope of this article.

potential investors and would therefore be largely ineffective in stimulating trade and investment between these two countries. Part IV concludes that after decades of adherence to the promise of tax treaties, we must acknowledge their failure to deliver, and search for alternative ways to achieve the goal of promoting aid through the vehicles of investment and trade.

II. BACKGROUND: TAX TREATIES, INVESTMENT, AND TRADE

This Part provides the context for a discussion of the role of tax treaties in delivering investment and aid to LDCs. Section A describes some of the strategies employed by the U.S. to assist LDCs, and how tax treaties comport with these strategies. Section B explains the role tax treaties play as the locus of international tax law, by outlining the purposes and goals that surrounded the origin and evolution of these agreements. Section C discusses the limitations that arise because international tax law concepts are embodied in a network of overlapping, varying, and mostly bilateral agreements between select nations, and introduces some of the problems faced by the LDCs of Sub-Saharan Africa, which operate largely outside of this network.

A. U.S. Strategy for Assistance to LDCs

As discussed in the introduction, the U.S. has adopted a foreign aid strategy towards Sub-Saharan Africa that centers on the idea that creating investment and trade opportunities for LDCs will most effectively boost economic growth in these countries, thereby lifting them out of poverty through commercial interaction with the global community.[15] A key component of this foreign aid strategy is therefore the identification and elimination of barriers to trade and investment. Among the most significant potential barriers are double taxation, which occurs when two countries impose similar taxes on the same taxpayer in respect of the same income, regulatory barriers, such as exchange and other market controls, and tariffs. These barriers have historically been addressed in very different ways.

Regulatory barriers and tariffs have been addressed by most countries in a generally uniform manner through regional and global trade agreements.[16] The main multilateral agreement is the General Agreement on Tariffs and Trade (GATT), with respect to which 147 countries are signatories through

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[15] *See supra,* note 2.

[16] Regulatory barriers are also addressed, to a lesser extent, in bilateral investment treaties (BITs), as discussed at Part III.D, infra.

the World Trade Organization (WTO).[17] Additional tariff and regulatory barrier reduction between the U.S. and Sub-Saharan Africa has been accomplished through The African Growth and Opportunity Act (AGOA), an agreement that seeks to increase growth and alleviate poverty through the elimination of tariffs and quotas for selected imports from designated Sub-Saharan African nations,[18] and the Millennium Challenge Act of 2003 (MCA), a new official direct assistance initiative that will direct foreign aid only to countries demonstrating a commitment to poverty reduction through economic growth.[19]

According to the Organization for Economic Cooperation and Development (OECD),[20] the harmful effects of double taxation on cross-

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[17] 37 of the 47 LDCs in Sub-Saharan Africa are members of the WTO. These GATT and other agreements are available on the WTO website at http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm1_e.htm.

[18] *The Trade and Development Act of 2000,* H. R. 434-21, 19 U.S.C. 3721, more commonly known as the African Growth and Opportunity Act (AGOA I), as amended by Section 3108 of *The Trade Act of 2002* (AGOA II), and as further amended by *The AGOA Acceleration Act of 2004*, signed by President Bush on July 12, 2004 (AGOA III; the three acts are collectively referred to herein as AGOA). AGOA eliminates "competitive need limitations" (quotas) and tariffs on over 1,800 items that would otherwise be subject to such constraints under the Harmonized Tariff Schedule of the United States (unless otherwise exempt under a free trade agreement). AGOA § 103(2); *see also* USITC Publication 3653 (2004), available at www.usitc.gov; see also http://www.agoa.gov/faq/faq.html#q17. AGOA is a preferential trade regime, rather than a free trade agreement. For a discussion of AGOA and other trade and aid initiatives entered into with Sub-Saharan Africa over the past several years up to 2002, see Brown, *supra* note 7, at 45, 49-51. As of March, 2005, 36 of the 47 LDCs in Sub-Saharan Africa were eligible for AGOA benefits. For a list of currently-eligible countries, see the AGOA website, at http://www.agoa.gov/eligibility/country_eligibility.html

[19] The Millennium Challenge Act of 2003, Pub. L. 108-199, Division D; *see* Bill to Establish Millennium Challenge Account and the Millennium Challenge Corporation, S. 571, 108th Cong., 1st. Sess., March 6, 2003. For information on the MCA, see the MCA website, available at http://www.mca.gov/; *see also* Colin Powell, *Welcome Message from The Honorable Colin L. Powell,* available at http://www.mca.gov/ (stating that the MCA "reflects a new international consensus that development aid produces the best results when it goes to countries that adopt pro-growth strategies for meeting political, social and economic challenges."). The MCA is not solely directed at Sub-Saharan Africa, but over half of its currently identified recipient countries are located in this region.

[20] The OECD is an international organization consisting of 30 member countries, all of which are developed countries with the nominal exception of South Korea, which the CIA still considers an LDC despite its per capita GDP of $17,800, well over the typical $10,000 threshold separating developed from less-developed, and despite the fact that just 4% of the population is considered to be living in poverty conditions. *See* WORLD FACTBOOK 2004, *supra* note 1 (Appendix B provides a definition of LDCs that includes the "Four Tigers," a group which includes South Korea, and country data on South Korea provides GDP and poverty statistics, available at http://www.cia.gov/cia/publications/factbook/geos/

border trade and investment "are so well known that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries."[21] The U.S. government mirrors this sentiment, identifying the elimination of "tax barriers" as a major component of its dedication "to eliminating unnecessary barriers to cross-border trade and investment."[22]

Yet, unlike other barriers to trade and investment, double taxation has not been reconciled on a global scale. Instead of a world tax organization to coordinate efforts and resolve disputes,[23] relieving double taxation remains the purview of individual countries.[24] Nevertheless, a consensus has

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ks.html). As discussed below, the OECD developed and continually updates a model income tax convention that both encapsulates and sets international tax standards.

[21] OECD COMMITTEE ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL 7 (Jan. 28, 2003).

[22] Treasury Press Release JS-1786, *supra* note 5; *see also* Treasury Press Release JS-1267, Treasury Welcomes Senate Approval of New U.S.-Sri Lanka Tax Treaty (March 26, 2004), at http://www.ustreas.gov/press/releases/js1267.htm (stating that the new treaty with Sri Lanka is "an important step in our ongoing efforts to broaden the reach of our tax treaty network."); Treasury Press Release JS-1809, *supra* note 4 ("This new tax treaty relationship will serve to eliminate tax barriers to cross-border trade and investment between the two countries…[by providing] greater certainty to taxpayers with respect to the tax treatment of their cross-border activities and [reducing] the potential for double taxation of income from such activities.")

[23] *See "What is the WTO?," at* http://www.wto.org/english/thewto_e/whatis_e/whatis_e.htm. The several international organizations concerned with standardizing and coordinating global taxation do not approach the level of member country participation in the WTO. For example, the OECD is one of the primary international organizations that concerns itself with setting standards for international taxation, but it has only 30 members, few new members are added (the latest addition was the Slovak Republic, in 2000), and many countries with rapidly growing economies, such as Brazil, Russia, India, and China, are not members.

[24] The vast majority of international agreements that address the problem of double taxation are bilateral. However, there are a few regional multilateral tax treaties currently in force, including the Andean Pact Income Tax Convention between Bolivia, Colombia, Ecuador, Peru, and Venezuela (November 16, 1971); the Arab Economic Unity Council Tax Treaty between Egypt, Iraq, Jordan, Kuwait, Sudan, Syria, and Yemen (Y.A.R.) (December 3, 1973); the Agreement Among the Governments of the Member States of the Caribbean Community for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income, Profits, or Gains and Capital Gains and for the Encouragement of Regional Trade and Investment between the Caribbean Community (CARICOM) countries of Antigua, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Christopher and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago (July 6, 1994); the Tax Convention Between the Member States of the West African Economic Community (C.E.A.O.) between Burkina Faso, Cote D'Ivoire, Mali, Mauritania, Niger, and Senegal (October 29, 1984); the Agreement on the Avoidance of Double Taxation on Personal Income and Property, signed by Bulgaria, Czechoslovakia,

emerged regarding the appropriate tax treatment of cross border investment activity.[25] Under this consensus, double taxation is addressed primarily by tax treaties, which allocate tax revenue among jurisdictions based on concepts of residence and source.[26]

Thus, the United States, along with the rest of the developed world, has a network of tax treaties, spanning most of its major trading partners across the globe.[27] Expanding the tax treaty network is alternately termed a commitment, an ongoing effort,[28] and the "primary means" for the elimination of tax barriers to international trade and investment.[29] Officials from other countries echo these sentiments.[30]

From the perspective of LDCs, a major problem with embodying international tax laws in tax treaties is that LDCs typically have few of these treaties in place. But the tax treaty network, with its central role in the evolution of international tax law, directly affects these countries regardless of their level of inclusion. To demonstrate the extent of this influence, the following Section discusses why and how tax treaties became the source of international tax law, and explores the impact the international tax system has had on the conclusion of tax treaties between the U.S. and the LDCs of Sub-Saharan Africa.[31]

Germany (G.D.R.), Hungary, Mongolia, Poland, Romania, and the Soviet Union, and still in force with respect to various successor states (May 27, 1977); and the Convention Between the Nordic Countries for the Avoidance of Double Taxation With Respect to Taxes on Income and on Capital, between Denmark, the Faeroe Islands, Finland, Iceland, Norway, and Sweden (September 23, 1996) (generally based on the OECD Model).

[25] For an introduction to the evolution of international taxation from decisions and compromises made by the U.S. and the League of Nations in the 1920s to the "flawed miracle" that exists today, see Reuven Avi-Yonah, *The Structure of International Taxation: A Proposal For Simplification,* 74 TEX. L. REV. 1301 (1996).

[26] *Id.*

[27] *See* discussion *infra,* text at notes 96 and 97.

[28] Treasury Press Release JS-1267, *supra* note 22.

[29] Treasury Press Release JS-1786, *supra* note 5. *See also* Treasury Press Rel. JS-1809, *supra* note 4, and Gregory F. Jenner, *U.S. Treasury Thanks Senator for Comments on Possible Chile-U.S. Tax Treaty,* 2004 WTD 83-16 (Apr. 22, 2004) ("Income tax treaties can serve the important purpose of addressing tax-related barriers to cross-border trade and investment").

[30] For example, Bangladeshi officials assert that when the new treaty between the U.S. and Bangladesh enters into force, it "will encourage U.S. investment in the education, highway, and communication sectors in Bangladesh," U.S. Treaty Update, 15 J. of Int'l Tax. 4 (December 2004).

[31] *See, e.g.*, Michael A. Samuels, *supra* note 7, Richard G. Lugar, *supra* note 7, and Charles B. Rangel, *supra* note 7.

B. Origins of Tax Treaties as International Law

Every country establishes its jurisdiction to impose income taxation under sovereign claim of right. In the U.S., the taxation of income from international transactions turns on whether the income is earned by a resident[32] or a non-resident.[33] In the case of residents, the U.S purports to tax "all income from whatever source derived."[34] In the case of non-residents, the U.S. taxing jurisdiction is generally limited to income derived from investments and business activities carried out in the U.S.[35] Most developed countries similarly impose worldwide, or residence-based, income taxation on residents, and source-based taxation on income earned within their borders.[36] As a result, ample potential exists for double taxation of transactions between two developed countries.[37] The U.S. and most of the other countries that impose worldwide taxation therefore provide a foreign tax credit, which removes the residence-based layer of tax while preserving the source-based layer.[38] Thus, the U.S. and most other countries generally relieve double taxation on a unilateral basis, under statutory law.

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[32] Whether individual or entity; *see* IRC § 7701(a)(1).

[33] IRC §§ 7701, *et seq.*

[34] IRC § 61, *see also* IRC § 1 and 11(a), Treas. Reg. §§ 1.1-1(c) and 1.11-1(a). The authority to extend its jurisdiction in this broad fashion is confirmed by *Cook v. Tait,* 265 U.S. 47 (1924) ("the basis of the power to tax was not and cannot be made dependent upon the situs of the property in all cases, it being in or out of the United States, nor was not and cannot be made dependent upon the domicile of the citizen, that being in or out of the United States, but upon his relation as citizen to the United States and the relation of the latter to him as citizen").

[35] IRC §§ 871, 881-882.

[36] OECD countries generally impose some form of worldwide taxation, although a few (Austria, Australia, and Switzerland) provide certain statutory exemptions, and many provide for exemption under treaty, as discussed below. Some countries such as France are generally source-based, or territorial systems, which generally refrain from taxing the foreign income earned by their residents. However, these countries enforce worldwide taxation of certain kinds of income earned in low-tax jurisdictions in order to prevent capital flight. Thus, France imposes worldwide taxation on certain low-taxed foreign income. For tax system features and rates, *see generally* Ernst & Young, WORLDWIDE CORPORATE TAX GUIDE 2004.

[37] The most common form of double taxation occurs upon a residence-source overlap, as a taxpayer's country of residence (the home country) imposes residence-based tax on income earned in a foreign (source, or host) country, while the host country imposes source-based tax on the same item. Source-source and residence-residence overlaps may also occur due to differing definitions of these concepts.

[38] *See generally* Ernst & Young, *supra* note 36.

The same result is attained under treaties. Treaties are contracts, generally between two countries,[39] under which the signatory countries agree to the taxation each will impose on the activities carried out between their respective jurisdictions.[40] Because the U.S. unilaterally provides a mechanism to prevent U.S. taxation in the event foreign taxation applies, treaties aimed at relieving double taxation would appear to be duplicative.[41] Indeed, treaties might seem unnecessary *ab initio,* since the U.S. provided the foreign tax credit mechanism almost immediately following the inception of the income tax itself, indeed decades before any tax treaties were ever negotiated.[42] Nevertheless, the U.S. began entering into tax treaties in 1932 and the practice continues to the present.[43]

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[39] But *see supra*, note 24.

[40] In the U.S., treaties have the same effect as acts of Congress, and are equivalent to any other U.S. law. U.S. Constitution, Art. VI, cl. 2; *see American Trust Co. v J.G. Smyth,* 247 F.2d 149 (1957); *J. Samann v Commissioner,* 313 F2d 461 (1963); and *Dames & More v. Regan,* 453 U.S. 654, 686-88 (1981). As such, they are subject to and may be overridden by subsequent revisions in domestic law ("treaty override") under the "last in time" rule of IRC § 7852(d). *See* Philip F. Postlewaite & David S. Makarski, *The ALI Tax Treaty Study—A Critique and a Modest Proposal,* 52 BULL. SEC. TAX'N 731, 740 (1998-1999) (arguing that treaty override is seen as a "serious problem" because it potentially places the U.S. in violation of existing international obligations); Richard L. Doernberg, *Overriding Tax Treaties: The U.S. Perspective,* 9 EMORY INT'L L. REV. 71 (1995) (discussing treaty override in the U.S. and concluding that "these provisions embody an important contractual principle": that breach of an obligation is desirable when "what is gained from the party that breaches exceeds what is lost by the party against whom the breach occurred," thus a breach might be appropriate as long as the United States compensates the aggrieved party).

[41] See generally, Elisabeth Owens, *United States Income Tax Treaties: Their Role in Relieving Double Taxation,* 17 RUTGERS L. REV. 428 (1963) (arguing that treaties play a relatively small role in relieving double taxation, owing to the U.S. foreign tax credit); *see also* Tsilly Dagan, *The Tax Treaties Myth,* 32 N.Y.U. J. INT'L L. & POL. 939 (2000) (showing that tax treaties are not needed to relieve double taxation, since each country would find it in its own best interest to unilaterally relieve double taxation on its citizens and residents).

[42] After a brief and limited stint during the civil war, the income tax was re-introduced in 1913. *See* STEVEN R. WEISMAN, THE GREAT TAX WARS 5, 278 (2002). The foreign tax credit was enacted quickly thereafter, in 1918. *See* Revenue Act of 1918, ch. 18. 222(a)(1), 238(a), 240(c), 40 Stat. 1057, 1073, 1080-1082 (1919). Section 222(a)(1) was applicable to individuals, 238(a) to corporations, and 240(c) defined the taxes for which credit would be allowed.

[43] The first U.S. tax treaty was signed with France in 1932 and entered into force on April 9, 1935. Since then, the U.S. tax treaty network has grown by an average of one treaty per year, based on the entry-in-force dates of all U.S. tax treaties ever entered into force. The most recent treaty to enter into force is with Sri Lanka. *See* Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes On Income, Mar. 14, 1985, U.S.-Sri Lanka, TIAS (entered into force Jun. 13, 2004). The most recently signed is with Bangladesh, which was signed on September 26, 2004 but has

One of the original reasons to enter into treaties was that before they existed, there was no international standard for relieving double taxation: the U.S. was alone in providing a comprehensive foreign tax credit that unilaterally relieved residence-based taxation.[44] The effect of unilateral relief of double taxation was seen as a "present of revenue to other countries," for whom the possibility of source-based taxation was preserved.[45] In stark contrast, Britain imposed worldwide taxation and provided a foreign tax credit that was extremely limited and generally preserved its residence-based taxation.[46] Other European nations, especially Italy and France, relied heavily on source-based taxation and therefore vigorously defended the U.S. position of ceding residence-based taxation to that of source.[47]

The conflicting views of the U.S. and the U.K. about the proper method for relieving double taxation prompted several years of debate out of which a consensus finally emerged.[48] Under this consensus, "personal taxation"

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not yet entered into force. *See* Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes On Income, Sept. 26, U.S.-Bangl., TIAS; *see also* Muhammad Kibria, *Bangladesh, United States Sign Tax Treaty,* 2004 WTD 188-3 (Sep. 28, 2004).

[44] H. David Rosenbloom & Stanley I. Langbein, *United States Tax Treaty Policy: An Overview,* 19 COL. J. TRANSN'L. L. 359 (1981); Michael J. Graetz & Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation,* 46 DUKE L. J. 1021, 1023 (1997).

[45] Edwin R. A. Seligman, *Double Taxation and International Fiscal Cooperation,* 133-35 n.10 (1928). Source-based taxation was even enhanced to the extent the foreign country's tax rates were lower than that of the U.S. In such cases, foreign countries could raise their tax rates to the U.S. level with the assurance that these taxes would be creditable in the U.S., leaving the investor indifferent as to the higher foreign rate. *See* Richard E. Caves, MULTINATIONAL ENTERPRISE AND ECONOMIC ANALYSIS 190 (1996) ("Neutrality depends on who pays what tax, not which government collects it.").

[46] Britain's view was supported by the Netherlands. Both countries were primarily capital-exporting nations, and thus the importance of preserving residence-based taxation was high. The U.S. was also a capital-exporting nation at the time, but favored the primacy of source-based taxation. Graetz & O'Hear, *supra* note 44.

[47] *Id*.

[48] Discussions began in the newly formed International Chamber of Commerce in 1920. In 1921 the ICC adopted a resolution that taxing jurisdiction turned on the nature of the tax, with distinctions being made between "super" and "normal" taxes. However, the U.S. rejected this resolution and endorsed closer adherence to the U.S. system, with exceptions made for particular kinds of income, including that from international shipping (as to which residence-based taxation was to be preserved) and that from sales of manufactured goods (to be apportioned under formula). The ICC synthesized the views of the U.S. and fourteen other countries and produced a new resolution in Rome, in 1923. The League of Nations began to take over the discussions in 1923, using the Rome resolutions as a basis for discussion. The compromise of the ICC as to "super" and

was to be preserved for residence-based taxation, and "impersonal taxation" was to be preserved for source. How these terms would be defined and implemented in the context of the then vastly differing tax systems depended on long and contentious negotiations, held under the auspices of the League of Nations, in which the U.S. played a large part.[49]

Ultimately, the League of Nations promulgated a model tax treaty under which countries would reciprocally restrict source-based taxation of passive income items such as dividends and interest, in favor of preserving residence jurisdiction over these items,[50] and reciprocally relieve residence-based taxation on foreign-source business income, as had been done unilaterally by the U.S. through the foreign tax credit.[51] Thus, through tax treaties, the U.S. retreated from its position of unilaterally providing foreign tax credits. The tax concessions thereby obtained from treaty partners reduced the revenue cost of the foreign tax credit, in accordance with the main goal of U.S involvement in first negotiating these instruments.[52]

The concepts embodied in the League of Nations model treaty evolved into a model treaty developed by the OECD in 1963 and updated periodically since then (the OECD Model).[53] The OECD Model has become the standard upon which most of the over 2,000 tax treaties currently in force are based.[54] Following the League of Nations and OECD standards, tax treaties minimize source-based taxation of income derived from passive investment activity, such as dividends, interest and royalties, and preserve residence-based taxation of these items. Once activities

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"normal" taxes resurfaced in League of Nations discussions. Graetz & O'Hear, *supra* note 44, at 1067-1070.

[49] Graetz & O'Hear, *supra* note 44.

[50] *Id*, at 1086-1087 (citing Britain's strong role in producing this result); Avi-Yonah (1996), *supra* note 25, at 1306.

[51] Graetz & O'Hear, *supra* note 44, at 1023. The League of Nations first produced a model treaty in 1928.

[52] Mitchell B. Carroll, *International Tax Law: Benefits for American Investors and Enterprises Abroad,* 2 Int'l L. 692, 693-694 (1968) ("the American involvement was motivated by a desire to reduce foreign taxes on American business so as to reduce the costs of the foreign tax credit").

[53] The OECD Model was itself based on a series of model treaties promulgated by the League of Nations. It has since been updated several times to cope with the changing nature of business, culminating with the most recent update in 2003. Unless otherwise noted, references in this article to the OECD Model refer to the 2003 version, which is available at www.oecd.org.

[54] Compiled from Ernst & Young, *supra* note 36, and the Tax Analysts Worldwide Tax Treaties database, as of February, 2005, available in Lexis Nexis.

increase to a sufficiently significant level of engagement, however, source-based jurisdiction again takes precedence.[55]

As a member of the OECD, the U.S. participated in the development of the OECD model, but also developed its own model to reflect specific policies (the US Model).[56] First published in 1977 and most recently updated in 1996, the US Model is based on the OECD Model in most respects.[57] One notable difference between the models is the OECD Model's allowance of the alleviation of double taxation either via a foreign tax credit or by providing that the residence country will exempt the income earned in the source country (known as exemption).[58] The US Model allows only the credit method, in keeping with its historical preference to impose worldwide taxation and alleviate double taxation via the foreign tax credit mechanism.[59] All modern U.S. tax treaties are based on the U.S. Model, with modifications made to reflect changes in law or policy since the release of the latest model.[60]

Worldwide income taxation is typically justified on the grounds that it promotes capital export neutrality (CEN), an efficiency principle under which taxpayers will not differentiate between locating activities domestically or abroad on tax grounds, since in either case the income generally will be subject to tax at the same rate. [61] Thus, if taxation is

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[55] The required level of engagement is defined as a "permanent establishment" as discussed *infra*.

[56] Treasury Department Technical Explanation of the United States Model Income Tax Convention (September 20, 1996).

[57] The Joint Committee on Taxation compares provisions of both the US and OECD models when analyzing and describing new tax treaties entered into by the U.S.. *See, e.g.*, Testimony of the Staff of the Joint Committee on Taxation Before the Senate Committee on Foreign Relations Hearing on the Proposed Tax Treaties with Japan and Sri Lanka (JCX-13-04), February 23, 2004 (explaining the use of the U.S. and OECD models in treaty negotiations and describing ways in which the new Japan-U.S. Treaty deviates from the U.S. and OECD models).

[58] OECD Model, Art. 23A (exemption method) and B (credit method). For example, among OECD countries, Belgium, Denmark, Finland, Germany, and Poland have treaties in which they completely relinquish their residual taxation of income derived by a permanent establishment. Ernst & Young, *supra* note 36. For a recent example, see Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, Dec. 18, 1996, Belg.-Ecuador, U.N.T.S. (entered into force Mar. 18, 2004).

[59] *See generally* Graetz & O'Hear, *supra* note 44.

[60] A revised U.S. Model is apparently forthcoming from Treasury. It was originally scheduled for release in December, 2004.

[61] Capital export neutrality and its converse, capital import neutrality, discussed *infra,* were first developed by Peggy Musgrave in 1969 and they have been vigorously analyzed and debated ever since. Peggy Musgrave, *United States Taxation of Foreign Investment*

imposed by a source country, the U.S. as home country generally provides an offsetting tax credit against the U.S. tax imposed on the same item of income, leaving the U.S investor in the same tax position as if the investment had been subject only to domestic tax.[62]

However, most countries, including the United States, do not completely adhere to CEN principles. Because the U.S. generally does not tax the foreign income of foreign companies, it is a relatively simple matter to avoid U.S. tax on much foreign income by placing the income stream in a foreign entity.[63] In so doing, U.S. persons may defer U.S. taxation until the foreign earnings are repatriated in the form of dividends or capital gains.[64]

Income: Issues and Arguments (1969). For an overview of these norms, and an argument that capital export neutrality is generally the best principle for international taxation of both portfolio and direct investment, *see* Avi-Yonah (2000), *supra* note 158, at 1604. *See also* Caves, *supra* note 45 (Stating that all relevant taxes taken together are neutral if domestic and overseas investments that earn the same pre-tax return also yield the same after-tax return); STAFF OF JOINT COMM. ON TAXATION, 108TH CONG., BACKGROUND MATERIALS ON BUSINESS TAX ISSUES PREPARED FOR THE HOUSE COMMITTEE ON WAYS AND MEANS TAX POLICY DISCUSSION SERIES 53-54 (Comm. Print 2002) (arguing that a worldwide tax system promotes economic efficiency, because investment location decisions will be governed by business considerations rather than tax considerations, and equity, because domestic and multinational activities are treated alike, and suggesting that worldwide taxation in some form is requisite to preserve the tax base from erosion by flight of activities to tax havens.) A third norm, national neutrality, designates foreign taxes as a cost of doing business abroad, thereby indicating only a deduction for such taxes in the home country. Consequently, under national neutrality, taxpayers are discouraged from engaging in foreign activities. Only a few countries, such as Guinea and Mauritania, base their tax systems on national neutrality; others such as France and many of its former African colonies including Cameroon, Cote d'Ivoire, the French-controlled Congo, Gabon, and Senegal, as well as the Czech Republic and Hong Kong allow only a deduction for certain taxes paid but provide for a foreign tax credit for such taxes under treaty. *See generally* Ernst & Young, *supra* note 36.

[62] If tax credits perfectly offset foreign taxes paid, the taxpayer is indifferent to the allocation of the tax. *See* Caves, *supra* note 45. Most foreign tax credit systems are not perfectly offsetting but impose limitations as to creditability of taxes based on type or source of income and amount paid relative to domestic tax otherwise imposed. In the U.S., foreign taxes are currently segregated among several baskets according to the type of income that gave rise to the tax for purposes of applying a limit on the allowable tax credit. IRC §§ 901-904. As a result, pooling of income from low-tax countries may be advantageous to taxpayers who have paid foreign taxes in excess of the allowable tax credit. *See, e.g.*, David R. Tillinghast, *Tax Treaty Issues,* 50 U. MIAMI L. REV. 455 (1996), Michael J. Graetz, *Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies,* 26 BROOK. J. INT'L L. 1357, 1360 (2001).

[63] *See, e.g.*, Julie A. Roin, *United They Stand, Divided They Fall: Public Choice Theory and the Tax Code,* 74 CORNELL L. REV. 62, 113 (1988) (discussing the ease of avoiding U.S. tax through foreign entities); Avi-Yonah (1996), *supra* note 25, at 1324 (arguing that as a result of the distinction between foreign and domestic companies in IRC

Deferral of this kind is the equivalent of a statutorily optional exemption of foreign income from U.S. taxation, as U.S. tax can be suspended indefinitely, according to the needs and desires of the shareholders.[65] Thus deferral allows taxpayers to convert U.S. residence-based taxation to source-based taxation when it suits their purposes.[66] To protect revenues, the U.S. has responded with a series of anti-deferral rules to prevent the easy escape of capital.[67] To date, these anti-deferral measures have largely

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7701(a)(4) and (5) and the ensuing difference in taxation under IRC §§ 11(d), 881, and 882, "taxpayers can easily choose between classification as foreign or domestic according to the formal jurisdiction of their incorporation).

[64] Deferral is limited to some extent, as discussed infra, at Part III.B. However, a U.S. person that earns active foreign income through a foreign corporation is generally not subject to U.S. tax until profits are repatriated as a dividend or the stock is sold, under the rules of Subpart F, §§ 951 et seq.

[65] To allow deferral is therefore to provide incentives for active business operations to be located outside of the U.S., in low-tax jurisdictions. Robert J. Peroni, *Back to the Future: A Path to Progressive Reform of the U.S. International Income Tax Rules,* 51 U. MIAMI L. REV. 975, 987 (1997) (arguing that deferral "undercuts the fairness and efficiency of the U.S. tax system" by allowing profits earned overseas in low-tax jurisdictions to escape tax while equivalent domestic activities would be subject to tax). As a tax expenditure that costs the U.S. approximately $7.5 billion per year, deferral may be viewed as a subsidy, or tax incentive, for foreign business activities. *See Analytical Perspectives, Budget of the United States Government, Fiscal Year 2*005 287 (U.S. Government Printing office, 2004) available at http://www.whitehouse.gov/omb/budget/fy2005/. Capital gains may be avoidable in the context of a conversion or liquidation of a subsidiary. *See Dover v. Commissioner,* 122 T.C. No. 19 (2004) (allowing the conversion of a foreign corporate subsidiary to disregarded entity status to avoid creation of subpart F income on its subsequent sale), however, the IRS disagrees with this conclusion. *See* CCA 199937038 (June 28, 1999) (holding that proceeds from sale of subsidiary after change in classification to disregarded entity did not escape subpart F) ; FSA 200049002 (August 4, 2000) (same) and FSA 200046008 (August 4, 2000) (same, with sale made to related party).

[66] *See* Peroni (1997), *supra* note 65.

[67] *See, e.g.*, S. Rep. No. 313, 99th Cong., 2d Sess. 651 (1986) ("it is generally appropriate to impose current U.S. tax on easily movable income earned through a controlled foreign corporations since there is likely to be limited economic reason for the U.S. person's use of the foreign corporation"). In practice, current taxation applies to a significantly lesser extent than is contemplated under the subpart F rules, as these rules are apparently "not fully effective in meeting their objectives." Rosanne Altshuler, Harry Grubert & T. Scott Newlon, *Has U.S. Investment Abroad Become More Sensitive to Tax Rates?* in INTERNATIONAL TAXATION AND MULTINATIONAL ACTIVITY 9, 22, 28 (James R. Hines, Jr., ed., Univ. of Chicago Pr. 2001) (Less than 50% of after-tax income of subsidiaries located in three Caribbean tax havens was subject to current tax under subpart F); *see also* Robert J. Peroni, Clifton Fleming, Jr. & Stephen E. Shay, *Getting Serious about Curtailing Deferral of U.S. Tax on Foreign Source Income,* 52 S. METH. UNIV. L. REV. 455, 464 (1999) ("anti-deferral provisions can be readily circumvented"). For a

been restricted to passive income items, so that deferral is still available in the case of active income (residual taxation of which the U.S. might forego, under the foreign tax credit, if foreign taxes are in fact imposed).

Nevertheless, the concept of residence-based jurisdiction is the default system of most developed countries, and the protection of residence-based taxation was (and is) therefore given as a reason—perhaps the primary reason—for entering into tax treaties. The OECD Model, as the baseline for the majority of the world's tax treaties, thus represents an international consensus that the appropriate jurisdiction to tax income arising from cross-border activity is primarily that based on residence.[68] However, there are several limitations to the reach of this consensus.

C. Limitations on Use of Treaties as International Tax Law

1. *Limited Coverage, Scope, and Uniformity*

Not all countries have tax treaties, and no country has tax treaties with all the other countries of the world. The average individual tax treaty network comprises just 17 treaty partners, and over half of all countries have tax treaty networks of five or fewer treaty partners.[69] In addition, the benefits of treaties are often limited to activities conducted between the two signatory countries.[70] As a result, there would have to be over 32,000 bilateral tax treaties to cover every possible cross-border transaction.[71] The U.S. would have to enter into new treaties with over 190 countries to ensure

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discussion of the deferral privilege and its inconsistency with U.S. international tax principles including the norm of capital export neutrality, *see* Peroni (1997), *supra* note 65.

[68] Avi-Yonah (1996), *supra* note 25, at 1303 (stating that a "coherent international tax regime exists that enjoys nearly universal support"); Reuven Avi Yonah, *International Taxation of Electronic Commerce,* 52 TAX L. REV. 507 (1999) (arguing that the worldwide network of tax treaties constitutes an international tax regime with definable, common principles).

[69] About 30% of countries have no tax treaties in force. For the 35 countries considered by the U.S to be developed, the average network is about 49 treaties; for OECD countries, the average is 60. For less developed countries, the average is 8. Compiled from Ernst & Young, *supra* note 36, and the Tax Analysts Worldwide Tax Treaties database, as of February, 2005, available in LexisNexis.

[70] This is almost universally true when the U.S. is a party. *See* U.S. Model, Art. 22.

[71] This figure is based on the assumption that there are approximately 255 independent nations in the world today—a figure that is an estimate because sovereignty of nations is a matter of foreign policy that varies from nation to nation. (A currently prominent example is the case of Taiwan. *See, e.g.*, *Chen Redux: Inside the Rhetoric, There are Hints of a Thaw all round,* THE ECONOMIST, May 22, 2004, at 37 (discussing China's tight grip and world response); *see also* WORLD FACTBOOK 2004, *supra* note 1 (country data on Taiwan, *at* http://www.cia.gov/cia/publications/factbook/geos/tw.html.)

that its coverage spanned the globe. At its current average rate of expansion of one new treaty per year since its first treaty was signed with France in 1935, the prospect of completing the U.S. tax treaty network in a timely fashion appears slight.[72]

In addition, the OECD Model is aimed at only income taxation, to the exclusion of other kinds of taxes, such as consumption and trade taxes.[73] Thus the term "double taxation" refers more particularly to double income taxation, and the term "relief of double taxation" refers particularly to the alleviation of circumstances in which two countries assert income taxation on the same item of income. [74] Yet, there are a number of other taxes applied on businesses and individuals. Increasingly prominent throughout the world are consumption taxes, and, in developed countries, social security and other payroll taxes. As these taxes increase in application, tax treaties may cover a shrinking portion of revenues collected by countries.

Finally, as contracts forged through negotiation, individual treaties deviate to various degrees from the standards set in the OECD Model.[75]

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[72] Compiled from first entry-in-force dates of all U.S. tax treaties ever in force.

[73] For reasons owing to historical distinctions that may be less clear today, income taxes have generally been attended to in tax treaties, while trade taxes are addressed in trade agreements. *See generally* Paul R. McDaniel, *Trade and Taxation,* 26 BROOK. J. INT'L L. 1621 (2001); Reuven S. Avi-Yonah & Joel Slemrod, *Treating Tax Issues Through Trade Regimes,* 26 BROOK. J. INT'L L. 1683 (2001); and Alvin C. Warren, *Income Tax Discrimination Against International Commerce,* 54 TAX L. REV.131 (2001).

[74] The OECD Model describes double taxation as "the imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same subject-matter and for identical periods." OECD COMMITTEE ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL 7 (Jan. 28, 2003).

[75] Even if their language is similar or identical, tax treaties may also vary due to differing interpretations under the domestic law of each country, or, in the case of U.S. treaties, pursuant to the agreement of the competent authorities. This is authorized under Art. 3, para. 2 of the OECD, US, and UN Models, which states that any term not defined in the treaty is defined under the laws of each country as of the time the treaty is applied—i.e., "internal law, as periodically amended." Postlewaite & Makarski, *supra* note 40, at 741 (adding that "[w]hen countries take different approaches to treaty interpretation, serious consequences may result, such as double taxation or the avoidance of any taxation."). The US Model adds, "or the competent authorities agree to a common meaning pursuant to the provisions of Article 25 (the Mutual Agreement Procedure)." Variation among treaties is also authorized under Art. 25 of the OECD, US, and UN Models, which states that the competent authorities "shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application" of the treaty, and that the competent authorities "may also consult together for the elimination of double taxation in cases not provided for" in the treaty. The US Model adds that the "competent authorities also may agree to increases in any specific amounts …to reflect economic or monetary developments." US Model, Art. 25, para. 4. Finally, treaties may deviate from the international consensus even if they closely follow the model treaties due to periodic

Treaties among OECD member countries generally adhere to the pattern and main provisions of the OECD Model.[76] However, treaties between developed and less-developed countries often contain non-standard provisions. These provisions generally derive from a third model tax convention, first promulgated by the United Nations in 1980 (the UN Model). The UN Model was the product of a series of discussions and meetings of an Ad Hoc Group of Experts formed in 1967[77] to address concerns that the OECD Model (and, by association, the US Model) was not appropriate for tax treaties involving non-reciprocal cross border activity.[78]

2. *Assumption of Reciprocal Activity*

The US and OECD Models are directed at and work most effectively between two nations that export capital and transfer services in roughly reciprocal amounts. When treaty countries export and import capital to each other, each acts as a source country to investors from the other. Under these circumstances, tax treaties coordinate taxation without necessarily causing an imbalance in revenue allocation between the two countries: revenues given up by countries in their "source" role are recouped in their

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updates to the models and commentary thereto. For example, recent revisions to the OECD Model commentary with respect to the definition of a permanent establishment potentially broadens the scope of such provisions and may ultimately lead to a revision of Article 5 of the OECD Model. *See, e.g.*, Richard M. Hammer, *The Continuing Saga of the PE: Will the OECD Ever Get it Right?* 33 TAX MGMT. INT'L J. 472 (August 13, 2004) (suggesting that the current commentary should be revised because it is "murky and ambiguous," and arguing for the incorporation of a clear de minimum rule in the OECD Model itself).

[76] *See* OECD COMMITTEE ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL 10 (Jan. 28, 2003). However, improvements and advances in international business and tax practices contribute to increased deviation even among OECD countries. Recently, so-called "double non-taxation" provisions have been introduced in new treaties. These provisions directly contravene existing OECD provisions. *See, e.g.*, Michael Lang, *General Report,* in DOUBLE NON-TAXATION, CAHIERS DE DROIT FISCAL INTERNATIONAL vol. 89a (International Fiscal Assoc., 2004), at 77.

[77] The Group of Experts included members from Latin American, North American, African, Asian and European countries. The group also had observers from the IMF, the International Fiscal Association, the OECD, the Organization of American States, and the International Chamber of Commerce. UNITED NATIONS DEPT. OF ECONOMIC AND SOCIAL AFFAIRS, UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES vii (2001).

[78] See United Nations Dept. of Economic and Social Affairs (2001), *supra* note 34, at viii; Mutén, *supra* note 284 at 3.

"residence" role.[79] Consequently, such treaties are expected to have little revenue effect on either country.[80]

If instead the flow of capital moves primarily from one country to another, reciprocity is lost. One country becomes primarily the source, or source country, while the other becomes primarily the residence, or home country. Because LDCs are typically capital importing countries, their primary role under tax treaties is as source country.[81] Residence jurisdiction will therefore be minimally exercised by LDCs.[82] In such

[79] For example, while the U.S. may give up revenue by refraining from taxing dividends paid to foreign persons under a treaty, it recoups the loss by collecting the full tax on dividends paid by the foreign country to U.S. residents (without reduction under the foreign tax credit provisions, since under the treaty, the foreign country doesn't tax the dividend).

[80] *See, e.g.*, STAFF OF THE SENATE FOREIGN REL. COMM., 105TH CONG., REPORT ON THE TAX CONVENTION WITH IRELAND 17 (Comm. Print 1997) ("the proposed treaty is estimated to cause a negligible change in … Federal budget receipts"); STAFF OF THE SENATE FOREIGN REL. COMM., 108TH CONG., REPORT ON THE TAX CONVENTION WITH THE UNITED KINGDOM 16, 17 (Comm. Print 2003) (same). The balance apparently holds even in the case of complete exemption of source-country taxation. See, e.g., STAFF OF THE JOINT COMM ON TAXATION, 108TH CONG., EXPLANATION OF PROPOSED PROTOCOL TO THE INCOME TAX TREATY BETWEEN THE UNITED STATES AND AUSTRALIA (Comm. Print 2003) (suggesting that the new zero-rate for tax on direct dividends would provide "immediate and direct benefits to the United States as both an importer and an exporter of capital," and that "[t]he overall revenue impact of this provision is unclear, as the direct revenue loss to the United States as a source country would be offset in whole or in part by a revenue gain as a residence country from reduced foreign tax credit claims with respect to Australian taxes.").

[81] The flow of capital between the U.S. and an LDC typically originates from the former and flows to the latter, although this is less true with respect to the "advanced developing" countries, Hong Kong, Korea, Singapore, Taiwan, and Brazil. *See, e.g.*, Yoram Margalioth, *Tax Competition, Foreign Direct Investments and Growth: Using The Tax System to Promote Developing Countries,* 23 VA. TAX REV. 161, 198 (2003) (LDCs are generally not typical destinations for portfolio investment); *see also* Statement of Leslie B. Samuels, *supra* note 5 (capital flows are typically nonreciprocal between the U.S. and LDCs). Most multinationals are resident of developed countries. Of the top 100 multinational companies (as measured by foreign assets), just five are resident in LDCs (Hong Kong, Korea, Malaysia, Mexico, and Venezuela). UNCTAD, *The Top 100 TNCs, Ranked By Foreign Assets,* 2000, 01/09/02 (WIR/2002/TNCs), available at http://www.unctad.org/Templates/Page.asp?intItemID=2443&lang=1. Of the top fifty multinational companies from developing economies, none are based in the LDCs of Sub-Saharan Africa. UNCTAD, *The Top 50 TNCs from developing economies, ranked by foreign assets, 2000*, 01/09/02 (WIR/2002/TNCs), available at http://www.unctad.org/Templates/Page.asp?intItemID=2443&lang=1.

[82] It may be minimally exercised even in the absence of treaties, since few LDCs in Sub-Saharan Africa assert worldwide taxation on their residents. Among the exceptions are Angola, Ethiopia, Lesotho, Mauritius, Mozambique, Nigeria, Tanzania, and Uganda.

cases, a tax treaty shifts tax revenues inversely to the flow of capital. As a result, LDCs may contract their taxing jurisdiction under tax treaties without realizing any benefit from the corresponding contraction by the partner country.

Non-reciprocal contraction by the LDC occurs in the context of portfolio investment as its role as the source country requires it to reduce its tax rates on dividends, interest, and royalties, while the residence country preserves the right to impose full taxation on these items. Non-reciprocal contraction also occurs in the context of active business income, as threshold rules for taxing business income prevent source-country taxation of certain activities, such as storing and displaying goods or building and construction activities.[83] These threshold rules are embodied in the concept of the "permanent establishment."

The permanent establishment rules are found in Article 5 of each of the US, OECD, and UN model treaties. Under these rules, the source country agrees to refrain from taxing business income unless it is attributable to business activities that meet physical presence requirements, and even then, in some cases, only if the activities are conducted for a given duration or rise to a substantial enough level. Accordingly, under the US and OECD Models, a permanent establishment is generally deemed to exist and therefore create taxing jurisdiction if business activities are conducted through a fixed place of business and consist of more than "peripheral or ancillary activities," but certain activities such as building and construction must last more than a year.[84]

Responding to the non-reciprocal aspects of relationships between developed and less developed countries, the UN Group of Experts sought to preserve source country taxation in tax treaties in its Model. Thus, the UN Model provides for lower thresholds by shortening the duration and including certain activities not included in the OECD and US Models.[85] For

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Ernst & Young, *supra* note 36. Ghana, the subject of the case study presented in Part III of this Article, generally exercises territorial taxation but imposes tax on certain repatriated earnings. *See* Republic of Ghana, Internal Revenue Act of 2000 (G.I.R.A.) § 6 (residents' assessable income includes that "accruing in, derived from, brought into, or received in Ghana").

[83] See US, OECD, and UN Models, Art. 5.

[84] See US Models, Art. 5, Sec. 3. Peripheral and ancillary activities include exploratory or preparatory functions such as research and development, as well as activities considered incidental to the economic source of the income, such as storage, display, or delivery of goods. The US Model is virtually identical to the OECD Model.

[85] It otherwise adheres in large part to the OECD Model, and the two have become closer. Indeed, the relevance of the UN Model has diminished significantly and it may be seen as irrelevant to the extent developed countries agree to higher source-based tax in their

example, under the UN Model, a permanent establishment may arise after a duration of as low as six months for certain activities,[86] fewer ancillary activities are excluded,[87] and more income is attributed to permanent establishments via a force of attraction rule.[88] Nevertheless the UN Model limits source-country taxation in its use of the permanent establishment concept: in the absence of the treaty, the source country would typically provide little or no threshold to taxation.[89]

In addition, the UN Group of Experts determined that in treaties between developed and less developed countries, higher source-based taxation of passive items would be appropriate. Just how high, however, has not been determined. While the OECD Model provides recommended maximum source country tax rates for dividends (5 and 15%, for direct and regular dividends, respectively), interest (10%), and royalties (zero),[90] and

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tax treaties, which they have done to a significant extent. *See, e.g.*, John F. Avery Jones, *Are Tax Treaties Necessary?* 53 TAX L. REV. 1, 2 (1999) ("there seems to be little need for a separate model for developing countries").

[86] UN Model, Art. 5, para. 3. In paragraph 3(a), building and construction activities and related supervisory activities are a permanent establishment if they last more than six contiguous months; in paragraph 3(b), consulting services are a permanent establishment if such services continue for a cumulative (even if non-contiguous) six months. In the OECD model, building and construction activities must continue for more than twelve months to constitute a permanent establishment, related supervisory activities are not included, and there is no parallel provision regarding consulting services. For a comparison of the OECD and UN Model permanent establishment provisions, *see* Bart Kosters, *The UN Model Convention and Its Recent Developments,* ASIA-PACIFIC TAX BULLETIN January/February 2004, *at* http://unpan1.un.org/intradoc/groups/public/documents/other/unpan014878.pdf.

[87] For example, in the OECD and US Models, the use of facilities or maintenance of a stock of goods for delivery is specifically excluded from the definition of permanent establishment, while in the UN Model it is not. Compare US and OECD models, Art. 5 para. 4 and UN Model Art. 5, para. 4.

[88] The OECD and US Models provides source-country taxation only of profits that are attributable to the permanent establishment. The UN Model includes profits attributable to the sale of the same or similar goods or merchandise as those sold through the permanent establishment and profits from the same or similar business activities as those conducted through the permanent establishment. Compare US and OECD models, Art. 7 para. 1 and UN Model Art. 7, para. 1.

[89] For an argument that thresholds are appropriate, should be used even in the absence of a treaty, and should be made more uniform (in the current models, there are different thresholds for different activities), see Brian J. Arnold, *Threshold Requirements for Taxing Business Profits Under Tax Treaties*, *in* THE TAXATION OF BUSINESS PROFITS UNDER TAX TREATIES 55 (Brian J. Arnold, Jacques Sasseville, and Eric M. Zolt, eds. 2003). The permanent establishment concept has been revised and updated to adapt to changes in business and technology over the years, but remains consistent with the original version introduced in the first OECD Model (1963).

[90] See OECD Model, Art, 10, 11, and 12, respectively.

the US Model looks virtually identical (but provides zero source-country taxation of interest), the UN Model leaves the source country taxation of these items to be established through bilateral negotiations. The UN Model thus implies that higher tax rates are appropriate in tax treaties with LDCs, but declines to recommend exactly what rate is appropriate.[91]

The UN Model provisions and concepts have been used frequently in U.S. tax treaties with developed as well as less developed countries over the years.[92] For example, the U.S. income tax treaties with the Barbados, Canada, China, Cyprus, Egypt, Estonia, India, Indonesia, Jamaica, Kazakhstan, Korea, Latvia, Lithuania, Mexico, Morocco, the Philippines, Thailand, Tunisia, Turkey, the Ukraine, and Venezuela, each provide for lower permanent establishment duration requirements, narrower definitions of ancillary and preparatory activities, higher source-country tax rates on passive income items, or a combination of these features.

The consequence of preserving source-country taxation to overcome non-reciprocal capital flows, however, is that it undermines the relief of double taxation ostensibly sought as the primary purpose for entering into the treaty in the first place. This has been a problematic area, for it appears to drafters and negotiators of tax treaties and treaty models to be indeterminable whether it is better for LDCs to preserve source-country taxation so as to collect the maximum amount of revenues, or to relieve source-country taxation so as to attract the maximum amount of foreign investment. Tsilly Dagan eloquently illustrated the conundrum and presented a game theory rationale that explains why many LDCs have opted for the latter.[93] As discussed in Part III, this choice is one of the main reasons tax treaties have become obsolete for many investors in LDCs, yet new U.S. tax treaties with LDCs continue to be sought, and, when concluded, they continue to provide for higher source-country taxes on passive income items, even when the treaty rate exceeds that of the internal laws of the LDC.[94]

The importance of reciprocity as requisite to make a tax treaty appropriate is demonstrated in the current composition of the U.S. tax treaty network. Like all developed countries, reciprocal trade and investment partners are covered by tax treaties: the U.S. has them in place with all of its major trading partners[95] and the bulk of its foreign direct investment sources

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[91] See Arts. 10, 11, and 12 in each model.
[92] Kosters, *supra* note 86, at 9.
[93] *See supra*, note 41.
[94] *See* discussion *infra* at note 134.
[95] Major trade partners include Canada, China, Germany, Japan, Mexico and the UK. World Factbook (2004), *supra* note 1. The most glaring exception in the U.S. tax treaty

and destinations.[96] Yet, with just 55 comprehensive tax treaties covering 62 countries, the U.S. network is comparatively small relative to the other major economics of the world,[97] and it excludes more than 20% of U.S. foreign direct investment.[98] Moreover, just 16 U.S. tax treaties are with LDCs, [99] as compared with an average of 22 in other leading economies.[100] To the extent that tax treaties influence the flow of trade and investment between the U.S. and the rest of the world, they may impact U.S. foreign investment, trade, and aid efforts to LDCs. The following Part explores whether more complete U.S. tax treaty coverage could impact these flows by considering a hypothetical tax treaty with Ghana, an LDC in Sub-Saharan Africa.

III. U.S. TAX TREATIES WITH LDCS: CASE STUDY OF GHANA

This Part presents as a case study a hypothetical tax treaty based on current U.S. tax treaty standards with respect to LDCs. The case study demonstrates that the lack of tax treaties between the U.S. and the LDCs of Sub-Saharan Africa may be explained in large part by the fact that in today's global tax climate, these agreements would not significantly impact the global tax burden currently faced by current or potential international investors. As a result, even if governments commit to concluding them, and even with support from academics, practitioners, and lawmakers, tax

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network is probably Brazil, with whom negotiations have been stalled since 1992. *See infra,* note 302.

[96] The tax treaty network currently covers approximately 78% of U.S. foreign direct investment, as valued at historical cost (book value of U.S. direct investors' equity in and net outstanding loans to foreign affiliates). *See* Maria Borga & Daniel R. Yorgason, *Direct Investment Positions for 2003: Country and Industry Detail* 40, 49 (July, 2004), available at http://www.bea.doc.gov/bea/ARTICLES/2004/07July/0704dip.pdf

[97] In contrast, the U.K. and France each have tax treaties with over 100 countries; Canada and the Netherlands with over 80. Ernst & Young, *supra* note 36, at 129, 250, 612, 938.

[98] *See supra,* note 69.

[99] *See supra,* note 4. When the tax treaty with Sri Lanka (signed in 1985) entered into force in July of 2004, it was the first new country added to the tax treaty network since the treaty with Slovenia entered into force in 2001, and the first new LDC since Venezuela was added in 1999.

[100] 17 of the 30 OECD countries have larger LDCs tax treaty networks. For example, the U.K. and France each have tax treaties with 60 LDCs, Canada has 40, Germany has 36, Norway has 35, and Italy and Sweden each have 32. Compiled from Ernst & Young, *supra* note 36, and the Tax Analysts Worldwide Tax Treaties database, as of February, 2005, available in LexisNexis.

[100] See US Model, Art. 22.

treaties between the U.S. and the LDCs of Sub-Saharan Africa would nevertheless be largely ineffective in stimulating cross-border investment and trade. Section A introduces Ghana as the subject of the case study. Section B outlines the framework of a hypothetical tax treaty between the U.S. and Ghana. Section C discusses the probable impact of the hypothetical tax treaty on the flow of investment and trade between the two countries, and demonstrates that the tax treaty is unlikely to produce significant increases in investment and trade from the U.S. to Ghana.

A. Ghana as the Subject of a Case Study

The pursuit of a tax treaty with Ghana, a nation of 20 million people in West Africa, would support current U.S. commercial and non-commercial interests in this country. Non-commercial interests of the U.S. in Ghana include longstanding diplomatic ties[101] and an interest in fostering economic stability in this region of the world for humanitarian reasons, as well as a recognition that conditions of extreme poverty like those found in Ghana are a potential breeding ground for terrorism.[102]

U.S commercial interests in Ghana include both trade and investment relationships. Several of the largest foreign investments in Ghana are owned by U.S. companies,[103] and U.S. companies continue to express an interest in pursuing business opportunities in this country.[104] U.S.

[101] *See U.S. Department of State, Background Note—Ghana,* available at http://www.state.gov/r/pa/ei/bgn/2860.htm ("The United States has enjoyed good relations with Ghana at the nonofficial, personal level since Ghana's independence. Thousands of Ghanaians have been educated in the United States. Close relations are maintained between educational and scientific institutions, and cultural links, particularly between Ghanaians and African-Americans, are strong.")

[102] Embassy bombings in Kenya and Tanzania in 1998, allegedly linked to the international terrorist organization of al Qaeda, provide perhaps the most illustrative reason for U.S. interests in brokering peace and stability in Sub-Saharan Africa. The U.S. also has interests in Sub-Saharan Africa for social justice reasons, including the extreme poverty faced by a majority of the population in this region. For a discussion of the importance of pursuing tax treaties in response to these issues, *see* Brown, *supra* note 7, at 61.

[103] These include the Volta Aluminum Company, Ltd (Valco), a Ghanaian aluminum manufacturing company that is jointly owned by Kaiser Aluminum Corp (a Texas corporation owning 90%) and Alcoa Inc., (a Pennsylvania corporation owning 10%); Regimanuel Gray, a construction company jointly owned by Regimanuel Ltd. (a Ghanaian company) and Gray Construction (a Texas corporation); and Equatorial Bottlers, a bottling company wholly owned by the Coca Cola Company (a Delaware corporation).

[104] *See, e.g.*, *Newmont to start up in Ghana,* THE DAILY TELEGRAPH (Sydney, Australia), December 22, 2003, Pg. 59 (discussing the purchase by Newmont Mining Corp, a Delaware Corporation, of the Ahafo gold mine in Ghana); Elinor Arbel, *AMR, Pier 1*

investment in and trade with Ghana is facilitated because, as a former colony of the U.K.,[105] Ghana's official language is English,[106] its laws are a blend of customary law and English common law, and its regulatory state derives much from the British system, thus providing a familiar framework for commercial relations.[107]

U.S. trade and aid initiatives specifically identify Ghana as regionally significant to U.S. trade interests due to its central location in an international business corridor that stretches from Nigeria to Côte d'Ivoire.[108] As is the case for most LDCs,[109] the U.S. is one of Ghana's

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Imports, Sun Microsystems: U.S. Equity Movers Final, BLOOMBERG NEWS, August 16, 2004, (discussing plans by Alcoa Inc., a Pennsylvania corporation, to buy and restart an aluminum smelter in Ghana); and G. Pascal Zachary, *Searching for a Dial Tone in Africa,* THE NEW YORK TIMES, July 5, 2003, sec. C., p. 1, col. 2 (quoting a former senior executive of Microsoft who surveyed Ghana as a potential regional hub for an information-technology industry, who stated that Ghana "has the potential to become for Africa what Bangalore became for India," and discussing Rising Data Solutions, a Maryland corporation that recently introduced a call center in Ghana and Affiliated Computer Services, a Dallas company that began doing business in Ghana in 2001 and is looking to expand its operations).

[105] Seventeen LDCs in sub-Saharan Africa are former colonies of the U.K.: Botswana, The Gambia, Ghana, Kenya, Lesotho, Malawi, Mauritius, Nigeria, Seychelles, Sierra Leone, Somalia, Sudan, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe; all but Somalia and Tanzania designate English as their official language; an additional four countries list English among their official languages. *See* World Factbook (2004), *supra* note 1.

[106] The use of English may be an important factor for the foreign investment location decisions of U.S. Multinational firms. *See* Kravis & Lipsey, *The Location of Overseas Production and Production for Export by US Multinational Firms,* NBER Working Paper No. W0482 (August 1982), available at http://ssrn.com/abstract=262704.

[107] U.S. Multinational companies may prefer to invest in countries with which they have "economic, political, language, or cultural ties." John H. Dunning, THE GLOBALIZATION OF BUSINESS 41 (1993) (discussing "geographical clustering" of multinational companies).

[108] 2003 Comprehensive Report on U.S. Trade and Investment Policy Toward Sub-Saharan Africa and Implementation of the African Growth and Opportunity Act 5 (May 2003). Ghana is also poised to be the financial hub of a West African monetary zone (WAMZ) that is expected to be established in July, 2005. *See, e.g.*, Hon. Yaw Osafo-Maafo, Minister of Finance and Economic Planning, *The Budget Statement and Economic Policy of the Government of Ghana for the 2004 Financial Year* (February, 2004), para. 43. When established, the WAMZ will facilitate commerce in the region by introducing a single currency (the ECO) in the Economic Community of West African States (ECOWAS), which includes Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, the Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo. For information on ECOWAS, see the organization's website at http://www.sec.ecowas.int/.

principal trading partners, although U.S. goods comprise a small portion of Ghana's total imports.[110] As a result, like most of the LDCs in Sub-Saharan Africa, Ghana is a relatively untapped market for U.S. exports.[111]

Current trends in U.S. trade and investment interests in Ghana support the notion that increasing investment in this country is a viable goal, and that the goal is being met by current efforts in executing international agreements. For example, U.S. trade with Ghana increased following the enactment and implementation of AGOA.[112] Nevertheless, U.S. investment in Ghana remains relatively slight, by global standards.[113] Low levels of investment in Ghana may be explained by a number of factors including several non-tax barriers to investment. Ghana's low level of infrastructure has been blamed as a major impediment to increased investment.[114]

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[109] The U.S. is a principal export partner to 65% of LDCs, and a principal import partner to 62%. Compiled from WORLD FACTBOOK 2004, *supra* note 1.

[110] *See U.S. Department of State, Ghana Country Commercial Guide FY2002,* available at http://strategis.ic.gc.ca/epic/internet/inimr-ri.nsf/en/gr109073e.html (stating that "in the past, Ghana conducted most of its external trade with Europe, but trade with the United States is becoming increasingly significant"). Ghana's import market is currently dominated by Nigeria (contributing 21% of all imports), followed by the U.K. with 7.2%. Along with the U.S., China, Italy, and Côte d'Ivoire each contribute approximately 6% of total imports. In comparison, the U.S. is currently a principal exporter to 20 other LDCs in Sub-Saharan Africa, contributing over 50% of imports in Namibia, about 30% in Chad and Equatorial Guinea, and about 15% in Eritrea and Angola. World Factbook (2004), *supra* note 1.

[111] As a potential export market, Ghana and other LDCs in Sub-Saharan Africa are also important to the U.S. labor market. See John Cochran, *Bush Visits Africa — But Why Now?,* ABC NEWS REPORT (July 8, 2003), available at http://abcnews.go.com/sections/wnt/World/africa030708_bush.html (over 100,000 U.S. jobs depend on exports to Africa).

[112] Since 2000, when AGOA was first implemented, U.S. exports to Ghana have grown steadily but imports from Ghana have decreased. United States International Trade Commission, U.S. Trade and Investment with Sub-Saharan Africa, available at http://reportweb.usitc.gov/Africa/trade_balance.jsp.

[113] UNCTAD, WORLD INVESTMENT REPORT 14 (2003) (hereinafter, "WIR 2003"), *at* http://www.unctad.org/Templates/Page.asp?intItemID=1465&lang=1.

[114] *See* US. DEPARTMENT OF STATE, GHANA COUNTRY COMMERCIAL GUIDE FY2002, Ch. 7, Part A.1. (stating that infrastructure shortcomings have impeded domestic productivity and discouraged foreign direct investment), *at* http://strategis.ic.gc.ca/epic/internet/inimr-ri.nsf/en/gr109073e.html. Along with the rest of Sub-Saharan Africa, which experienced a large and continuing decline in foreign direct investment (FDI) in tandem with the global financial crisis of the late 1990s, Ghana's share of global foreign investment has dropped significantly over the past few years, and it considered an underperformer with respect to its foreign direct investment potential. Its 40% decline in FDI from 2001 to 2002 mirrors the experience of the continent, to which FDI declined as a whole from $19 billion in 2001 to $11 billion in 2002 (a 41% decline).

Examples of Ghana's infrastructural shortcomings include obvious physical burdens such as poorly maintained roads,[115] interruptions in electricity,[116] a lack of clean water,[117] and a paucity of institutions such as schools and hospitals.[118] Equally problematic are Ghana's excessive administrative requirements and bottlenecks as well as other barriers to the entry and operation of business by foreign persons.[119] For example, Ghana continues to struggle with land and property protection,[120] restricts foreign

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These declines are sharp when compared to that for global FDI, which declined as a whole by 21% in the same period. *See* WIR 2003, *supra* note 113 at 3, 14.

[115] As John Torgbenu, a taxi driver in Accra, describes the multitude of certifications needed to obtain a cab license in Ghana: "the cars must be road-worthy, but the roads need not be car-worthy." See also *Memorandum of Economic and Financial Policies of the Government of Ghana for 2003-05,* March 31, 2003 (MEFP) at para. 8 ("Ghana's basic infrastructure continues to remain in very poor shape. The building of roads, ports, and communication networks…have been driving forces behind the government's efforts to secure a predictable flow of external financing for infrastructure development").

[116] Despite the presence of West Africa's largest hydro-electric plants at Volta Lake in northern Ghana, electricity outages are such a frequent phenomenon that individuals, businesses and institutions that can afford generators have them, and put them to use on a regular basis. Fueling the modernization process is one of the key developments sought in connection with Ghana's requests for IMF funding. *See* MFEP (2003), *supra* note 115.

[117] Ghana is among the majority of LDCs in the world that have not developed an improved water supply. *See* statistics and information gathered by the World Health Organization, *at* http://www.who.int/water_sanitation_health/hygiene/en/.

[118] Low levels of education, literacy, and health care issues are among the institutional issues Ghana faces. *See, e.g.*, George Gyan-Baffour, *The Ghana Poverty Reduction Strategy: Poverty Diagnostics and Components of the Strategy*, *at* http://www.casmsite.org/Documents/Elmina%202003%20-%20Workshop%20-%20Poverty%20Reduction%20-%203.pdf.

[119] Much of these administrative regimes are a lasting legacy of colonization, under which the European nations imposed severe market controls to preserve the resources of their colonies for their exclusive use. *See*, *e.g.*, FRANCIS AGBODEKA, AN ECONOMIC HISTORY OF GHANA 7 – 21 (1992). For an overview of ease of entry issues for LDCs generally, see JEFFREY C. HOOKE, EMERGING MARKETS: A PRACTICAL GUIDE FOR CORPORATIONS, LENDERS, AND INVESTORS (2001), (discussing the entrenched obstacles to entry in LDCs); *see also* Leora Klapper, Luc Laeven & Raghuram Rajan, *Business Environment and Firm Entry: Evidence from International Data,* NBER Working Paper No. 10380 (2004), *at* http://papers.nber.org/papers/w10380.pdf (finding that bureaucratic entry regulations are a significant burden that hampers the entry of firms into foreign markets).

[120] Courts in Ghana are overwhelmed with land disputes. Interview with Kwame Gyan, Law Professor, University of Ghana-Legon, December, 2003 (notes on file with the author.

ownership of real property,[121] and has only recently dismantled regulations that closed several industries to foreign investors all together.[122]

Ghana's current administration has pledged to make significant improvements to its infrastructure, as part of its approach to poverty reduction and economic growth through the building of a business-friendly environment.[123] The reduction of administrative obstacles, combined with greater certainty with regard to the legal and regulatory regime, is credited with a recent surge in foreign investment from South Africa to other countries in Sub-Saharan Africa.[124] It is hoped that this surge will be followed by increased investment from other countries, including the U.S.

An increased share of foreign investment is also expected to lead to spillover effects that would remedy some of the current deficiencies in physical infrastructure. Limited spillover effects have been achieved recently in connection with Ghana's gold mining operations, which have provided funding to improve transportation routes.[125] Similarly, in Nigeria,

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[121] The inability to own land translates to an inability to use land as collateral for financial transactions, which is a key to economic growth. *See* Enrique Gelbard, *Measuring Financial Development in Sub-Saharan Africa* 18, IMF Working Paper # 99/105 (1999), *at* http://ideas.repec.org/p/imf/imfwpa/99105.html.

[122] *See* WIR 2003, *supra* note 113 at 36.

[123] Hon. Yaw Osafo-Maafo, Minister of Finance and Economic Planning, The Budget Statement and Economic Policy of the Government of Ghana for the 2003 Financial Year (November, 2003), para. 22 (pledging the government's "commitment to deliver a macro-economic environment that underpins our strategy for growth and poverty reduction"); Hon. Yaw Osafo-Maafo (2004), *supra* note 108, at para. 4 (pledging to continue to "create an enabling environment for wealth creation). *See also* various documentation in connection with IMF lending, including the MFEP (2003), *supra* note 115.

[124] Nicole Itano, *South African Companies Fill a Void,* THE NEW YORK TIMES, Nov. 4, 2003, at Section W; P. 1, Col. 3 ("It's safer to go in, it's easier to get materials in and out, easier to repatriate your profits," according to Keith Campbell, a managing director of a South African risk management firm, and vice-chairman of the South Africa-Angola Chamber of Commerce). The overhaul of economies has often been initiated by the international lending organizations, which have faced much criticism and been the subject of much debate in the face of the apparent failure of many of their reform efforts. However, the extreme opposite approach, as unfortunately presented in the case of Zimbabwe, illustrates the need for some fundamental certainty in dealing with foreign businesses in order to attract foreign investment and maintain a stable economy.

[125] Ghana's gold mines have recently sparked interest from foreign investors, who will spend millions of dollars to upgrade and develop operations following years of neglect and under-maintenance of these operations, because they expect productivity to increase dramatically and produce significant profit as a result. *See Mr. Jonah goes to Jo'burg,* ECONOMIST, January 15, 2004 (AngloGold (South Africa) expects to spend between $250 and $500 million to upgrade its newly acquired Ghanaian gold mine (Ashanti Goldfields)); *Newmont to go for Ghana Gold,* THE ADVERTISER, Monday, December 22, 2003, Finance section, p. 50. (Newmont (U.S.) plans to spend about $350 million to develop its recently-

one of Ghana's close neighbors, investors in the telecommunications industry funded the installation of communication networks throughout the country.[126] Ghana's growing telecommunications industry may draw like commitments from future investors.[127] However, the components of infrastructure that are not produced by spillover, such as the legal and regulatory framework that protects businesses and creates an environment for growth, must generally be directly supported and funded by the government.[128]

Despite the infrastructural obstacles present in Ghana, U.S. investment in this country continues to grow, albeit slowly. The following section explores whether and how such investment might be affected by a tax treaty between the two countries.

B. Structure of a Tax Treaty between Ghana and the U.S.

As discussed in Part I, the US Model serves as the template for all new tax treaties negotiated by Treasury, though the OECD Model and other recent treaties are also consulted. Thus, in structure and overall content, a tax treaty between the U.S. and Ghana would emulate the model treaties, especially the US Model, to a substantial degree. However, in negotiations

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acquired Ghanaian gold mine (Ahafo)). *See also Big-game Hunting,* ECONOMIST, August 13, 2004; Gargi Chakrabarty, *Newmont OKs Project in Ghana; Gold Producer Invests $350 Million in W. African Mine,* ROCKY MOUNTAIN NEWS (Denver, CO), December 19, 2003; and Gargi Chakrabarty, *Latest Global Hot Spot For Gold Mining: Ghana,* ROCKY MOUNTAIN NEWS (Denver, CO), October 30, 2003, page 1B.

[126] South Africa's Vodacom recently spent $119 million building a cellular network in the Congo, a critically impoverished country that has only recently emerged from devastating civil war. South Africa's MTN Group spent approximately 1.75 billion building cellular networks in five different Sub-Saharan Africa countries ($900 million in Nigeria alone), and experiences a 40% profit margin in these markets—despite having to build power generators to overcome a lack of stable power sources and a transmission network to connect cities and towns across the country—compared to its 30% return at home in South Africa. Nicole Itano, *South African Companies Fill a Void,* THE NEW YORK TIMES, Nov. 4, 2003, at Section W; P. 1, Col. 3.

[127] *See supra,* note 104.

[128] Coercion of various forms may induce companies to provide such infrastructure in the absence of voluntary action. For example, in 2003, foreign workers were kidnapped in Nigeria, in an effort to extract a promise from a foreign company to build a school and a health center. *See Nigeria's oil-rich area mired in poverty,* THE DAILY GRAPHIC (Ghana), December 3, 2003, at p. 5. Clearly no government should be encouraged to rely on these kinds of tactics to build adequate infrastructure, but the fact that citizens of a nation are willing to engage in illegal acts to secure public goods illustrates the tensions and pressures facing both international businesses and the governments struggling to attract such businesses.

with LDCs, Treasury also consults the UN Model.[129] As a result, these treaties usually contain several standard deviations from the US Model, described in reports and technical explanations as "developing-country concessions."[130] They are called concessions because they typically concede U.S. residence-based taxing jurisdiction in favor of greater source-country taxation.[131]

An example of a U.S. treaty with an LDC, as compared to the US Model Treaty, demonstrates the operation of these concessions. At the time it was entered into, the U.S. tax treaty with Jamaica was deemed the "model U.S. treaty for developing countries."[132] At 24 years of age, that treaty is substantially out of date, as many tax laws in the U.S. (and presumably in

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[129] *See supra*, text at note 60, and *see*, *e.g.*, Department of the Treasury Technical Explanation of the Convention Between The Government of the United States of America and the Government of the Democratic Socialist Republic of Sri Lanka for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income Signed at Colombo March 14, 1985, As Amended by a Protocol Signed at Washington on September 20, 2002 ("Negotiations also took into account the [OECD Model], the [UN Model], and recent tax treaties concluded by both countries.)

[130] This designation has been consistently propounded throughout U.S. tax treaty history, and continues virtually unchanged today. For example, compare reports prepared by the Senate Foreign Relations Committee and the Joint Committee on Taxation in connection with the tax treaties with India (1977), the Philippines (1989), and Sri Lanka (2004). *See* STAFF OF THE JOINT COMM. ON TAXATION, 95th CONG., EXPLANATION OF PROPOSED INCOME TAX TREATY BETWEEN THE UNITED STATES AND INDIA (Comm. Print 1977) ("The proposed treaty contains a number of developing country concessions…providing for relatively broad source-basis taxation"); STAFF OF THE SENATE FOREIGN RELATIONS COMM., REPORT ON THE TAX CONVENTION WITH THE REPUBLIC OF INDIA (1989); STAFF OF THE JOINT COMM. ON TAXATION, 108TH CONG., EXPLANATION OF PROPOSED INCOME TAX TREATY BETWEEN THE UNITED STATES AND THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA 3, 64 (Comm. Print 2004) (hereinafter, "EXPLANATION OF SRI LANKA TREATY") (describing these deviations as substantive, and outlining the major provisions).

[131] *Id* at 64. To the extent that source-based taxing jurisdiction is theoretically more justifiable, the term concession is something of a misnomer. See discussion in Part II, Section B. Nevertheless, as much source-based jurisdiction has been ceded in favor of residence-based jurisdiction in the evolution of the model treaties, a reversal of this norm, especially in the case of non-reciprocal capital flows, can in theory shift greater tax revenue collection to the country of source. By so doing, it requires the residence-country to revert to the role of relieving double taxation via the generosity of the foreign tax credit, discussed *supra,* text at note 44. However, the theory that revenues are conceded under these provisions only holds if the source country actually imposes and collects the tax. This is an assumption which cannot be relied upon in today's global economy, as discussed *infra*.

[132] STAFF OF THE JOINT COMM. ON TAXATION, 97TH CONG., EXPLANATION OF JAMAICA TREATY (Comm. Print 1981).

Jamaica) have changed significantly since it entered into force in 1981.[133] However, the principles of enlarging source-country taxation found in the Jamaica-U.S. treaty continue to appear in new tax treaties with other LDCs.[134] Therefore, the following discussion uses the Jamaica-U.S. treaty to model what a Ghana-U.S. tax treaty might look like, if concluded on the basis of precedent.

In the U.S. tax treaty with Jamaica, as in most tax treaties with LDCs, the expectation that non-reciprocal capital flows may negatively impact the LDC is addressed by preserving source-country taxation. This is mainly accomplished through modifications to the articles dealing with the determination of thresholds for taxing income from business activities (the permanent establishment provision) and those dealing with the taxation of passive-type income (dividends, interest, and royalties provisions).[135]

First, under the permanent establishment concept, source-country taxation is enlarged by expanding the definition to allow the LDC to impose taxation on more of the business profits earned by foreign persons in the source country. Thus, in the Jamaica-U.S. treaty, the permanent establishment provision mirrors the structure of the U.S. and OECD Models, but incorporates the UN Model approach, shortening the threshold durational requirement from one year to six months in the case of construction, dredging, drilling, and similar activities.[136] It also provides that the furnishing of services can create a permanent establishment if continued for more than 90 days a year.[137] Finally, it provides that maintaining substantial equipment or machinery in a country for 4 months

[133] Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, May 21, 1980, U.S.-Jam., T.I.A.S. No. 10207, 1982-1 C.B. 257 (entered into force on December 29, 1981).

[134] Evidently in some cases, this is done regardless of the pre-existing legal framework in the LDC. *See* STAFF OF THE JOINT COMM. ON TAX., 108TH CONG., EXPLANATION OF SRI LANKA TREATY, *supra* note 130, at 62 (stating that "it is not clear that …Sri Lankan laws have been fully taken into account" since "[s]everal of the articles of the proposed treaty contain provisions that are less favorable to taxpayers than the corresponding rules of the internal Sri Lankan tax laws").

[135] *See supra*, Part II. Section C.

[136] U.S.-Jamaica, Art. 5, para. 2(i). The activity must continue for "more than 183 days in any 12-month period," and at least 30 days in any given taxable year to constitute a permanent establishment.

[137] U.S.-Jamaica, Art. 5, para 2(j). The services must continue for "more than 90 days in any 12-month period" and at least 30 days in any given taxable year to constitute a permanent establishment.

can constitute a permanent establishment.[138] One or more of these deviations from the US Model are found in most U.S. tax treaties with LDCs.[139] Consequently, similar provisions would likely be suggested, negotiated and agreed to in a Ghana-U.S. tax treaty.

Under the passive income provisions, source-country taxation is enlarged by allowing source-country to impose tax rates on these items of income in excess of the maximum rates provided in the US Model. The US Model allows source country tax rates of no more than 5% on "direct dividends" (those paid to corporate shareholders holding at least 10% of the paying company's stock), 15% on "regular dividends" (all other shareholders), and zero on interest and royalties.[140] In contrast, the Jamaica-U.S. treaty provides for source-country tax rates of 10% on direct dividends,[141] 15% on regular dividends,[142] 12.5% on interest,[143] and 10% on royalties.[144]

Despite the general trend of higher source-country taxation of passive income items in U.S. tax treaties with LDCs, source-country taxation of certain items of passive income have recently been lowered in a number of

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[138] U.S.-Jamaica, Art. 5, para 2(k). The equipment or machinery must be maintained "for a period of more than 120 consecutive days," and at least 30 days in any given taxable year to constitute a permanent establishment.

[139] *See*, *e.g.*, India-U.S., art. 5, para. (j), (k), and (l) (providing for the same concessions as in the Jamaica-U.S. treaty). Similar deviations are also in U.S. tax treaties with other developed countries. *See*, *e.g.*, Canada-U.S., art. 5, para 4 (providing that the use of a drilling rig or ship for more than 3 months in any twelve-month period constitutes a permanent establishment). Since Canada is a developed country, the Senate Report does not mention the UN Model as a source of consultation, and the Joint Committee does not identify the deviation as a concession by the U.S., but rather explains that "[t]he shorter period was included in the treaty at the insistence of Canada which felt that a one-year period was unrealistic, given the adverse conditions of drilling in the Canadian offshore and the fact that the drilling season there is very short." *See* STAFF OF THE SENATE COMM. ON FOR. REL, 96th Cong. (Comm. Print 1980); STAFF OF THE JOINT COMM. ON TAXATION, 96TH CONG., EXPLANATION OF TAX CONVENTION WITH CANADA (Comm. Print 1980). Narrow thresholds continue to appear in newly-signed U.S. tax treaties, such as the one with Bangladesh. *See supra* note 43, at art. 5, para. 3 and 6 (not yet in force).

[140] US Model Arts. 10, 11, and 12. The OECD Model differs from the US Model in that it provides for source-country tax rates of 5% in the case of dividends held by 25% or greater corporate shareholders, 15% in the case of all other dividends, 10% in the case of interest, and zero in the case of royalties. OECD Model Arts. 10, 11, and 12. As discussed in Part II, Section C, the UN Model leaves the maximum tax rate blank, implying that countries should negotiate a higher rate in the case of treaties between developed and less developed countries. UN Model Arts. 10, 11, and 12.

[141] U.S.-Jamaica, Art. 10, para. 2(a).

[142] U.S.-Jamaica, Art. 10, para. 2(b).

[143] U.S.-Jamaica, Art. 11.

[144] U.S.-Jamaica, Art. 12.

U.S. tax treaties, including one with Mexico, an LDC. The U.S. agreed to eliminate source-country taxation on direct dividends paid with respect to stock held by foreign controlling parent companies[145] in a recent protocol to the Mexico-U.S tax treaty.[146] A most-favored nation provision in the original treaty[147] caused the elimination of source-country taxes on these direct dividends when the U.S. negotiated the same provision in recent treaties and protocols with Australia,[148] Japan,[149] and Britain.[150] According to Treasury officials, the elimination of source-country tax on direct dividends earned by foreign controlling companies reduces tax barriers and increases the economic ties between the partner countries.[151] Following the logic of this position, a Ghana-U.S. tax treaty should involve a significant lowering, if not complete elimination, of source-country taxation of dividends. The fact that the U.S. tax treaty with Mexico, an LDC, very

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[145] Those owning at least 80% of the foreign subsidiary's stock.

[146] *See* Second Additional Protocol that Modifies the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Nov. 26, 2002, U.S.-Mex., art. II, TIAS; *see also* Report of the Senate Foreign Relations Committee on the Additional Protocol Modifying the Income Tax Convention with Mexico, S 108-4, Sec. VI, Part A (March 13, 2003) (protocols eliminate tax on certain direct dividends).

[147] *See* Convention for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Income Taxes, Sep. 18, 1992, U.S.-Mex., art. 10, Protocol, art. 8, TIAS ("If the United States agrees in a treaty with another country to impose a lower rate on dividends than the rate specified … both Contracting States shall apply that lower rate instead of the rate specified….").

[148] Protocol Amending the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, May, 2003, U.S.-Austl., art. 6.

[149] Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income Nov. 6, 2003, U.S.-Japan, art 11, TIAS (entered into force July 1, 2004).

[150] Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, Jul. 24, 2001, U.S.-U.K., art. 10, TIAS.

[151] *See* STAFF OF THE SENATE FOREIGN RELATIONS COMM, 108TH CONG., REPORT ON THE CONVENTION WITH JAPAN (Comm. Print 2003) (noting that many bilateral tax treaties to which the United States is not a party eliminate taxes on direct dividends, that the EU's Parent-Subsidiary Directive achieves the same result, and that the United States has signed treaty documents with the U.K. and Australia that include provisions similar to the one in the Mexico protocol); *see also* Treasury Secretary John W. Snow Remarks at the U.S.-Japan Income Tax Treaty Signing Ceremony, November 6, 2003, (stating that the new Japan-U.S. Treaty will significantly reduce existing tax-related barriers to trade and investment between Japan and the United States and will foster closer economic ties between the two countries).

recently adopted this position would seem to support the expectation of a similar provision in a tax treaty with Ghana.

However, the more likely result is that in a Ghana-U.S. tax treaty, source-country tax rates on dividends would be closer to the rates found in the Jamaica treaty than those found in the Mexico treaty.[152] In other recent U.S. tax treaty negotiations with LDCs, none incorporate a zero rate for dividends paid to controlling company shareholders, and all provide for maximum source-country tax rates on passive income items that are higher than those provided in the US Model.[153]

Thus, as in the case of the permanent establishment provisions, the higher source-country rates that are typical in U.S. tax treaties with LDCs would likely be suggested, negotiated and agreed to in a Ghana-U.S. tax treaty.[154] Using the Jamaica-U.S. treaty and other recent treaties with LDCs as a guide, a Ghana-U.S. tax treaty could be expected to provide maximum source-country tax rates of 10% to 15% on direct dividends, 10 to 15% on regular dividends,[155] and 10% on interest and royalties.

The narrower permanent establishment thresholds and higher source-country tax rates are expected in a Ghana-U.S. tax treaty because they continue to appear in other U.S. tax treaties with LDCs. They appear in these treaties because it is believed that they will provide some benefit to the governments of the LDCs entering into these agreements. Yet, the overriding purpose of these treaties is the same as that for treaties

[152] The Mexico treaty now provides for a maximum of 5% source-country taxation on direct dividends, 10% on regular dividends, and zero on direct dividends paid to foreign companies with a controlling interest in the paying company. *See* Mexico Protocol of 2002, *supra* note 146.

[153] *See*, e.g., Sri Lanka-U.S., *supra* note 43, art. 10, 11, and 12 (providing maximum rates of 15% on all dividends, and 10% on interest and royalties); Bangladesh-U.S., supra note 43 (same rates as in Sri Lanka-U.S. treaty). Other than the lower rates on dividends, the Mexico-U.S. treaty is consistent with other tax treaties with LDCs in that it provides for maximum source-country tax rates of 15% on interest and 10% on royalties. *See* Mexico-U.S., *supra* note 147.

[154] *See* the U.S. tax treaties with Greece (a developed country), the former countries of the U.S.S.R. (each a transition country), and Trinidad & Tobago (an LDC), each providing for a maximum 30% source-country tax rate for dividends, and those with Israel (a developed country), India, and the Philippines (each an LDC), providing a maximum 25% rate. The newest U.S. tax treaty, with Sri Lanka (an LDC), provides for a 15% tax rate on all dividends. The Sri Lanka treaty was considered by the Senate in February, 2004 together with the Japan-U.S. Treaty, which provides for zero taxation on certain dividends paid to controlling shareholders. *See* Testimony of the Staff of the Joint Committee on Taxation Before the Senate Committee on Foreign Relations Hearing on the Proposed Tax Treaties with Japan and Sri Lanka, 108th Cong. (2004).

[155] 32 of the U.S. tax treaties currently in force provide a rate of 10% on regular dividends.

exclusively between developed countries: they are supposed to relieve double taxation and therefore increase cross-border investment between the partner countries. The next section explores the extent to which either of these goals are achieved under the hypothetical tax treaty between Ghana and the U.S. described above.

C. Effect of a Ghana-U.S. Tax Treaty on Potential U.S. Investors

Assuming that Ghana is a viable destination for U.S. investment as described above, a tax treaty between these two countries would theoretically complement U.S. investment interests as well as its trade and aid initiatives. However, this section demonstrates that in today's global tax climate, a tax treaty that follows the international standards set forth in the model treaties may be ineffective in achieving its goals. This may occur as a result of several inter-related phenomena.

First, the scope of tax treaties appears to be too narrow in the context of these LDCs. Second, double taxation appears to be disappearing in international transactions involving these LDCs as a result of the widespread reduction in taxation caused by global tax competition and an ever-increasing availability of opportunities to avoid and evade income taxation. Third, there may be little differential between tax treaties and statutory law in the LDCs of Sub-Saharan Africa. Fourth, tax treaties may have little impact on multinational investment behavior in the face of non-tax issues, such as inadequate infrastructure, in LDCs. Finally, tax treaties may offer little more than perception about the commercial and legal climate of a country for foreign investment.

Because of the impact of each of these factors on global commercial activity, a tax treaty between Ghana and the U.S. would yield an insignificant impact on investment and trade between these two countries. Each of these factors, and their effect on the potential impact of a tax treaty, is discussed below.

1. *Non-Comparable Taxation*

The first phenomenon that tends to reduce the potential benefit of a tax treaty between the U.S. and Ghana is the fact that U.S. multinationals are likely to face non-income taxation in Ghana.[156] Like many LDCs, Ghana relies on a broad range of taxes that are not relieved under treaty, including

[156] That is, if they face any taxation at all. *See infra,* section 2.

consumption, excise, and trade taxes.[157] The reliance on trade and excise taxes is historical, arising out of developed country practices that have since been abandoned in developed countries in favor of personal income taxation and, outside of the U.S., consumption taxation in the form of the value added tax (VAT).[158]

Value added taxes are relatively new to LDCs, having been introduced in the 1970s and 1980s, largely as a result of tax reforms initiated by international monetary organizations as a condition of lending.[159] Prior to the introduction of the VAT, many LDCs, including those in Sub-Saharan Africa, historically relied heavily on trade taxes for revenue following the customs of the developed world that were introduced under colonization.[160] The increased focus on the VAT was part of an overall effort to gradually reduce and eventually allow complete elimination of taxes on international trade.[161]

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[157] *See, e.g.*, Guttentag, *supra* note 4, at 452 ("we have noted a trend where developing countries question the desirability of maintaining high source based taxation, but need to find alternative sources of revenue… many of them rely to a lesser extent on OECD type tax systems…instead, there is a greater reliance on value added taxes and asset taxes.").

[158] The shift from trade to income and consumption taxation in the U.S. and other developed countries is discussed in WEISMAN, THE GREAT TAX WARS, *supra* note , at 14, 42, 44; William D. Samson, *History of Taxation,* in THE INTERNATIONAL TAXATION SYSTEM 33–35 (Andrew Lymer & John Hasseldine, Eds., 2002).; and Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1576 (2000).

[159] From 1950, when the VAT in its modern form emerged, until 1980, many countries shifted from consumption taxes to payroll (social security) taxes, and since 1980 many countries have begun to shift from personal income taxes to VAT. Ken Messare, Flip de Kam & Christopher Heady, TAX POLICY: THEORY AND PRACTICE IN OECD COUNTRIES 28 (2003). *See also* Malcolm Gillis, *Tax Reform and Value-Added Tax: Indonesia,* in WORLD TAX REFORM: CASE STUDIES OF DEVELOPED AND DEVELOPING COUNTRIES 227 (Michael Boskin & Charles E. McClure Jr., eds., 1990); Stewart (2003), *supra* note 4 at 169.

[160] Vito Tanzi, *Taxation in Developing Countries,* in TAX SYSTEMS IN NORTH AMERICA AND EUROPEAN COUNTRIES 8-9 (Luigi Bernardi & Jeffrey Owens, eds., 1994) (discussing revenue composition in LDCs). Trade taxes averaged about 27 percent of total revenues from 1994 to 1999 in Sub-Saharan Africa largely, from 5 percent of revenues collected in Angola to 49 percent in Uganda. Scott Riswold, *IMF VAT Policy in Sub-Saharan Africa,* 2003 WTD, Sep. 1, 2003. For a discussion of the impact of colonization on tax systems in LDCs, *see* Stewart (2003), *supra* note 4 at 145.

[161] Such efforts have been encouraged by international monetary organizations such as the International Monetary Fund (IMF) and the World Bank as part of an overall tax reform package introduced in various forms as a condition to ongoing lending arrangements. Stewart (2003), *supra* note 4 at 170.

In Ghana, a 20% VAT was introduced in 1995 and quickly repealed in the face of violent protests.[162] After a lengthy educational campaign, the government reinstated the VAT, this time at 10%, in 1998.[163] Since then, the VAT has not led to a decrease in any other taxes. A decrease in international trade taxes (tariffs) and excise taxes was initially realized soon after introduction of the VAT, but this trend has since reversed itself, and these taxes are currently increasing as a percentage of total revenues collected.[164] Moreover, a temporary rise in corporate income taxation that accompanied the introduction of the VAT appears to have leveled off, and corporate tax rates are currently decreasing.[165] As a result, the introduction of VAT in Ghana has lead to an overall increase in taxes that are not addressed by treaties.[166]

Finally, investors are likely to encounter non-comparable taxation in Ghana as a result of government stake-holding in many formerly state-owned enterprises. For example, cocoa produced in Ghana is not subject to income taxation,[167] but is subject to levy by the Ghana Cocoa Board, a monopsony for the international sale of Ghanaian cocoa products.[168] Similarly, income taxation on Ghanaian mining activities approaches zero,

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[162] *Ghana, Despite Its Successes, Is Swept by Anti-Tax Protests,* THE NEW YORK TIMES, May 23, 1995, sec. A, p. 6, col. 3 (describing VAT-related riot that led to 5 deaths).

[163] Miranda Stewart & Sunita Jogarajan, *The International Monetary Fund and Tax Reform,* 2004 BRITISH TAX REVIEW no. 2, 146, 155 (2004).

[164] The remainder of Ghana's tax revenue derives from excise taxes, mainly on petroleum. Ernest Aryeetey, THE STATE OF THE GHANAIAN ECONOMY IN 2002 26 (2003).

[165] *Id.*

[166] *See* Reuven S. Avi-Yonah, *From Income to Consumption: Some International Implications,* 33 SAN DIEGO L. REV. 1329, 1350 (1996) (theorizing the obsolescence of the U.S. tax treaty network in the event the U.S. adopts a consumption tax and repeals the income tax, since "[f]undamentally, income tax conventions apply to taxes on 'income and capital'"). There are some tax treaties that address consumption taxes, specifically value-added taxes (VAT). However, in most countries, the VAT employed is destination-based, meaning that exports are exempt from VAT and imports are subject to VAT. As a result, double VAT is avoided to a certain extent without need for international agreement (some double taxation will continue to occur to the extent there are varying definitions of exempted and included items). The inconsistency occurs to various degrees in every country that employs a VAT. However, developed countries continue to rely more heavily than LDCs on income taxation, which is relieved by, and therefore necessitates the continued existence of, tax treaties.

[167] G.I.R.A § 11 ("income from cocoa of a cocoa farmer is exempt from tax").

[168] Acting as the intermediary between farmers and the global market, the Ghana Cocoa Board has the "sole responsibility for the sale and export of Ghana cocoa beans," and delivers only a fraction of realized proceeds to farmers, thus imposing a gross basis tax that currently approximates some 33%. *See* Ghana Cocoa Board Prices, *at* http://www.cocobod.gh/GCBP_export_prices.cfm. *See also* Aryeetey, *supra* note 164.

but the government extracts mining profits by owning shares in all mining operations and requiring the payment of dividends on such shares.[169] Thus a focus on the VAT, income, international trade, and excise taxes in Ghana provides only an incomplete picture of the full burden of taxation imposed in this country. As treaties focus only on income taxation, they address taxation in LDCs to a very limited degree.

2. *Decreasing Global Tax Burdens*

As non-comparable taxation increases, income taxation is decreasing throughout the world. As a result, multinationals investing in LDCs may face little or no income taxation on their foreign earnings. First, taxation may be reduced or eliminated by residence countries pursuant to rules that provide assets in offshore companies an indefinite suspension ("deferral") of residence-based taxation. Second, taxation may be reduced or eliminated by source countries pursuant to tax incentives that eliminate taxation for a specified duration or perpetually. Third, taxation by both countries may be reduced or eliminated through strategies of tax avoidance and evasion. Finally, taxation by both countries may be reduced or eliminated pursuant to express efforts to do so by both taxing jurisdictions, usually through a tax treaty. The combination of reduction or elimination of taxation in both countries, whether express or not, leads to complete non-taxation[170] of multinational activities. As discussed more fully below, the resulting lack of taxation obviates the need to pursue tax relief under treaty.

Reduced Taxation Through Deferral

As discussed above, most developed countries impose taxation on a worldwide basis, yet most protect this right only with respect to certain items of income, allowing suspension of taxation on other items to continue indefinitely at the will of the shareholders.[171] Thus, despite the support for the primacy of residence-based taxation that originally served as a major reason for entering into tax treaties,[172] much residence-based taxation is undermined by the persistent allowance of deferral.

Deferral is antithetical to residence-based taxation. By allowing it, nominally residence-based jurisdictions like the U.S. mirror territorial

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[169] Aryeetey, *supra* note 164.

[170] Sometimes called double non-taxation to indicate the coordinative effort that produces it.

[171] *See supra*, text at note 36.

[172] *See supra*, text at note 68.

systems by effectively providing tax exemption for foreign income.[173] Deferral is defended on grounds of neutrality: it is argued that companies from residence-based countries like the U.S. face heavier global tax burdens than companies from territorial countries, when both operate in third countries that impose little or no source-based taxation. For example, it is suggested that U.S.-based multinational companies operating abroad may be subject to little source-based taxation as foreign countries compete to attract their investment by offering low tax burdens, but because of the U.S. system of worldwide taxation, the U.S.-based company is still subject to the higher U.S. domestic tax rates. In contrast, it is supposed that multinationals from territorial systems will have a tax advantage in the minimally-taxing foreign country because these companies can combine low taxation abroad with exemption at home.[174]

Based on this argument, deferral continues to be vigorously defended under CIN principles, as requisite to allow U.S. companies to compete in low-tax countries against the multinational companies of territorial jurisdictions.[175] That few multinational companies are actually residents of

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[173] *See* Peroni (1997), *supra* note 65. Passive income items such as dividends, interest, and royalties, are generally not eligible for deferral and are therefore subject to current tax in the U.S.

[174] *See* Roin, *supra* note 63 at 114 (citing deferral proponents who argue that "[a]ny businesses that Americans can successfully operate in low tax jurisdictions…foreign investors can carry on equally well [and that if deferral was ended] foreign investors would use their now unique tax advantage to overwhelm their American competitors, wherever located").

[175] *See, e.g.*, Mark Warren, *Repealing the Deferral Rule: The Wrong Answer to U.S. Job Losses* (Republican Policy Committee, May 3, 2004), reprinted in 2004 WTD 88-16 (arguing that "some countries" exempt the foreign earnings of their multinationals, U.S. companies would face a higher overall tax burden when operating in low-tax jurisdictions in the absence of deferral, and that U.S. companies "cannot be expected to compete if they are handicapped by a 35- percent corporate-tax rate on their worldwide income"); National Foreign Trade Council, Inc., *The NFTC Foreign Income Project: International Tax Policy for the 21st Century-Part One: A Reconsideration of Subpart F,* 1999 WTD 58-37 (Mar. 25, 1999), and related Statement of Fred F. Murray, Vice President for Tax Policy National Foreign Trade Council, Inc. Testimony Before the House Committee on Ways and Means Hearing on Impact of U.S. Tax Rules on International Competitiveness June 30, 1999, *at* http://waysandmeans.house.gov/legacy/fullcomm/106cong/6-30-99/630murr.htm (arguing that "if the local tax rate in the company of operation is less than the U.S. rate, … competitors will be more lightly taxed than their U.S.-based competition," whether they are locally based or foreign, unless "their home countries impose a regime that is as broad as subpart F, and none have to date done so"). The argument is perhaps as old as taxation itself. In the newly independent United States, import duties were favored over export duties or other forms of taxation, because the imposition of either export duties or property taxes on farmers would equally increase the price of goods destined for export, thus serving

territorial systems,[176] and deferral provides the equivalent to exemption for much of the foreign income earned by U.S. multinationals while simultaneously providing them with a competitive advantage over their domestic counterparts[177] appears to have little effect on the efforts of U.S. multinationals to preserve the deferral privilege.[178]

The effect of deferral is to increase the sensitivity of U.S. taxpayers to foreign tax rates, thus forcing source countries to continually lower their internal tax burdens so as to attract the ever more demanding foreign capital. Deferral thus causes tax competition, as any income taxation imposed by a source country such as Ghana subjects a potential foreign investor to a burden it could otherwise avoid.[179] Elimination of competition and tax sensitivity could be achieved if all countries adhered to CEN. However, this would require international coordination and cooperation to a degree that appears overwhelmingly unattainable.[180]

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to "enable others to undersell us abroad." *See* COMMITTEE OF THE UNITED STATES IN CONGRESS ASSEMBLED, REPLY TO THE RHODE ISLAND OBJECTIONS, TOUCHING IMPORT DUTIES, December 16, 1782 (reprinted in 1 THE DEBATES IN THE SEVERAL STATES OF THE ADOPTION OF THE FEDERAL CONSTITUTION 100-106 (Jonathon Elliot, ed., Lenox Hill Pub., 1974) (1836).

[176] For example, of the top 100 multinationals, 18 are from generally territorial systems (one from Hong Kong, three from Switzerland, one from Malaysia, and 13 from France). Since France imposes a form of world-wide taxation on low-taxed earnings of controlled foreign companies, even this number is an exaggeration. Other countries may impose worldwide income generally, but exempt the foreign income of their multinationals under treaty. See *The Top 100 TNCs, Ranked By Foreign Assets, 2000, supra* note 81.

[177] Domestic companies are subject to worldwide taxation, and cannot generally opt to suspend the taxation of their profits. *See generally*, Clifton Fleming Jr., Robert J. Peroni & Stephen E. Shay, *An Alternative View of Deferral: Considering a Proposal to Curtail, not Expand, Deferral,* 2000 WTD 20-13 (Jan. 31, 2000) (arguing that deferral is a subsidy for operating business abroad and that proponents of deferral "have not candidly acknowledged the broad nature of the scope of the existing deferral privilege").

[178] *See supra*, note 175.

[179] Deferral removes the existing (residual) tax burden, thereby ensuring that any tax imposed by a foreign country is a tax wedge. In the absence of deferral, the tax wedge is created by the home country and, outside of limitations on foreign tax credits, taxes imposed by the source country do not increase the wedge. For a discussion of the interaction of deferral and the subsequent efforts of source countries to eliminate tax wedges, *see* Dagan, *supra* note 41.

[180] *See* Victor Thuronyi, *International Tax Cooperation and A Multilateral Treaty,* 26 BROOK. J. INT'L L. 1641, 1681 (2001) (an internationally harmonized system is "too utopian to merit discussion"), and Charles E. McLure, Jr., *Tax Policies for the XXIst Century,* in VISIONS OF THE TAX SYSTEMS OF THE XXIST CENTURY (1996); *but see* Yariv Brauner, *An International Tax Regime In Crystallization,* 56 TAX L. REV 259 (2003) (arguing that there has been a "modelization" of the international tax rules that could be built upon to achieve some measure of rule harmonization). Recent developments in the EU indicate that less,

The consequence is that U.S. multinationals may generally avoid U.S. taxation on their foreign income by operating through subsidiary companies in source countries,[181] which they generally do.[182] As suspension and effective elimination of taxation on foreign income becomes the norm in the developed world, LDCs respond accordingly, by increasingly offering corresponding tax relief in the form of tax incentives. These incentives have become a standard tool for capturing a share of the global flow of foreign investment.[183]

Reduced Taxation Through Tax Incentives

Tax incentives of various forms are used by most countries to encourage particular behavior in taxpayers, and neither the U.S. nor Ghana is an exception. The U.S. employs numerous tax incentives to attract foreign investment or encourage domestic investment. These provisions are generally embedded in the tax base, rather than being reflected in the tax

rather than more, cooperation is likely. *See* Joann M. Weiner, *EU Governments Fear Increased Tax Competition in Wake of Accession,* 2004 WTD 81-1 (Apr 6, 2004), and *European Commission Rejects Effort For Harmonized Corporate Tax Rates,* DAILY TAX REPORT G-8, June 1, 2004.

[181] Shay (2004), *supra* note 202, at 31 (multinationals are free to choose to operate through a branch or subsidiary, and they will generally choose subsidiary form unless the foreign effective tax rate is greater than the U.S rate or if they benefit from pooling high- and low-taxed earnings).

[182] For example, several of the largest foreign investments in Ghana are U.S. controlled foreign corporations (CFCs), including the Volta Aluminum Company, Ltd, Regimanuel Gray, and Equatorial Bottlers, discussed *supra* at note 103. Operating through a domestic subsidiary is also more advantageous from a Ghanaian perspective, since foreign companies are subject to strict scrutiny from the taxing and regulatory authorities to an extent exceeding that paid to domestic companies. The differential treatment is especially acute in the case of mining and other extractive operations, which are strictly regulated and limited as to foreign ownership by the Government of Ghana. Interview with Bernard Ahafor, *supra* note 204. *See also* Shay (2004), *supra* note 202, at 31 (multinationals are free to choose to operate through a branch or subsidiary, and they will generally choose subsidiary form unless the foreign effective tax rate is greater than the U.S rate or if they benefit from pooling high- and low-taxed earnings).

[183] The evidence is perhaps most obvious in regards to the number of countries offering tax holidays—over one hundred in 1998 and increasing—and the share of foreign investment directed at tax havens that are decried by the OECD for their harmful tax practices. While these countries command a fraction of the world's population and its GDP, they attract a disproportionately large amount of U.S. foreign investment capital. *See* Avi-Yonah (2000), *supra* note 158, at 1577, 1589, and 1643.

rate.[184] For example, along with the privilege of deferral, tax credits for research and development (R&D) and accelerated depreciation deductions are among the major tax incentives offered by the United States.[185]

Ghana also offers accelerated depreciation deductions and R&D credits similar to—but perhaps not as generous as—those of the United States.[186]

[184] Since the 1960s, an awareness of the danger of the hidden costs of such incentives has led to expenditure budgeting, which quantifies the cost of embedded provisions. For an example, *see* Analytical Perspectives (2004), *supra* note 65, explaining the concept of expenditures and providing a selected list. Incentives currently embedded in the U.S. tax base include accelerated depreciation and exclusions of certain forms of income such as tax-exempt interest. Tax incentives include any exclusions or exemptions that reduce or defer the tax base. *See generally* Alex Easson & Eric Zolt, *Tax Incentives, World Bank Course on Practical Issues of Tax Policy in Developing Countries,* April 28-May 1, 2003 at 3, *at* http://www.worldbank.org/wbi/publicfinance/documents/taxpolicy/Zolt&Easson.pdf ("tax incentives can take the form of tax holidays for a limited duration, current deductibility for certain types of expenditures, or reduced import tariffs or customs"). Ireland and Belgium, which offer low rates for foreign investors, are exceptions (and a source of consternation to their OECD counterparts) to the general rule of tax base rather than tax rate concessions in developed countries. *See, e.g.*, Avi-Yonah (2000), *supra* note 158, at 1601.

[185] Congress first provided a deduction for research and experimental expenditures in 1981, because it saw a decline in research activities it attributed to inadequacies in the IRC § 174 deduction, which at that time only applied to investment in machinery and equipment employed in research or experimental activities. Congress concluded that "in order to reverse this decline in research spending … a substantial tax credit for incremental research and experimental expenditures was needed." JCS-71-81, General Explanation of the Economic Recovery Tax Act of 1981 (H.R. 4242, 97th Congress, P.L. 97-34), GPO December 31, 1981, at section C. In the same act, Congress provided for accelerated depreciation deduction allowances because the existing depreciation deduction allowances "did not provide the investment stimulus that was felt to be essential for economic expansion." Id at Section A. Enhanced bonus depreciation provisions were enacted in 2001 under the theory that "allowing additional first-year depreciation will accelerate purchases of equipment, promote capital investment, modernization, and growth, and will help to spur an economic recovery," HR. Rep. No. 107-251, House Ways and Means Committee Report on Economic Security and Recovery Act of 2001, at Part II, Title I, section A. Bonus depreciation was expanded in 2003 for the same reason. H.R. Rep. No. 108-94, House Ways and Means Committee Reports on P.L. 108-27 (Jobs and Growth Tax Relief Reconciliation Act of 2003) at section 201. ("increasing and extending the additional first-year depreciation will accelerate purchases of equipment, promote capital investment, modernization, and growth, … help to spur an economic recovery … [and] increase employment opportunities in the years ahead). *See also* Richard E. Andersen, IRS Relaxes Rules for Research Credit: Opportunities for R&D-Intensive Multinationals, 4 J. Taxn. Global Trans. 17 (Spring, 2004) (discussing structures with which foreign and domestic multinationals can use R&D credits to generate tax-free profits in the U.S., and citing a 2003 study by Bain & Co, entitled "Addressing the Innovation Divide," in which it was found that in the past decade, European drug makers placed their R&D in the United States versus in local expansion by a two-to-one margin).

However, most LDCs including Ghana also offer significantly more generous incentives, in the form of low corporate tax rates and myriad tax exemptions.[187] Ghana imposes only an 8% tax on income from the export of most goods, rates ranging from 16 to 25% for certain industries and businesses carried out in certain geographic areas, and complete exemption from taxation (tax holidays) for periods ranging from 3 to 10 years for new activities conducted in certain industries or geographic areas.[188] Many LDCs, including Ghana, have also set aside geographic areas as havens from the normal tax and regulatory regimes, specifically to host manufacturing and processing plants (free zones). In Ghana's free zone, established in 1995, companies enjoy a ten year tax holiday followed by tax rates never to exceed 8%.[189]

International organizations such as the World Bank and the IMF currently decry the harm that tax holidays cause in depriving LDCs of much-needed revenue.[190] The elimination of income taxation on corporate taxpayers, coupled with the pressure to reduce taxes on international trade,

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[187] For example, by 1998, over 100 countries had tax holidays. Avi-Yonah (2000), *supra* note 158.

[188] G.I.R.A. §11 (Industry Concessions) and First Schedule, Part II (Rates of Income Tax Upon Companies). Although tax holidays are limited in duration, insufficient enforcement prevents the IRS from curbing instances in which companies facing expiring tax holidays simply dissolve and reincorporate under a different name to restart the clock. Interview with Kweku Ackaah-Boafo, February 6, 2004 (Discussing a Canadian company well known to have dissolved and reincorporated to avail itself of tax benefits).

[189] G.I.R.A., First Schedule.

[190] *See, e.g.*, Janet Stotsky, *Summary of IMF Tax Policy Advice,* in TAX POLICY HANDBOOK 279, 283 (Parthasarathi Shome, ed. International Monetary Fund 1995) (stating that tax incentives "have proved to be largely ineffective, while causing serious distortions and inequities in corporate taxation"); Zmarak Shaliz, LESSONS OF TAX REFORM 60 (1991) ("The use of so-called tax expenditures (tax preferences and exemptions to promote specific economic and social objectives) should, in general, be deemphasized."). This is a reversal of position for the World Bank, which at one point encouraged LDCs to offer tax incentives to attract foreign investment, and was concerned with the effect elimination of tax incentives might have on its assistance projects. Stewart (2003), *supra* note 4 at 169, text at note 186; Shaliz (1991) at 68-69. The World Bank has since "recommended the removal or tightening of incentives in Argentina (1989), Bangladesh (1989), Brazil (1989), Ghana (1989), and Turkey (1987), among others." Shaliz (1991) at 69. Tax incentives are also contrary to WTO rules prohibiting tax subsidies. *See* WTO Agreement on Subsidies and Countervailing Measures, Art. 1, para. 1.1. However, these provisions are rarely enforced with respect to LDCs. *See* Reuven Avi-Yonah & Martin B. Tittle, *Foreign Direct Investment in Latin America: Overview and Current Status,* Inter-American Development Bank (2002), *at* http://www.iadb.org/INT/Trade/1_english/2_WhatWeDo/1d_TaxDocuments.htm.

has created critical revenue shortfalls in many countries.[191] Nevertheless, new tax incentives continue to be introduced in both developed and less developed countries around the world,[192] often in response to private sector lobbying.[193] Some recent examples include the introduction of a new free zone in the United Arab Emirates,[194] a new five-year exemption period for audit, accounting, and law firms in Singapore,[195] and a new ten-year corporate tax holiday for income from investments of at least €150 million in Turkey.[196]

As a result of these kinds of initiatives, U.S. multinationals may face little or no income taxation on income derived in LDCs. The impact of tax treaties on activities giving rise to such income is therefore minimized, as double taxation, and even single taxation, is avoided through unilateral tax rules. However, even if home or source countries nominally impose taxation on multinationals, widespread tax avoidance and evasion neutralizes these taxes. Tax treaties appear to have little effect in these circumstances.

Reduced Taxation Through Tax Avoidance and Evasion

In the event that deferral or tax incentives are not available, multinational companies manage their worldwide tax exposure by using tax planning techniques to shift income to low- or no-tax jurisdictions through earnings stripping, transfer pricing, thin capitalization, and similar means of tax avoidance and, in the extreme, tax evasion.[197] For example, U.S.

[191] Cordia Scott & Sirena J. Scales, *Tax Competition Harms Developing Countries, IMF official Says,* 2003 WTD 238-9 (Dec. 10, 2003).

[192] For example, *see* Kwang-Yeol Yoo, *Corporate Taxation of Foreign Direct Investment Income* 1991-2001, OECD Economics Department Working Papers No.365, *at* http://www.olis.oecd.org/olis/2003doc.nsf/43bb6130e5e86e5fc12569fa005d004c/48ae491b8e2db4a9c1256d8e003b567f/$FILE/JT00148239.PDF.

[193] For example, see David Roberto R. Soares da Silva, *Tech Companies in Brazil Seek Tax Incentives to Promote R&D,* 2004 WTD 138-6 (Jul. 19, 2004) (domestic and multinational technology companies are currently lobbying for a three-year exemption from federal taxes for income from sales of "all new products that contain significant technological innovation").

[194] Under this new initiative, free-zone companies in Dubai will be exempt from income and tax. *See* Cordia Scott, *Dubai Woos Europe With Tax-Free Outsourcing Zone,* 2004 WTD 118-12 (Jun. 17, 2004).

[195] Lisa J. Bender, *Singapore Launches Tax Incentives for Audit, Accounting, Law Firms,* 2004 WTD 66-5 (Apr. 5, 2004).

[196] Mustafa Çamlica, *Turkey Plans Tax Holidays for Large Investments,* 2004 WTD 82-8 (Apr. 28, 2004).

[197] *See* Reuven S. Avi-Yonah, *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation,* 15 VA. TAX REV. 89, 95 (1995) ("transfer pricing

multinationals typically use over- and under-invoicing to assign foreign profits to subsidiaries in tax havens.[198] As a result, firms can increasingly make physical location decisions that are largely independent of tax-related business decisions, shifting profits to the most advantageous tax destination.[199] Efforts by governments to curb such practices are abundant[200] but largely ineffective[201] in the face of efforts by taxpayers to engage in them.[202]

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manipulation is one of the simplest ways to avoid taxation"); David Harris, Randall Morck, Joel Slemrod & Bernard Yeung, *Income Shifting in U.S. Multinational Corporations,* in STUDIES IN INTERNATIONAL TAXATION 277, 301 (Alberto Giovannini, R. Glenn Hubbard & Joel Slemrod eds., 1993), and James R. Hines, Jr., *Tax Policy and the Activities of Multinational Corporations,* in FISCAL POLICY: LESSONS FROM ECONOMIC RESEARCH 401, 414-15 (Alan J. Auerbach ed., 1997). The line between tax avoidance and tax evasion is murky. Tax avoidance generally refers to lawful attempts to minimize taxation, as Judge Learned Hand famously noted in *Commissioner v. Newman,* 159 F.2d 848, 850 (U.S. Circ. Ct App, 2d Circ. 1947) ("Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands…"). Tax evasion generally encompasses the unlawful and fraudulent avoidance of tax accomplished by hiding taxable income and assets from taxing authorities.

[198] *See* Council of the European Union, *Final Draft Report of the Ad hoc Working Party on Tax Fraud* 4, 16 (Brussels, April 27 2000) (direct tax fraud is typically committed through false invoicing, under-and over-invoicing, non-declaration of income earned in foreign jurisdictions, and "use by taxpayers of a fictitious tax domicile, with the purpose to evade fulfilling their tax obligations in their country of domicile for tax purposes"); *see also* Martin A. Sullivan, *U.S. Multinationals Move More Profits to Tax Havens,* 2004 WTD 31-4 (Feb. 9, 2004) (although they comprise just 13% of productive capacity and 9% of employment, subsidiaries of U.S. multinationals located in the top 11 tax havens were assigned 46.3% of foreign profits in 2001), and Hooke, *supra* note 119, at 86 (suggesting that to control costs, it is "sound operating procedure" for a foreign investor of an export platform in a LDC to interpose an offshore bank, and overcharge the foreign company for imported supplies and management fees to reduce income in the source country.).

[199] *See* Christoph Spengel & Anne Schäfer, *International Tax Planning in the Age of ICT*, ZEW Discussion Paper No. 04-27 (2004), *at* http://ssrn.com/abstract=552061 (arguing that information and commercial technology makes geographic distances "less relevant" and allows companies to choose location and form of investment on the basis of international tax differentials).

[200] Transfer pricing rules are a common feature in the tax systems of most countries, as are rules denying deductions for interest and royalties in certain cases and, often, rules requiring a certain combination of debt and equity (thin capitalization rules).

[201] In the U.S., the transfer pricing rules are long and complicated and constantly evolving, but still considered inadequate in preventing profit-shifting, as are U.S. earnings- and interest-stripping rules (see IRC § 163(j); these are essentially thin capitalization rules), each of which are similarly limited in their success in curbing avoidance of U.S. taxation. For an overview of U.S. efforts to control transfer pricing, see Avi-Yonah (1995), *supra* note 197. For a recent example of the failure of interest stripping rules, consider the

In LDCs such as Ghana, where enforcement of the tax law has been relatively less of a focus than reform of the tax law, tax authorities are all but helpless against these practices.[203] It is popularly said that Ghanaian companies keep three sets of books: one for the banks, showing large profits so as to secure financing; one for the Ghanaian Internal Revenue Service (IRS), showing large losses so as to avoid paying taxes; and one set, very closely-guarded by the owners, that contains the most accurate information.[204] There is no official data available regarding whether, and to what extent, U.S. multinationals take advantage of enforcement weaknesses.[205] Ghana recently introduced a Large Taxpayers Unit to curtail tax evasion, but the Ghanaian IRS relies on the good faith of company officials and their independent auditors because the resources are lacking to perform audits on all but a few companies.[206] Given that the overall tax

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growing use of Canadian Income Funds to avoid the application of IRC § 163(j). *See, e.g.*, Jack Bernstein & Barbara Worndl, *Canadian-U.S. Cross-Border Income Trusts: New Variations,* 34 TAX NOTES INT'L 3-281 (April 19, 2004).

[202] *See, e.g.*, Stephen E. Shay, *Exploring Alternatives to Subpart F,* 82 TAXES 3-29, 36 (March, 2004) ("The drive on the part of taxpayers, multinational and others, to push down effective tax rates has accelerated in recent years.").

[203] *See* Stewart (2003), *supra* note 4.

[204] Interviews with Margaret K. Insaidoo, Justice of the High Court of Ghana, Tuesday, Dec. 9, 2003; Bernard Ahafor (Attorney, Private Practice), Tuesday, Dec. 2, 2003; and Sefah Ayebeng (Chief Inspector of Taxes, Internal Revenue Service), Thursday, Dec. 11, 2003. Notes on file with the author. The implication is that firms keep separate books in an attempt to defraud the government, rather than in the ordinary course of keeping separate tax and cost accounting books, for which there is generally no statutory proscription. *See, e.g.*, Charles E. Hyde & Chongwoo Choe, *Keeping Two Sets of Books: The Relationship Between Tax & Incentive Transfer Prices* (February 14, 2004), *at* http://ssrn.com/abstract=522623 (arguing that keeping two sets of books with respect to transfer pricing is "not only legal but also typically desirable" for many MNEs).

[205] Anecdotal evidence that multinationals are thought to evade taxation where possible is not lacking, however. *See*, *e.g.*, Sirena J. Scales, *Venezuela Temporarily Closes McDonald's Nationwide*, 2005 WTD 26-11 (Feb. 9, 2005) ("Venezuela's Tax Agency (SENIAT) has temporarily closed all 80 McDonald's restaurants in the nation, citing failure to comply with tax rules…..")

[206] Seth E. Terkper, *Ghana Establishes Long-Awaited Large Taxpayer Unit,* 2004 WTD 64-10 (Apr. 2, 2004). A mid-size taxpayers unit is also in the planning stages. Interview with Sefah Ayebeng, *supra* note 204. A more effective audit process may not be sufficient to induce increased compliance, however. A recent empirical study about Australian investors that were accused of engaging in abusive tax transactions argues that taxpayers' level of trust regarding the fairness, neutrality, and respect accorded to them by the revenue authorities was correlated to their level of voluntary compliance, and that although trust alone should not be relied upon in enforcing a tax system, "a regulatory strategy that combines a preference for trust with an ability to switch to a policy of distrust is therefore likely to be the most effective." Kristina Murphy, *The Role of Trust in Nurturing Compliance: A Study of Accused Tax Avoiders, 28 Law and Human Behavior,* 2-

compliance rate is estimated to be less than 20% in Ghana, good faith appears to be rather elusive.[207]

As a consequence of tax avoidance and evasion strategies, income is often exempt from taxation even if it nominally applies in the residence country, the source country, or both. In such a taxing environment, there is little taxation, let alone double taxation, to be relieved by treaty. Governments are not unaware of the problem. Tax avoidance and evasion has typically been addressed in treaties through information sharing provisions, in which the respective taxing jurisdictions agree to assist each other in collecting revenues.[208] These provisions have a perhaps unintended consequence, however. Introduction of a tax treaty may decrease investment, as investors seek to avoid the implementation of the information sharing provisions that have become standard in tax agreements.[209]

The intersection of the taxation of portfolio interest and U.S. interest reporting rules provides an illustration of this tension. The United States is

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187 (April, 2004). In an interesting twist, South Korea recently announced that domestic and foreign companies meeting target job creation goals will be free from audits in 2004 and 2005 under a new tax incentive program. James Lim, *South Korea offering Companies That Create Jobs Shield From Audits,* 34 DAILY TAX REPORT G-3 (February 23, 2004).

[207] The compliance rate is an estimate of Ghanaian IRS officials and not an official government statistic. Interviews with Sefah Ayebeng, *supra* note 204 (estimating compliance at 20%) and Fred Ajyarkwa (official, Internal Revenue Service) (estimating it at 17%).

[208] The US Model requires contracting states to exchange all relevant information to carry out the provisions of the tax treaty or the domestic laws of the states concerning taxes covered by the treaty, including assessment, collection, enforcement, and prosecution regarding taxes covered by the convention. See Art. 26, para. 1. It also calls for treaty override of domestic bank secrecy or privacy laws. The OECD Model does not include the assessment/collection language but extends the scope of taxes to "every kind and description imposed on behalf of the contracting states." See Art. 26, para 1. It does not include an equivalent to the US Model's secrecy law override. The UN Model limits assistance to taxes covered by the Convention as in the US Model, and explicitly adds that information exchange is intended to prevent fraud or evasion of taxes. See Art. 26, para 1.

[209] Bruce A. Blonigen & Ronald B. Davies, *The Effects of Bilateral Tax Treaties on U.S. FDI Activity,* NBER Working Paper No. w8834 (March 2002), *at* http://www.nber.org/papers/w8834 (showing a decrease in foreign investment upon the introduction of a tax treaty and suggesting that such decrease may be the result of the dampening effect tax treaties may have on tax evasion due to information sharing provisions); Ronald B. Davies, *Tax Treaties, Renegotiations, and Foreign Direct Investment,* University of Oregon Economics Working Paper No. 2003-14 (June 2003), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=436502 ("treaties have either a zero or even a negative effect on FDI" because they dampen the ability of businesses to engage in tax evasion activities, especially through transfer pricing).

a potential tax haven for foreign investors because of its zero tax on portfolio interest and rules under which banks are generally not required to report interest payments made to nonresident aliens.[210] Efforts to require interest payment reporting have consistently met strong resistance by the private sector, which argues that such rules would "hinder tax competition between nations," "undermine the global shift to lower tax rates and fundamental tax reform," and "help oppressive governments track down flight capital."[211] Several members of Congress echo these sentiments, arguing that expanded reporting rules "would likely result in the flight of hundreds of billions of dollars from U.S. financial institutions" and could cause "serious, irreparable harm to the U.S. economy."[212] The implication is that while the U.S. does not condone tax evasion, there has emerged no political will strong enough to counter the private interests benefiting from the rules as they currently exist.[213]

Similar sentiments may exist in the context of tax treaties, especially when the partner country, as in the case of Ghana, has a very limited ability to enforce the tax laws prior to the introduction of a treaty. If foreign investors are able to avoid taxation in Ghana, for instance through aggressive tax planning, a tax treaty that requires or permits Ghana to provide tax information to the U.S. taxing authority may not be welcome.[214]

Reduced Taxation Through Coordination ("Tax Sparing")

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[210] IRC §§ 871(h) and 882(c); Treas. Reg. § 1.6049-5. Canadian residents are a current to the interest reporting rules, and proposed regulations would extend the reporting requirements to include all interest over $10 paid to any non-resident alien individual. Treas. Reg. § 1.6049-8(a).

[211] *Free Market Interest Groups Urge Treasury to Withdraw Alien Interest Reporting Rules,* 16 DAILY TAX REPORT G-2 (January 27, 2004).

[212] *House Lawmakers Ask Bush to Withdraw IRS Interest Reporting Rules for Aliens,* 69 DAILY TAX REPORT G-8 (April 10, 2002); *See* also Sen. Gordon Smith, *Letter on Proposed Nonresident Alien Interest Reporting Rules (REG-133254-02) to Treasury Secretary John Snow,* reprinted in the DAILY TAX REPORT, February 20, 2003 (urging Treasury not to move forward with interest reporting rules because it "would drive the savings of foreigners out of bank accounts in the United States and into bank accounts in other nations," and expressing the Senator's failure to understand "why we put the enforcement of other nations' tax laws as a priority at Treasury.")

[213] Perhaps recent efforts to create a multinational task force to combat abusive tax-avoidance can provide the pressure needed to reform this long standing impasse. *See* Sirena J. Scales, *Multination Task Force Created to Combat Abusive Tax Avoidance,* 2004 TNT 81-4 (April 26, 2004).

[214] Moreover, to the extent that a U.S. tax treaty coordinates transfer pricing rules, a treaty might increase the taxation of a multinational that could otherwise benefit from conflicting domestic standards. *See* Statement of Leslie B. Samuels, *supra* note 5.

The proliferation of tax incentives and tax holidays in LDCs coupled with deferral in the U.S. and opportunities for tax avoidance in both countries limits the need for tax treaties to relieve double taxation. Since the 1950s, tax sparing has been promoted as a way to use tax treaties to increase investment to targeted LDCs, even in the absence of double taxation.[215] Tax sparing prevents residence-country taxation of income exempted from tax by source countries,[216] by providing that if a source country refrains from taxing income derived in its jurisdiction (usually pursuant to a tax holiday), the residence country nevertheless grants a tax credit for the tax nominally imposed.[217]

Thus, under tax sparing, two taxing jurisdictions cooperate to exempt multinational companies from income taxation in both countries. Although similar effects could be accomplished unilaterally by residence countries,[218] tax sparing is generally seen as a mechanism that should be offered in the context of a tax treaty, as a measure to encourage foreign investment to selected LDCs.[219] Tax sparing has particularly been promoted as a vehicle for investment and aid to the nations of Sub-Saharan Africa.[220]

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[215] *See generally* OECD, TAX SPARING: A RECONSIDERATION (1998). Recent literature includes Brown, *supra* note 7; and Damien Laurey, *Reexamining U.S. Tax Sparing Policy with Developing Countries: The Merits of Falling in Line with International Norms,* 20 VA. TAX REV. 467 (2000) (arguing that LDCs "need tax holidays to attract foreign investment," and therefore tax sparing is requisite to counter the effect of residual home country taxation under tax treaties). Tax sparing is also defended as justifiable on grounds of capital import neutrality, on the basis that it allows American multinationals to compete with companies from other exemption-providing countries in the global marketplace. *See infra* discussion at note 218. However, tax sparing violates the concept of capital export neutrality, and has been consistently rejected by the Treasury Department on the grounds that tax treaties are supposed to relieve double taxation, not eliminate taxation altogether, and that tax treaties are not meant to provide benefits to U.S. persons.

[216] Tax sparing was first introduced in the U.K. by the British Royal Commission, which prepared a report in 1953 recommending tax sparing as a means of "aiding British investment abroad." Rejected by the U.K. in 1957 after several years of debate, tax sparing was enabled in U.K. tax treaties as a result of legislative action in 1961. The purpose of the legislation was "enabling the U.K. to give relief to developing countries for taxes spared under foreign incentive programs." TAX SPARING: A RECONSIDERATION, *supra* note 215, at 15.

[217] Many examples and explanations of tax sparing exist. For an overview of tax sparing, see Richard D. Kuhn, United States Tax Policy with Respect to LDCs, *32 Geo. Wash. L. Rev. 262 (1963).* (1963).

[218] For example, the U.S. could expand the definition of a creditable tax to include certain nominally-imposed taxes. *See, e.g.*, McDaniel (2003), *supra* note 252, at 268-269.

[219] For example, see proposals suggested by Brown, *supra* note 7, and Laurey, *supra* note 215, regarding the use of tax treaties to implement foreign aid initiatives by encouraging foreign investment through tax sparing. *See also* J. Clifton Fleming, Jr.,

However, there is little evidence that tax sparing increases foreign investment.[221] In Ghana's case, tax sparing provisions in its treaties with the U.K.[222] and France[223] have produced no significant increase in foreign investment from these countries.[224] On the contrary, tax sparing could potentially *decrease* investment in LDCs, since it enables foreign investors to repatriate earnings that they would otherwise leave abroad under the protection of deferral.[225] As such, tax sparing appears fundamentally

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Robert J. Peroni & Stephen E. Shay, *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income,* 5 FLA. TAX REV. 299, 347 (2001) (suggesting that limiting tax sparing to its use in tax treaties "would allow appropriate distinctions to be made among nations and would assist the United States in negotiating appropriate reciprocal tax concessions for its residents").

[220] Brown, *supra* note 7 (arguing for tax sparing in tax treaties specifically with Sub-Saharan Africa).

[221] For an overview of the conflicting economic literature regarding the interaction of tax sparing and FDI, see McDaniel (2003), *supra* note 252, at 284.

[222] *See* Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes On Income and Capital Gains, 1993, Ghana-U.K., art. 25, para 4, S.I. 1993 No. 1800 (U.K. grants tax credits for Ghanaian tax paid including "any amount which would have been payable as Ghana tax for any year but for an exemption or reduction of tax granted for that year or any part thereof"); Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes On Income and Capital Gains, Nov. 29, 1977, Ghana-U.K., art. 21, para. 2, 1162 U.N.T.S. 341 (same).

[223] *See* Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes On Income and On Capital Gains, Dec 4., 1992, Fr.-Ghana, art. 24, para 3, 94 TNI 74-25 (France grants tax credits for Ghanaian tax paid including "any amount which would have been payable as Ghana tax for any year but for an exemption or reduction of tax granted for that year").

[224] *See* B. R. MITCHELL, INTERNATIONAL HISTORICAL STATISTICS, AFRICA, ASIA & OCEANIA, 1750-1988, at 499, 550-552 (1992); KWODWO EWUSI, STATISTICAL TABLES ON THE ECONOMY OF GHANA, 1950-1985 (Dec. 1986), at Table 155; *and* AGBODEKA, *supra* note 119.

[225] *See, e.g.*, Peroni, Fleming & Shay (1999), *supra* note 67, at 469 (deferral encourages "[r]etention and reinvestment of earnings by foreign companies"); *see also* Laurey, *supra* note 215, at 484 (tax sparing would "allow U.S. multinationals to repatriate earnings based on business needs instead of on adverse tax consequences"). In a 2002 study of the annual filings of the companies in the S&P 500, it was found that such companies had accumulated over $500 billion in un-repatriated foreign earnings. Anne Swope, Bruce Kasman & Robert Mellman, *Bringing It All Back Home: Repatriation Legislation's Final Lap* (JP Morgan Chase Bank, 2004), *at* www.morganmarkets.com). This figure represents a trend of ever-increasing "trapped" foreign profits. Conversely, by acting as an incentive to repatriate capital, tax sparing may be advantageous to the U.S. economy even though it has long been rejected for policy reasons. For example, in the context of the repeal of ETI, legislators proposed the enactment of a reduced rate of tax on repatriated profits, citing in support the need to direct capital back to the U.S in the quest to create jobs and boost the economy.

inconsistent with the goal of using tax treaties to increase investment flows from developed to less developed countries.

Moreover, tax sparing increases tax competition by creating an additional disadvantage for countries that do not have tax holidays, while leaving countries that have a tax holiday in effect in the same or worse position as they were when only deferral was available.[226] The OECD has initiated efforts to combat what it terms "harmful tax practices"—in essence, any tax regime that undermines residence-based taxation by providing tax breaks and refusing to cooperate in information sharing.[227] Persisting in the allowance of deferral and tax holidays and promotion of tax sparing seem equally inconsistent with the treaty-related goal of protecting residence-based tax bases.

Foreseeing the surge in lobbying by U.S. multinationals upon the ratification of any treaty with tax sparing, the U.S. has been unequivocal in its rejection of these provisions.[228] While the potentially negative impact on investment in LDCs is one valid reason why tax sparing should continue to be rejected, the primary position of the U.S. has been that tax sparing inappropriately allows the reduction of U.S. taxation of U.S. persons, a result specifically precluded by all U.S. treaties currently in force.[229]

Some LDCs, notably those in Latin America, have terminated tax treaty negotiations with the U.S. over the issue of tax sparing.[230] However, the U.S. position on tax sparing is only "one of several obstacles in the way of U.S.-developing country tax treaties."[231] In fact, tax sparing is largely unnecessary in the quest for complete non-taxation. As discussed above, tax holidays granted by LDCs to investors from deferral-granting countries

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[226] *See, e.g.*, Margalioth (2003), *supra* note 81 at 198.

[227] *See generally* STAFF OF THE OECD FISCAL AFFAIRS COMM., THE OECD'S PROJECT ON HARMFUL TAX PRACTICES: THE 2004 PROGRESS REPORT (2004).

[228] Tax sparing was contemplated but ultimately rejected in tax treaties with Egypt, India, and Israel, largely due to the efforts of Stanley Surrey, who argued vigorously against the provision. *See* Laurey, *supra* note 215 (citing TAX SPARING: A RECONSIDERATION, *supra* note215, at 15-17). Tax sparing was also introduced in a tax treaty with Pakistan, but a subsequent change in Pakistan law rendered the provision obsolete and the treaty entered into force without it.

[229] This rule is enforced under the "saving clause" found in all U.S. tax treaties. *See* the US Model, art. 1, para. 4.

[230] Laurey, *supra* note 215, at 471, 493 (many LDCs have "refused to sign U.S. tax treaties that do not contain tax sparing clauses," especially those in Latin America because this region "resents the U.S. [residence-based] tax policy").

[231] McDaniel (2003), *supra* note 252, at 292.

such as the U.S. are effective so long as capital is reinvested rather than repatriated.[232]

3. *Domestic Tax Rates Equal to or Better Than Treaty Rates*

In treaties between developed countries, domestic tax regimes are often significantly different than treaty-based tax regimes.[233] This is especially the case with respect to tax rates on passive income paid to foreign persons, which are typically much higher under domestic statutes than under tax treaties.[234] However, LDCs increasingly impose tax rates that are much closer to, and in some cases are less than, the typical rates provided in treaties.

For example, dividends paid to foreign shareholders would normally be subject to a 10% tax in Ghana, unless the company paying the dividend operates in a free zone, in which case the tax rate may be zero.[235] Thus Ghana's statutory tax rate is the same as or less than what would be expected under the hypothetical Ghana-U.S. treaty outlined above. In addition, Ghana's internal rate is lower than the 15% maximum provided in the US Model for regular dividends.[236] Nevertheless, it is higher with respect to direct dividends than the maximum 5% provided in the US Model and the zero rate for dividends paid to foreign controlling company shareholders found in new treaties.

Because most dividends paid out of Ghana would likely constitute direct dividends, many of which would be paid to controlling shareholders,[237] a treaty rate that followed the US Model or recent U.S. treaty practice would reduce taxation on U.S. investors in Ghana from the internal rate of 10% (or zero)[238] to 5% or zero. However, as discussed above, if U.S. tax treaty precedent is followed, it is unlikely that a Ghana-U.S. tax treaty would

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[232] Tillinghast (1996), *supra* note 62, at 478.

[233] Some countries have incorporated treaty concepts into their domestic laws. For example, the U.K. and Italy have adopted permanent establishment thresholds for the taxation of business profits based on the OECD Model. However, these examples are rare.

[234] OECD Model rates do not exceed 15% for dividends, 10% for interest, and 0 for royalties. OECD Model, Art. 10, 11, and 12. In contrast, maximum statutory tax rates in OECD countries average 18, 14, and 16% on dividends, interest, and royalties, respectively. *See generally,* Ernst & Young, *supra* note 36.

[235] Ghana currently imposes a 10% tax on most dividends, but provides tax incentives, including exemptions of taxation on passive income paid by domestic companies to foreign investors, as described above. See G.I.R.A. §§ 2 and *see infra*, text at notes 184 to 196.

[236] US Model, art. 10.

[237] *See infra*, text at note 182.

[238] The rate depends on whether the payment derives from sources protected by a free zone or tax holiday regime.

provide for these lower rates. In fact, if a Ghana-U.S. tax treaty provided for regular dividend taxation lower than 10%, direct dividend taxation at 5%, and no source country taxation of interest and royalties pursuant to the US Model, it would be the first and only U.S. tax treaty to do so with any country, developed or less developed.[239]

If the U.S. provided as concession to Ghana that instead of a maximum 5% rate for direct dividends, the maximum source-country rate would be 10%, the result would only be that Ghana's statutory 10% rate would be maintained.[240] No benefit in the form of reduced taxation would be realized under this agreement. In fact, if the recently concluded Sri-Lanka-U.S. treaty serves as a model, a Ghana-U.S. treaty could even provide for maximum rates that are *higher* than Ghana's internal rates, though again this could hardly benefit current or potential investors.[241]

Similarly, Ghana's statutory rates of 5-10% on interest and 15% on rents and royalties[242] comport with the average respective rates offered under other U.S. treaties, although the US Model contemplates zero source taxation of both.[243] Just as in the case of direct dividends, preserving a

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[239] The closest rates to these are found in the treaty with Russia, which provides for source country tax rates of 10% on regular dividends, 5% on direct dividends, and zero on interest and royalties. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Jun. 17, 1992, U.S.-Russ., TIAS. To compare the rates in other treaties, see INTERNAL REVENUE SERVICE, U.S. TAX TREATIES 33 (Internal Revenue Service Pub. 901, Rev. May, 2004) (note that although updated in May, 2004, this document has no information regarding the U.S. tax treaty with Sri Lanka (signed , entered into force Jun. 13, 2004).

[240] The treaty with Ghana would be one of six U.S. treaties with a top 10% rate for dividends. *See* U.S. TAX TREATIES, *supra* note 239 at 33, 34 (providing 10% as the maximum tax rate on dividends in U.S. tax treaties with China, Japan, Mexico, Romania, and Russia)

[241] In the treaty with Sri-Lanka, the Joint Committee queries whether this is intended, and supposes that Sri Lanka could raise its rates up the maximum 15% provided, thereby increasing its revenues from foreign investment. Yet in the same document, the Committee proclaims that the treaty will be good for the U.S. because it reduces Sri Lankan tax on U.S. investors and provides a clearer framework. These two positions appear difficult to reconcile, as the Joint Committee appears to recognize. See JOINT COMM. ON TAX., EXPLANATION OF SRI LANKA TREATY, *supra* note 130, at 62.

[242] Ghana currently imposes a 10% tax on most interest payments, and a 15% tax on rents and royalties, with alternate rates ranging from 5 to 15% for certain payments, depending on the residence of the recipient and the payor. G.I.R.A. §§ 2, 84, and the First Schedule, Parts IV through VIII.

[243] With respect to interest, see US Model, art. 11. Thirty-one existing U.S. treaties, including several of the most recently signed treaties and protocols, reflect this goal. *See, e.g.*, Japan-U.S. Treaty, art 11; U.S.-U.K. Treaty, art. 11; and Australia Protocol, art. 7. Interest tax rates range from 5 to 30% in the remaining treaties. With respect to royalties,

higher rate of tax would be likely under UN Model standards, but would generally be a neutral factor for investors.

Concessions that allow for higher source country taxation of passive income items reflect the concerns addressed by the UN Model regarding the worldwide allocation of tax revenues, and are meant to protect the taxing jurisdiction of capital importing nations like Ghana against the effects of the US and OECD Model treaties, which allocate income away from source and towards residence countries.[244] However, as the case of Ghana illustrates, preserving higher source country taxation is a neutral measure at best, and it is contradictory to the notion otherwise promoted by U.S. policy makers that reducing tax rates will reduce tax barriers to direct investment and thereby increase capital flows between countries.

To date, there is no consensus regarding the appropriate balance of attracting investment through lower tax rates and preserving the allocation of revenue to source countries.[245] Preserving source country revenues has been prioritized on the grounds that low taxation has a deleterious effect on infrastructure. In LDCs, providing adequate infrastructure to attract multinationals has been a continuous challenge that is further complicated by tax competition, a phenomenon not alleviated by tax treaties.

4. *Inadequate Infrastructure and Non-Tax Barriers*

U.S. investors may be significantly influenced in their investment location decisions by broad infrastructure-related criteria such as the rule of law and the protection of property, as well as the immediate need for a suitable workforce and adequate physical infrastructure.[246] The need for a suitable workforce in turn necessitates basic infrastructure including social structures such as schools and health care systems. In direct tension with these needs is the diminishing ability of LDCs to finance infrastructural development as they decrease taxes on business profits.

Many countries, including Ghana, offer tax incentives such as tax holidays and tax-free zones because attracting investment to sustain

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see US Model, art. 12. Twenty-six existing U.S. treaties, including several of the most recently signed treaties and protocols, provide zero source country tax on most royalties. *See, e.g.*, Japan-U.S. Treaty, art 12 and U.S.-U.K. Treaty, art. 12. As in the case of interest, royalty tax rates range from 5 to 30% in the remaining treaties.

[244] *See* Dagan, *supra* note 41.

[245] The lack of consensus is illustrated by the omission of standard rates in the UN Model, Art. 10, 11, and 12.

[246] Hooke, *supra* note 119, at 47, 49. A recent study found that the higher the average years of schooling of a source country's workforce, the more foreign investment tends to flow into such country.

economic development is deemed of greater importance than protecting tax revenues.[247] However, there is little consensus regarding the effectiveness of tax incentives and tax holidays in actually attracting foreign investment. Anecdotal evidence from various countries suggests that providing tax incentives to attract foreign investment has failed to deliver the promised benefits.[248] Despite a plethora of tax holidays and other tax incentives, few permanent employment opportunities have been created and exports have failed to increase in the many free zones located throughout West Africa, including Ghana.[249] According to John Atta-Mills, former Commissioner of the Ghanaian IRS, "experience shows that tax holidays and tax reductions are ranked very low in the priority of investors in their choice of location for their business," and that product demand, a skilled workforce, and infrastructure are more important to businesses.[250]

Economic evidence regarding the connection between taxation and foreign investment provides little additional certainty. A number of economic studies indicate that multinationals are very sensitive to tax considerations, and therefore corporate location decisions may be heavily influenced by tax regimes in source countries.[251] However, conflicting studies indicate that taxation is not a significant factor in the location decisions of U.S. multinationals.[252] Instead, these studies argue that

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[247] Brian Arnold, *General Report* 25, 28 *in* IFA REPORT ON TAX COMPETITION (IFA 2001) (stating that "certain countries…are more concerned with attracting activity and investment of the multinationals in order to sustain their economic development").

[248] *See, e.g.*, Tamas Revesz, *EU, Companies Urge Reform of Hungary's Local Industry Tax,* 2004 WTD 97-10 (2004) (Although Slovakia offered big investment subsidies and tax relief for foreign investors, its budget is in ruins, and the resulting forced cuts in government spending (especially transfers to households) have triggered serious hunger riots among the most seriously hit Roma population.)

[249] Papa Demba Thiam, *Market Access and Trade Development: Key Actors* 97, 101, in TOWARDS A BETTER REGIONAL APPROACH TO DEVELOPMENT IN WEST AFRICA (John Igue & Sunhilt Schumacher, eds., 1999). *See also* text at note 112 (trade data indicates imports from Ghana to the U.S. are currently declining).

[250] Seth E. Terkper, *Tax Measures in Ghana's 2004 Budget Inadequate, Opposition Party's Presidential Candidate Says,* 2004 WTD 63-12 (April 1, 2004).

[251] For an overview of this economic literature, see Avi-Yonah (2000), *supra* note 158, at 1590-1592; James R. Hines Jr., *Tax Policy and the Activities of Multinational Corporations,* in FISCAL POLICY: LESSONS FROM ECONOMIC RESEARCH 401-445 (Alan J. Auerbach, ed., 1997); and James R. Hines, Jr., *Lessons from Behavioral Responses to International Taxation,* NATIONAL TAX JOURNAL, June 1999, 52 (2), 305-322.

[252] *See* Paul R. McDaniel, *The U.S. Treatment of Foreign Source Income Earned in Developing Countries: A Policy Analysis,* 35 G. 35 G. W. INTL. L. REV. 265, 280 (2003) (providing an overview of some of this literature); *see also* G. Peter Wilson, *The Role of Taxes in Location and Sourcing Decisions,* in Giovanni, Hubbard & Slemrod (1993), *supra* note 197 (arguing that taxes are more influential in location decisions for administrative

"market size, labor cost, infrastructure quality…and stable international relations," among other considerations, are the most important factors for location decisions.[253] Studies focused particularly on foreign investment in Sub-Saharan Africa come to the same conclusion.[254]

In contrast, recent literature suggests that past studies present an incomplete picture of the role of taxation because they have focused on source country corporate income taxes, the burdens of which are relatively insignificant as compared to the burdens of non-income taxation in source countries.[255] As a result, these past studies may have obscured the more significant influence of non-income taxation on foreign investment decisions.[256] Since foreign non-income tax burdens significantly exceed income tax burdens, these taxes may strongly influence the behavior of U.S. multinationals.[257] The main explanation given for this influence is that non-income taxation is not creditable against U.S. residual taxation.[258]

The findings of this literature are consistent with earlier studies that suggest the relative importance of taxation in a particular country may be increasing with the availability of opportunities for avoiding taxation

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and distribution centers, but they "inhere in but rarely dominate the decision process" in the case of production locations).

[253] *Id.*

[254] *See, e.g.*, World Bank, WORLD BUSINESS ENVIRONMENT SURVEY 2000 (finding as a result of a survey of business including Ghana and 15 other Sub-Saharan African countries that firms investing in these regions indicate less sensitivity to taxation than to corruption, infrastructure, crime, inflation, financing, and political stability); Elizabeth Asiedu, *On the Determinants of Foreign Direct Investment to Developing Countries: Is Africa Different?* (July 2001), *at* http://ssrn.com/abstract=280062 (arguing that location-specific factors such as natural resource availability may make infrastructure and stability of particular importance in the context of investment to Sub-Saharan Africa).

[255] Mihir A. Desai, C. Fritz Foley & James R. Hines Jr., *Foreign Direct Investment in a World of Multiple Taxes,* xx J. PUB. ECON. xxx (2004)) ("foreign indirect tax obligations of American multinational firms are more than one and a half times their direct tax obligation"). In previous studies, James Hines found a "small but significant" link between lower source country taxes and foreign investment levels, as discussed in both McDaniel (2003), *supra* note 252 at 281, and Avi-Yonah (2000), *supra* note 158, at 1644.

[256] Desai & Hines (2004), *supra* note 255, at 34.

[257] *Id.*

[258] *Id.* ("Since American taxpayers can claim tax credits for income taxes paid to foreign governments, but are unable to claim similar tax credits for indirect taxes paid to foreign governments, it follows that foreign indirect taxes have much greater potential to influence their behavior"). For an argument that the definition of creditable taxes should be broadened to encompass many non-income taxes, *see* Glenn E. Coven, *International Comity and the Foreign Tax Credit: Crediting Nonconforming Taxes,* 4 FLA. TAX REV. 83 (1999).

elsewhere.[259] However, these findings conflict with other studies that show multinationals can use debt financing and transfer pricing manipulation to achieve tax neutrality in investment location decisions,[260] and that demonstrate, despite earlier studies showing a connection between tax and foreign direct investment, that non-tax factors dominate the location decisions of multinational firms.[261]

Given the possibility that taxation may not be an overriding factor in foreign investment location decisions, the influence of infrastructure cannot be ignored. To the extent infrastructure is important to potential investors, efforts to reduce taxation to attract foreign investment may be counterproductive, since raising sufficient revenues is integral to the level of infrastructure a country can offer.[262] As tax competition ensures less taxation of multinationals, the ability of LDCs to fund sufficient infrastructure to attract and sustain foreign investment relies more heavily on the ability to tax resident individuals, whether directly or indirectly. Historically, this has been a great challenge for LDCs.[263]

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[259] *See* Altshuler, Grubert & Newlon, *supra* note 67 at 9, 22, 28 (suggesting that tax rates are extremely important to U.S. multinationals in allocating their foreign direct investment, especially in the case of manufacturing, and that the relative importance of taxes may be increasing)

[260] Avi-Yonah (1996), *supra* note 25, at 1315, Gary C. Hufbauer, *U.S. Taxation of International Income: Blueprint for Reform 134* (1992) (suggesting that a multinational company can unilaterally achieve CEN "because it can make its investment decision without regard to the combined rates of tax").

[261] Haroldene Wunder, *The Effect of International Tax Policy on Business Location Decisions,* TAX NOTES INT'L 1332 (Dec. 24, 2001) (updating the Grubert & Mutti 2000 study).

[262] *See* Kaldor (1963), *supra* note 263 (stating that "the importance of public revenue to the underdeveloped countries can hardly be exaggerated if they are to achieve their hopes of accelerated economic progress"). *See* also David Rosenbloom, *Response to "U.S. Tax Treatment of Foreign Source Income Earned in Developing Countries: Administration and Tax Treaty Issues,"* 35 G. W. INTL. L. REV. 401, 406 (2003) (stating that "taxes are, by definition, involuntary exactions"). Thailand has recently taken a slightly different approach. In June, 2004, the Prime Minister, the Ministry of Education, and the Social and Human Development Services Ministry unveiled tax incentives for individuals and companies that make charitable donations to social development programs including education, museums, libraries, art galleries, recreational facilities, children's playgrounds, public parks, and sports arenas. The government hopes that "these incentives will raise funds from the private sector to alleviate the poverty crisis in Thailand." Sirena J. Scales, *Thai Government Announces Tax Incentives for Charitable Contributions,* 2004 WTD 129-10 (Jul. 6, 2004).

[263] Nicholas Kaldor, *Will Underdeveloped Countries Learn to Tax?* 41 FOREIGN AFFAIRS 410 (1963).

Compliance rates for income and non-income taxation are typically very low in Ghana. It is estimated that 80% of business is conducted on the informal market—that is, not subject to regulation or taxation because it is conducted in the form of cash or barter.[264] Thus, only those who work for the government or for the few companies that comply with wage withholding obligations pay their income taxes.[265] An appearance that the laws are not applied uniformly may in turn lead to increased tax avoidance and evasion.[266] The situation is exasperated when corruption or mismanagement of public funds also exists. While Ghana's corruption factor is relatively modest in comparison to many of its neighbors in Sub-Saharan Africa,[267] the notion persists that wealth can be achieved by becoming a government official.[268] These perceptions plague the revenue collection efforts of tax agencies in LDCs such as Ghana.[269]

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[264] The agricultural industry is thought to contribute significantly to this number, since over 60% of Ghana's population is employed in agriculture (a slightly lower percentage than the average of approximately 70% in Sub-Saharan Africa). WORLD FACTBOOK 2003, *supra* note 1, (Field Listing - Labor force), *at* http://www.cia.gov/cia/publications/factbook/fields/2095.html. The informal economy also includes most professionals such as doctors and lawyers, most other service providers, and most shopkeepers and sellers of goods in local markets. Interview with Justice Insaidoo, *supra* note 204; Interview with Sheila Minta, Solicitor/Barrister, Addae & Twum Company, Accra, Ghana, December 9, 2003 (notes on file with the author).

[265] Interview with Justice Insaidoo, *supra* note 204.

[266] Murphy (2004), *supra* note 206, at 201 ("perceptions of unfair treatment" appear to affect trust, and "taxpayer resistance could be sufficiently predicated by decreased levels of trust").

[267] *See* Transparency International, GLOBAL CORRUPTION REPORT 2003 215, 220, 225, 264, *at* http://www.globalcorruptionreport.org/download.htm (Suggesting that although the government faces much criticism in failing to address corruption within the civil service, prompting President Kufuor to promise an increase in accountability, Ghana's perceived corruption is much lower than that of many of its neighbors in Sub-Saharan Africa). In extreme comparison stands countries like the Congo, where corruption and bribery at all levels are openly acknowledged as requisite for survival. *See* Davan Maharaj, *When the push for survival is a full-time job,* L.A. TIMES, Part A; Pg. 1, July 11, 2004 (while government employees are not paid a salary, they still show up for work every day to collect bribes ranging from "about $5 for a birth certificate to about $100 for an import license.") In Benin, a close neighbor to Ghana, bribes collected from traders trying to import illegal goods into Nigeria provide some 15% of the nation's revenues. Davan Maharaj, *For sale -- cheap: 'Dead white men's clothing',* L.A. TIMES, Part A; Pg. 1, July 14, 2004.

[268] The phenomenon appears to exist throughout Sub-Saharan Africa. *See* Transparency International, *supra* note 267. In the Congo, it is said that "the only ones who have ever gotten rich are the leaders and those with connections." *See* Davan Maharaj, *supra* note 267.

[269] The perceptions of a few individuals cannot represent national sentiment, nor can such sentiment, even if widespread, indicate the accuracy of the charge. However, a

The ability of LDCs to collect sufficient revenue to fund infrastructure is also challenged by international pressure to open markets and reduce trade barriers.[270] To the extent that Ghana continues to rely heavily upon trade taxes for its revenue, recent developments in tariff reduction at the WTO may cause additional revenue shortfalls in the future. Ghana also faces difficulty in finding consistent resources to fund infrastructure because success in collecting revenues from excise taxes, royalties, dividends, and similar payments may depend on fluctuating global market prices for exported commodities.

Finally, Ghana's ability to fund infrastructure is further subject to uncertainty due to its reliance on assistance from foreign donors.[271] In 2002, Ghana was the recipient of large amounts of foreign aid, much of which was connected to the peaceful transition of power through the democratic process. However, foreign aid fell in 2003, and it is expected to

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perception of unfairness and corruption may undermine the efficacy of a tax regime. A study to quantify the effect of corruption on tax compliance is underway in Tanzania, and more research is needed in this area. A further issue that may be significant to the tax collection efforts of LDCs is the perceived misuse of funds by the government, whether as a result of corruption or the ineptitude of officials. Informally, this author heard many expressions of dissatisfaction with the ability of the government to provide necessary services to the citizenry. Since that is a common complaint in developed countries as well, I do not deal with it here, but only note its existence as an additional potential difficulty in raising sufficient revenues from individuals. Finally, the extent to which local conditions and attitudes regarding taxation affect the behavior of multinationals is not conclusively established. It may be that multinationals generally conduct their business operations fundamentally in compliance with the laws in force, regardless of the degree to which their compliance is monitored or enforced, simply because their global operations may be subject to scrutiny by other governments or the public. However, evidence proving (or disproving) this theory appears to be lacking in the economic literature.

[270] The transition of the U.S. from an agrarian society, "rich in resources but lacking in capital investment," to an industrial one is credited in part to tariffs, without which the transition would have been much slower. See Weisman (2002), *supra* note 158 at 14; *see also* William A. Lovett, Alfred Eckes Jr. & Richard L. Brinkman, U.S. TRADE POLICY: HISTORY, THEORY, AND THE WTO 45 (2004) (the current association of free trade with rapid economic growth is "incompatible with American economic history," which shows that "[t]he most rapid growth occurred during periods of high protectionism").

[271] In Ghana, 17% of total revenue derives from non-tax sources. 86% of this amount (or just under 15% of total revenues) derives from grants; the other 14% derives from receipts from various fees charged by the government for particular services, and from amounts received in divestiture of state-owned enterprises). Aryeetey, *supra* note 164, at 30–31. In this respect, Ghana is somewhat better off than many of the other LDCs in Sub-Saharan Africa, which rely heavily on foreign aid to subsidize their expenditures. For example, 53% of Uganda's budget comes from external loans and grants. *See* Gumisai Mutume, *A New Anti-Poverty Remedy for Africa?,* 16 AFRICA RECOVERY 4-12, *at* http://www.un.org/ecosocdev/geninfo/afrec/vol16no4/164povty.htm.

continue its decline as aid is targeted to other countries, notably Iraq.[272] The consequence is a current budget gap of over 14%.[273] An increase in the overall level of funding by donor countries might alleviate the shortfall.[274] However, a subsequent change of policies by the aid donor could cripple the expectant aid recipient, as foreign aid typically substitutes for domestic revenue raising efforts rather than complementing them.[275]

Multinational companies may be expected to increase the government's ability to collect revenues by creating a larger wage base for personal income tax. However, wages in LDCs such as Ghana average $1 per day, producing little for the government to share.[276] If wages are raised through regulatory action, many multinationals may disengage to seek low wages elsewhere, since the low cost of labor is often a primary reason multinationals set up in LDCs.[277] Although workers may individually benefit from employment created by foreign investment even if wages are only minimally higher than that offered by other local employment, they are not necessarily placed in a better position with respect to paying taxes.[278]

Investment protection or insurance—whether made available through private or public institutions—may promote foreign investment despite a country's infrastructural deficiencies. In the U.S., investment protection is

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[272] Aryeetey, *supra* note 164.

[273] Ghana's 2002 budget provided for expected expenses of US$1.1 billion, including grants, and expected revenues of US$963 million, a 14% shortfall (all figures are based on current exchange rate of US$1 = Ghanaian ¢8,800).

[274] For example, as envisioned by the UN in the Millennium Development Goals.

[275] Kaldor (1963), *supra* note 263, at 410.

[276] 44.8% of the population of Ghana lives on less than $1 per day; in all of Sub-Saharan Africa, the figure is close to 46%. *See* Patricia Kowsmann, *World Bank Finds Global Poverty Down By Half Since 1981,* UN NEWSWIRE, April 23, 2004, available at http://www.un.org/special-rep/ohrlls/News_flash2004/23%20Apr%20World%20Bank%20Finds%20Global.htm. Globally, it is estimated that about half of the earth's population lives on under $2 per day, a fact that has been central to the most recent efforts of the U.S. to combat poverty with new foreign aid strategies aimed at economic growth. *See, e.g.*, Colin L. Powell, *Give Our Foreign Aid to Enterprising Nations,* NEWSDAY (New York), A34, June 11, 2003 (discussing the role of the Millennium Challenge Account in a new strategy of directing foreign aid to "support for sustainable development" in the face of the ongoing challenge of widespread global poverty).

[277] Hooke, *supra* note 119, at 18.

[278] Nicholas D. Kristof, *Inviting All Democrats,* THE NEW YORK TIMES, January 14, 2004, Section A; Page 19; Column 5 (arguing that "the fundamental problem in the poor countries of Africa and Asia is not that sweatshops exploit too many workers; it's that they don't exploit enough," as illustrated by the example of a young Cambodian woman who averages 75 cents a day from picking through a garbage dump ad for whom "the idea of being exploited in a garment factory—working only six days a week, inside instead of in the broiling sun, for up to $2 a day—is a dream.")

provided to U.S. investors through the United States Export-Import Bank ("Ex-Im Bank"), an independent federal government agency that "assume[s] credit and country risks the private sector is unable or unwilling to accept," through export credit insurance, loan guarantees, and direct loans to U.S businesses investing in foreign countries.[279] For example, Ex-Im Bank insurance covers the risk of foreign buyers not paying bills owed to U.S. investors, the risk that a foreign government might restrict the U.S. company from converting foreign currency to U.S. currency, or even the risk of loss due to wars.[280] This kind of investment protection in effect substitutes U.S. infrastructure for that existing in LDCs.[281]

The Ex-Im Bank has a Sub-Saharan Africa Advisory Committee devoted specifically to supporting U.S. investment activity in this region.[282] With investment protection available as a substitute for infrastructural shortcomings, investment in LDCs like Ghana may not be prohibitive. Yet, the persistently low level of foreign investment in Ghana and Sub-Saharan Africa as a whole suggests that investment protection is not enough to overcome the barriers perceived by potential investors.

5. *Entrenched Investor Perception*

Tax treaties with LDCs may provide little commercial benefit to investors when little or no income tax is imposed in these countries, so it is perhaps not surprising that they are correspondingly low on the list of U.S. treaty priorities.[283] Nevertheless tax treaties continue to be promoted for their ability to increase investment between developed and less-developed

[279] *See* the United States Export-Import Bank website, available at http://www.exim.gov/.

[280] Id.

[281] The subsidy is not without controversy. *See. e.g.,* Heather Bennett, *House OKs Measure to Block Loans to Companies Relocating in Tax Havens,* 2004 TNI 138-4 (July 19, 2004) (as part of a foreign aid bill, U.S. Export-Import Bank loans would no longer be made to corporate entities chartered in one of several listed tax havens because, according to Representative Sanders, who offered the bill, "companies that dodge U.S. taxes should not be rewarded with taxpayer handouts," but should "go to the government" of the applicable tax haven for such privileges).

[282] *See* Ex-Im Bank, Sub-Saharan Africa Advisory Committee, *at* http://www.exim.gov/about/leadership/africa.htm.

[283] *See* Testimony of Barbara Angus, *supra* note 5 (stating that the United States generally does not "conclude tax treaties with jurisdictions that do not impose significant income taxes, because there is little possibility of the double taxation of income in the cross-border context that tax treaties are designed to address; with such jurisdictions, an agreement focused on the exchange of tax information can be very valuable in furthering the goal of reducing U.S. tax evasion.").

countries. One theory for their promotion is that increased investment can be expected due to the signaling effects of tax treaties.[284] For example, it is suggested that tax treaties may signal a stable investment and business climate in which treaty partners express their dedication to protecting and fostering foreign investment.[285]

Proponents of this argument suggest that in the process of negotiating a tax treaty, governments of LDCs may subject their operations to increased transparency and accountability, thus providing additional benefits to potential investors (as well as domestic taxpayers) in the form of assurances regarding the proper management of public goods.[286] Thus, bilateral tax treaties may "serve largely to 'signal that a country is willing to adopt the international norms' regarding trade and investment, and hence, that the country is a safe place to invest, especially 'in light of the historical

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[284] Leif Mutén, *Double Taxation Treaties Between Industrialised and Developing Countries,* in DOUBLE TAXATION TREATIES BETWEEN INDUSTRIALISED AND DEVELOPING COUNTRIES; OECD AND UN MODELS, A COMPARISON 5, (Kluwer Law and Tax'n Pubs., 1990).

[285] For example, the Secretary of the Treasury proclaimed the importance of signing a tax treaty with Honduras in 1956, stating that as the first treaty with any Latin American country, "The agreement may…have a value far beyond its immediate impact on the economic relations between the United States and Honduras. It may generate among smaller countries an increased awareness of the need to create an economic atmosphere that will lend itself to increased private American investment and trade." Dulles, *supra* note 5, at 1444 (1962). Similar sentiment has been expressed in the context of many treaties, especially those with LDCs, over the years. *See, e.g.*, STAFF OF THE JOINT COMMITTEE ON TAXATION, 106TH CONG., EXPLANATION OF PROPOSED INCOME TAX TREATY AND PROPOSED PROTOCOL BETWEEN THE UNITED STATES AND THE REPUBLIC OF VENEZUELA 61 (Comm. Print. 1999) ("the proposed treaty would provide benefits (as well as certainty) to taxpayers"); STAFF OF THE SENATE FOREIGN RELATIONS COMMITTEE, 108TH CONG., TAXATION CONVENTION AND PROTOCOL WITH THE GOVERNMENT OF SRI LANKA (S. Exec. Rpt. 108-11, Mar. 18, 2004) ("in countries where an unstable political climate may result in rapid and unforeseen changes in economic and fiscal policy, a tax treaty can be especially valuable to U.S. companies, as the tax treaty may restrain the government from taking actions that would adversely impact U.S. firms"). These concepts are also reflected in commentary. *See, e.g.*, ANDERSEN & BLESSING, *supra* note 10, at ¶ 1.02[3][b] (in the context of LDCs, "tax treaties provide foreign investors enhanced certainty about the taxation of the income from their investments"). *See also* Davies, *supra* note 209. ("even a treaty that merely codifies the current practice reduces uncertainty for investors by lowering the likelihood that a government will unilaterally change its tax policy.").

[286] *See*, *e.g.*, Gabay (1990) (suggesting that the first advantage to a LDC of entering into a bilateral tax treaty is the negotiation process itself, because that process creates a degree of transparency, which in turn promotes "greater rationality in decision making," which "can be of great economic benefit to the less developed country.")

antipathy that many developing and transition countries have in the past exhibited to inward investment.'"[287]

Signaling is a slippery concept because it is difficult to measure whether signaling is occurring and, if so, whether it impacts investors. The potential for signaling a stable investment climate through tax treaties with LDCs in Sub-Saharan Africa is especially hampered by the persistence of negative perceptions about this region's investment climate.[288] 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.[289] Since few Sub-Saharan African countries have tax treaties, and many countries in the region suffer from civil unrest and economic failure, Ghana's ability to demonstrate stability and certainty may achieve little individual attention from foreign investors unfamiliar with its particular situation.[290]

In addition, the signaling effect is tied to a country's reputation in upholding its international compacts. Short of terminating a treaty, there is no formal enforcement mechanism should a country proceed to ignore its treaty obligations.[291] For example, it is difficult to imagine that a tax treaty

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[287] Stewart (2003), *supra* note 4 at 148, citing Richard J. Vann, *International Aspects of Income Tax,* in 2 TAX LAW DESIGN AND DRAFTING 726 (Victor Thuronyi ed., 2000).

[288] *See* UNCTAD (1999), *supra* note 2 at 4, 16 ("little attempt is often made to differentiate between the individual situations of [the] more than 50 countries of the continent").

[289] Laura Hildebrandt, *Senegal Attracts Investors, But Slowly,* 17 AFRICA RECOVERY 2-15 (2003), *at* http://www.un.org/ecosocdev/geninfo/afrec/vol17no 2/172inv3.htm ("foreign investors tend to lump countries together in regions, without making much distinction among individual countries," which might explain Senegal's limited success in attracting foreign investment despite "relatively good infrastructure [and] a history of political stability and secular democracy, with decidedly pro-market leanings); UNCTAD (1999), *supra* note 2, at iv, 5 ("little attempt is often made to differentiate between the individual situations of more than 50 countries of the continent").

[290] *See*, *e.g.*, Laura Hildebrandt (2003), *supra* note 289, at 15 ("Senegal's reputation for stability may be offset by conflicts elsewhere in the region, such as Cote d'Ivoire); *A Man of Two Faces,* THE ECONOMIST, Jan. 22, 2005, at 27 ("any …plan for Africa's redemption will work only if functioning states with reasonably good leaders (South Africa, Botswana, Senegal, Ghana, Mozambique) can be set apart from the awful ones….").

[291] In the case of a treaty violation, a taxpayer would request the Competent Authority of its home country to negotiate with the Competent Authority in the treaty partner country. For this reason, investors may desire a tax treaty to be in place, so that assistance in negotiating disputes with a foreign country could be sought from the U.S. Competent Authority. However, treaties provide no recourse in the event the Competent Authorities fail to reach a resolution.

could independently create a sense of stability in a country that would otherwise be unattractive due to historical failure to protect property rights.

Finally, treaty proponents point to the certainty achieved in establishing rules consistent with international norms, so that investors will know what to expect regarding the taxation of their investments in foreign countries. But signaling of certainty and stability is achieved more directly through agreements designed to provide these specific benefits. For example, delivering these benefits is the primary purpose of investment protection provisions that are included in global and regional trade agreements.[292] They are also encompassed in a global network of over 2,100 bilateral investment protection treaties (BITs).[293] Ghana has seventeen such treaties currently in force.[294] The U.S. has 47 in force and relies on these agreements to protect investment in source countries.[295]

Investment protection provisions and treaties outline the applicable legal structure and regulatory framework of the signatory countries, and provide settlement provisions in the event of disputes between investors and source country governments. Common features include guarantees and compensation in the event of expropriation, guarantees of free transfers of funds and repatriations of capital and profits, and dispute settlement provisions.[296] The goal of these agreements is to promote transparency, stability, and predictability for regulatory frameworks in source countries,

[292] Stephen S. Golub, *Measures of Restrictions on Inward Foreign Direct Investment for OECD Countries* 6, OECD Economics Department Working Paper No. 357 (2003). Most of the LDCs in Sub-Saharan Africa, including Ghana, have signed multilateral agreements dealing with the protection of foreign investment, such as the Convention establishing the Multilateral Investment Guarantee Agency (MIGA) and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States. *See* UNCTAD (1999), *supra* note 2, at 7-8.

[293] WIR 2003, *supra* note 113 at 89-90 (stating that BITs signal a country's attitude towards and climate for foreign investment, and that investors "appear to regard BITs as part of a good investment framework"). Worldwide, there are 2,181 BITs currently in force, encompassing 176 countries. *Id.,* at xvi. As in the case of tax treaties, significantly more BITs would be required to achieve global coverage. *See supra,* note 71.

[294] They are with Benin, Bulgaria, Burkina Faso, China, Cuba, Denmark, Egypt, France, Germany, Guinea, India, Malaysia, Mauritius, Netherlands, Romania, Switzerland, and the United Kingdom. *See* UNCTAD Bilateral Investment Treaty Database, available at http://www.unctadxi.org/templates/DocSearch.aspx?id=779.

[295] Testimony of Shaun Donnelly (Principal Deputy Assistant Secretary, Bureau of Economic and Business Affairs , State Department), April 1, 2004, 2004 WL 724003 (F.D.C.H.) ("BITs have afforded important protections to U.S. investors"). The U.S. currently has four BITs with LDCs in Sub-Saharan Africa: Cameroon, Mozambique, Senegal, and the Democratic Republic of the Congo. For a list of U.S. BITs currently in force, see UNCTAD Bilateral Investment Treaty Database, *supra* note 294.

[296] WIR 2003, *supra* note 113 at 89.

and therefore reduce obstacles to the flow of foreign investment.[297] BITs are further bolstered through subsidized loans, loan guarantees, and other financial assistance made available to foreign investors.[298]

Even if the stability and certainty signaled by tax treaties could make a source country that has such agreements more attractive than one that does not, U.S. investors are unlikely to lobby for tax treaties if they do not have a direct financial interest at stake, namely, an exposure to taxation that could be alleviated by treaty.[299]

The foreign investment patterns of U.S. businesses also imply that tax treaties may be an insufficient signal to investors.[300] First, U.S. investors will pursue investments in a non-treaty country if the business environment is sufficiently attractive, even in the absence of a tax treaty.[301] For example, although the U.S. has no treaty with Brazil,[302] U.S. foreign direct investment in Brazil is significant.[303] Second, the mere presence of a tax treaty will not generally overcome an otherwise poor business climate, or one that deteriorates after a treaty is in place. For example, the U.S. treaty with Venezuela entered into force in 1999, but flows of U.S. capital to

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[297] *Id.*

[298] *See supra,* note 279 (discussing the role of the U.S. Export-Import Bank in subsidizing U.S. investors to LDCs).

[299] The lobbying efforts of U.S. businesses may not be the most appropriate means of establishing a list of priorities for new treaties, however it is one of the primary factors considered by the office of International Tax Counsel in making such decisions. *See* Testimony of Barbara Angus, *supra* note 5.

[300] *See* Mutén, *supra* note 284 at 4.

[301] *See, e.g.*, Jones, *supra* note 85, at 4, 5 (arguing that tax treaties "make less difference to domestic taxpayers investing abroad," especially if taxes are low in source countries).

[302] Brazil is one of the South American countries that refuses to negotiate with the U.S. due to the tax sparing controversy. *See* Laurey, *supra* note 215, at 493 (citing an unpublished Brazilian Tax Sparing Position Paper); Mitchell, *supra* note 11 at 213; Guttentag, *supra* note 4 at 451, 452. The latest U.S. discussions with Brazil were held in 1992. As Brazil continued to insist on tax sparing and the U.S. refuses to continue negotiations with countries that insist on including such a provision, no further meetings are planned and there have been no recent activities to date. See John Venuti, Manal S. Corwin, Steven R. Lainoff & Paul M. Schmidt, *Current Status of U.S. Tax Treaties and International Agreements,* 33-8 TAX MANAGEMENT INT'L J. 480, 483 (August 13, 2004) (updated monthly).

[303] As valued at historical cost (book value of U.S. direct investors' equity in and net outstanding loans to Brazilian affiliates), U.S. foreign direct investment in Brazil is currently valued at $30 billion. At 1.7% of total U.S. foreign direct investment, Brazil's market for US foreign direct investment is not far behind that of some developed countries, including Spain (with 2.1% of U.S. foreign direct investment) and Australia (with 2.3%). Borga & Yorgason (2004), *supra* note 96, at 42, 49.

Venezuela subsequently dropped sharply due to "concerns over regulations and political instability in the country."[304]

Finally, some investors may not necessarily want a tax treaty because such agreements usually include measures that prevent tax evasion, as discussed above.[305] Thus while a tax treaty may send positive signals to investors, they may as likely send negative signals to the extent they lead the way to stronger enforcement of tax laws. Supporting tax evasion is clearly indefensible as a policy for encouraging investment in LDCs but the benefits of such opportunities to existing investors, and the cost of eliminating such opportunities, cannot be ignored.[306]

Nevertheless, easing enforcement and administration of the tax laws may be an alternative reason to continue expanding the U.S. tax treaty network, from the perspective of potential LDC treaty partners.[307] For example, the information exchange provisions might enable Ghana to extend its current, basically territorial, regime, to a worldwide regime.[308]

[304] United Nations Conference on Trade and Development, FDI in brief: Venezuela (2003), available at http://www.unctad.org/sections/dite_fdistat/docs/wid_ib_ve_en.pdf.

[305] In the past, tax treaties may have contributed to tax evasion by creating opportunities for "treaty shopping" through the use of multi-country tiered structures such as the one shut down in *Aiken Industries, Inc. v. Commissioner,* 56 TC 925 (1971). In that case, the Honduras-U.S. treaty then in force was used to channel interest payments free of tax from the U.S. to the Bahamas. The Honduras-U.S. treaty was terminated in 1966, before the case was decided but in connection with these kinds of structures, deemed to be void of any "economic or business purpose" by the Tax Court. Treaty shopping has since been curtailed in newer treaties and protocols by means of stronger limitation of benefits provisions. *See* Arnold (2001), *supra* note 247, at 73-74.

[306] Just as in the cases of deferral and bank secrecy, the private sector can be expected to protect tax advantages regardless of whether they comport with a coherent tax policy.

[307] Obtaining cooperation in tax enforcement through information sharing provisions is a major factor in the completion of treaties from the perspective of the U.S. For example, the newly-ratified tax treaty with Sri Lanka was originally negotiated almost 20 years ago but only entered into force this year. Ten years of the delay were due to Sri Lanka's reluctance in accepting U.S. requests regarding information exchange. *See* Colin L. Powell, Letters of Transmittal and Submittal, Doc 2004-7257 (Oct. 28, 2003). The fact that, as in the case of Ghana, Sri Lanka's statutory rates and tax incentive regimes indicate that the domestic tax regime is as or more favorable than that provided under treaty suggests that under that treaty, prevention of double taxation plays a much less significant role than prevention of tax evasion.

[308] *See* US Model, art. 26. For example, when Venezuela entered into a tax treaty with the United States, its tax regime was territorial: Venezuela imposed no tax on the foreign income of its residents. Its tax treaty with the U.S. included the typical exchange of information provision, which would theoretically allow Venezuela to pursue its residents who engaged in activities outside of the country, and Venezuela subsequently expanded its jurisdiction to encompass residence-based taxes. Convention for the Avoidance of Double

The benefit of such a regime would depend on the amount of savings shifted to the United States by Ghanaian persons, before and after the treaty. Presumably this is a relatively tiny amount by global standards,[309] but it might be significant to the overall revenue picture in Ghana. However, Ghana's limited tax treaty network significantly restricts the ability to enlarge its taxing jurisdiction, since Ghanaians could simply choose a location other than the U.S. for their offshore activities, avoiding Ghanaian tax even under a worldwide system.[310]

Moreover, as in the case of investment protection, the benefits of information exchange are as readily—and more broadly—achieved through agreements specifically addressing this issue. Information exchange is comprehensively addressed in TIEAs, which are generally bilateral, and through multilateral agreements such as the OECD Tax Information Exchange Agreement.[311] Under the US Model TIEA, assistance in tax enforcement and collection are extended not only to income taxes but to other taxes as well, making such agreements potentially more effective than tax treaties in fulfilling the goal of improved tax administration and enforcement.[312]

Absent reduction of double taxation, the non-commercial benefits of tax treaties appear incapable of independently exerting a significant influence on U.S. foreign investment, and some of the aspects of tax treaties may tend to discourage such investment. Ultimately, the value of continued expansion of the U.S. tax treaty network to LDCs may therefore be

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Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Jan. 25, 1999, U.S.-Venez., art. 27, TIAS.

[309] The U.S. Bureau of Economic Affairs compiles data regarding direct investment in the U.S., but Ghana is included only collectively with the rest of Africa excluding South Africa. Inbound direct investment from this region is valued at $1.8 billion, which represents less than 0.2% of that from Europe. Borga & Yorgason (2004), *supra* note 96, at 51.

[310] Ghana would not generally benefit from the larger U.S. tax treaty network since the exchange of information is limited to information that is relevant to the two contracting states only. US Model, art. 24.

[311] This agreement has been signed by the U.S. and Canada, among others.

[312] The U.S. entered into tax treaties with many countries in Sub-Saharan Africa and in the Caribbean simultaneously by territorial extension with their various colonial powers (from 1957-1958) and terminated most of these treaties simultaneously three decades later (in 1983-1984). The U.S. subsequently entered into TIEAs only with the Caribbean nations. The U.S. has trade agreements with countries in both the Caribbean and Sub-Saharan Africa, sends foreign aid to both regions, and has expressed a desire to increase investment, trade and aid to both regions. Yet there is no agreement on tax matters with respect to the LDCs in Sub-Saharan Africa.

extremely limited in the context of a global tax climate that reflects the circumstances illustrated in this case study.

IV. CONCLUSION

The pursuit of tax treaties to achieve investment and aid goals is undermined by competing tax regimes, including domestic U.S. rules that provide relief of current U.S. tax burdens in respect of foreign income earned by multinationals. To the extent multinationals can escape U.S. taxation simply by investing abroad, the U.S. fosters tax competition throughout the world as foreign countries compete to attract the U.S. capital fleeing taxation at home. As a result of this international tax competition, and a corresponding divergence in tax mix between developed and less developed countries, much of the tax ostensibly relieved under tax treaties no longer exists to a significant extent with respect to investment in many LDCs.

As a result, tax treaties with these countries may offer few commercial benefits to investors. Tax treaties may provide non-commercial benefits to partner countries and investors, by signaling stability or suitability, or providing certainty. However, these incidental benefits are likely insufficient to significantly impact investment in many LDCs, particularly those in Sub-Saharan Africa. Thus, as the case study of Ghana demonstrates, much of the conventional wisdom about the impact of tax treaties on the global flow of investment does not apply in the context of many of the LDCs most in need of realizing these benefits.

Tax treaties represent a significant opportunity cost for LDCs, diverting attention and resources away from the exploration of more direct ways to increase cross-border investment. Thus, every potential tax treaty relationship with LDCs should be approached critically. If a tax treaty cannot be expected to provide sufficient benefits to investors, it should not be pursued simply to include the target country in the network of treaty countries in a myopic adherence to traditional notions about the international tax and business community. After decades of adherence to the promise of tax treaties, their inability to deliver in situations involving LDCs must be acknowledged. If the U.S. is truly committed to increasing trade and investment to the LDCs of Sub-Saharan Africa, alternative ways to achieve these goals must be pursued.