1. Jurisdictional Principles—Some Considerations

In many capital-importing countries, as in the case of Argentina in 1932, the income tax was structured on the basis of an objective jurisdictional principle known as the “territorial source principle” or simply “source principle”. This principle provides a reduced or summarized version—in fact, it is no more than this—of the subjective jurisdictional principle based on the individual or enterprise that derives income, also taking into account certain characteristics or conditions, such as residence or, where applicable, nationality, known as the “worldwide income criterion”.
The source principle, soundly based on the integration of income into an economic circuit, has an objective nature because it takes into account the income produced and its origin independently of the person who derives the income, its beneficiary. According to the foregoing, the subjective jurisdictional principle is supported by social or political reasons or bases when it takes into account the beneficiary’s place of residence or nationality.

The source principle, linked directly and closely to the concept of sovereignty, finds additional justification in a logical and appropriate distribution of taxing powers in the international context since the principle validly assumes that each country establishes its own income tax policy in harmony with other countries. In addition, this is the most significant basis for the income tax since it is used in both alternatives, that is, both when taxation is restricted exclusively to income originating in a national territory and when the worldwide income criterion is used, by which a person resident in a country is subject to unlimited taxation and submits all his income, from both domestic and foreign sources, to tax.

If we measure the contribution that each source, domestic and foreign, adds to the total tax collection in each country, it can be observed that, even in countries that use the worldwide income criterion, the greatest contribution comes from a domestic or national source. In some developed countries, income from a domestic source contributes practically the total amount of tax collected. Even countries with large amounts of foreign income do not obtain a significant part of their total tax revenue from that source due to, without going into detail, logical guidelines, i.e. unilateral measures, in their domestic legislation granting a foreign tax credit (FTC) or an exemption for foreign income.

Further, it should be noted that granting FTCs is an essential measure in a tax structure based on the worldwide income criterion. Without granting FTCs, a country may face diverse problems because horizontal equity has been violated—equals are not treated equally—or because joint taxation, if applicable, by the two jurisdictions involved represents an amount that the courts could consider confiscatory. Certain countries, however, have constitutional provisions setting limits on the state’s power to tax which play a direct role in avoiding excessive taxation.

In capital-exporting countries, the business sector represents the most significant volume of total foreign income. This sector contributes between 8% and 15% of the total income tax collection in various countries, including domestic income, which, in this taxpaying sector, is very significant because it includes the income, both domestic and foreign, of multinational enterprises established in the source country.

The collection issue cannot be resolved with theatrical measures, e.g. by eliminating tax deferral as proposed by some in the United States, since the indirect or extended tax credit mechanism generally cancels the domestic tax on foreign income in the
residence country. It is beyond the scope of this article to go into greater detail on tax deferral, which, rather than being a stimulus to foreign investment, is the logical consequence of the supremacy of legal form over economic reality.

If we analyse the substantial similarities, we find that all countries, regardless of the jurisdictional principle adopted, establish a similar treatment for the domestic income derived by non-residents. In general, this income is subject to a final withholding tax in the source country on payment, and taxable income is determined on estimated or presumptive bases. Withholding taxes levied on presumptive bases in the source country have been one of the most controversial aspects in the relationship between countries since the end of the World War I, when the income tax began to be widely used.

The scheme applied is in fact the most practical and effective, but presumptive income is usually excessive or deficient because it is of a discretionary nature that is in conflict with the concept of actual income, the basic pillar of tax liability. This scheme is applied because there are simply no better alternatives for governments.

It is part of a broader issue that should be addressed in order to find a solution which, supported by consensus and appropriate to the new reality, will remove or minimize controversies between countries. This issue is one of the critical points that should be analysed in an intergovernmental-type debate, held in a neutral and transparent forum, on a new perspective on the income tax which will consider the possibility of revalidating the source principle.

The global tax forum that drives the organizations grouping developed countries, like the OECD, and also multilateral bodies, such as the International Monetary Fund and the World Bank, is not neutral and transparent, and it therefore seems ill-considered to call on that forum. Both developed and developing countries are aware that such bodies lack knowledge and experience on this issue. Likewise, there are many reasons why they cannot provide a neutral or objective arena. Where applicable, it should be the countries and their specific areas of competence which, if they consider it relevant, request the services, advice or technical assistance of certain organizations or of recognized experts for the consideration of specific issues. The leadership that the above organizations and bodies attempt to assume on this issue through a global tax forum is like putting the cart before the horse.

Today, more than ever, we should ask ourselves what the point is of clinging to a criterion such as worldwide income which is complex and has a minimum effect on collection, when faced with a situation that requires increasing measures which, without affecting capital mobility, would provide a greater balance between countries, as is constantly expressed by heads of state, for example, in the “Monterrey Consensus”. The heads of state, along with the Secretary General of the United Nations, say that, through more equitable schemes respecting the human condition to a greater extent
than so far experienced, globalization can provide a positive contribution to the community of nations, facilitating socioeconomic development in the least advanced countries.

Specifically, Subject I of this IFA Congress, “Source and residence: new configuration of their principles”, will debate a possible reconsideration of the current scheme, this being in a way a continuation of various analyses made in different parts of the world. At the Congress in Buenos Aires in 1984, Subject I dealt with the issue of fiscal obstacles to the normal flow of international investments. Twenty years have gone by without significant advances on this issue. Another 20 years should not go by without making the changes required by modern times.

2. REASONS JUSTIFYING THE EXCLUSIVE SOURCE PRINCIPLE

In practice, adopting a nexus principle limiting taxation exclusively to income from domestic sources and excluding income from foreign sources meant, for the countries adopting it, an implicit agreement for avoiding double taxation with the rest of the world. This option, exclusive taxation of income from domestic sources, is an appropriate alternative for the conditions and characteristics of a capital-importing country without foreign investment and with little or no economic activity overseas by its residents.

Non-taxation of income from foreign sources also assumes the possibility, if there is such income, of establishing a stimulus for its entry into the residence country of its beneficial owner. From the perspective of respect for the two principles governing taxation, equity and neutrality, the so-called “source” shows an obvious weakness compared to the subjective jurisdictional principle; nevertheless, it is no less true that, to judge by the collection results of source taxation, source taxation is less complex and more effective.

The source principle applied by all countries without exception has a conflicting aspect regarding the levy of tax which relates precisely to the proper definition of the source concept. In fact, this concept and its basic content have been distorted by legislators. The source concept is solidly based in economic terms on integrating income into a specific circuit or space. Nevertheless, it can be observed in the laws of many countries that the “domestic source” concept includes acts or events that transgress the rule of feasibility which should prevail in tax matters. These countries do not establish rational limits in the exercise of their taxing powers as source states because they use strange definitions of source, to such an extent that it is said that “source is what the legislator defines it to be”.

This causes difficulties because, when more than one country considers that the same income is from a domestic or national source, double taxation arises and, in this
case, it is not resolved by using the normal methods. Comparative legislation reveals strange definitions, the result of the casuistry that characterizes some domestic laws which adopt anti-abuse clauses in light of the manoeuvres used by companies, generally associated enterprises. In other cases, there is a strongly marked “voracity” to unjustifiably tax income that could not be taxed according to the principle of reasonableness.

Today we are faced with many varied challenges. One is to undertake a precise and thorough analysis of the objective jurisdictional principle, or source principle, in the search[*381] for an overall solution. It is possible that the harmonization of concepts may remove many of the conflicts mentioned above. There is no doubt that a clear normative framework facilitates the normal course of business and international economic activity in general. Quite apart from the political rhetoric, however, this is a complex question to address and it is difficult to achieve success for various reasons. One is that, in some developed countries, there is an enormous prejudice against initiatives involving harmonization because some small but very active sectors confuse public opinion on the pretext of loss of sovereignty or autonomy.

We cannot ignore a remarkable interpretation usually observed in developed countries, which is that maintaining or adopting the exclusive source principle does not take account of “international rules”. In this regard, completely lacking depth of argument, they spare no criticism of the few countries that still have this principle in their domestic legislation, stressing that adopting the exclusive source principle may create double exemption situations. In truth, there are no such generally applicable “international rules”. It is rather a question of rules accepted or self-imposed by a few developed countries with bilateral income flows, which (rules) lack the universal acceptance to be given such a character.

Concern over the above-mentioned double exemption objectively requires starting at the beginning, which is always advisable. Thus, we should start by considering granting an exemption in the country of origin of the income, generally a developed country and usually an exemption for the interest paid by its banks or its government (public bonds) to non-residents. Dealing with the flimsy or superficial analyses observed in much of the material on this particular part of the issue is exciting, but beyond the scope of this article. For this reason, this article has made only limited mention of this issue with the simple purpose of demonstrating some of the inconsistencies.
3. CRITERION OF WORLDWIDE INCOME _URBI ET ORBE_ AND MODEL TAX CONVENTIONS

Despite the foregoing, most countries have adopted the worldwide income criterion—perhaps due to the “demonstration effect” or to suggestions from certain multilateral bodies, which are very deficient on these issues, lack solid specific experience and have little or no perception of the differences between countries. Today, fewer than a dozen countries, six of which are developing countries in the Americas, use the exclusive source principle. We should ask, however, what the advantages or benefits are for developing countries in changing from a jurisdictional or limited nexus principle to a comprehensive worldwide income criterion when their residents in general do not derive income from a foreign source or origin. Compulsory incorporation of the schemes in force in developed countries seems to be the reason for this additional peculiarity. “We should harmonize” is the objective, even when the particular socio-economic realities do not harmonize.

One reason for this, obviously, is that universally applying or using the worldwide income criterion facilitates the conclusion of comprehensive tax treaties. It is elementary; we cannot ignore the fact that these treaties, in line with the existing models, involve a unilateral, exclusive and fiscal sacrifice for developing countries when they sign such treaties with developed countries. This is not unknown; it is simply ignored, taking into account that, in the relationship between developed and developing countries, income flows are exclusively or practically unilateral. The domestic doctrine of developing countries in general also ignores this and fails to make this kind of analysis for obvious reasons relating to current or potential professional reasons or, in certain cases, due to a marked foreign intellectual dependence.

“The model treaties under consideration restrict or cancel the income tax at source in developing countries and thus act as a mechanism for transferring tax revenues from poor countries to rich countries, which at the very least is unjust. The UN Model Tax Convention is a more acceptable version for these countries than the OECD Model Tax Convention. The UN Model, in fact, is simply an OECD version corrected to the extent acceptable to developed countries, which also produces transfers, but lesser ones. Therefore, the UN Model, in its structure and conception, is similar to the 1963 Draft OECD Model.

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1 Figueroa, Antonio Hugo, “Fiscal Obstacles and Capital Mobility” (Obstaculos Fiscales y la Movilidad de los Capitales); Seminar on Fiscal Obstacles to the Flow of International Investments in Paris in 1990, organized by the OECD/IMF.

2 The reference to the transfer of revenues from poor countries to rich countries should not be taken as a political statement; it is an objective fact that shows, among the negative aspects that hinder the shaping of a better world, yet another aspect relating to international taxation.
The provisions of the UN Model which present different alternatives from the OECD Model cannot be regarded as substantive or significant and, after 12 years (1967 to 1979) of intense debate, the provisions reflect the great difficulty that has existed and still exists in achieving a logical, appropriate balance in the exercise of taxing powers between the two groups of countries in order to avoid or minimize the fiscal sacrifice, in most cases useless, made by poor countries for the benefit of rich countries. In 2000, the new UN Model was published, though in fact there is practically nothing new about it apart from the incorporation of formalities contained in the 1999 version of the OECD Model.

Making changes to the UN Model requires consensus and in the UN Group of Experts this did not occur due to the resistance of certain developed countries, which is simply the result of the strong interests at stake. The only important advance that met with the experts' general agreement was the change in Art. 9 (Associated enterprises), which, in a new paragraph, removes the obligation in some cases to make a correlative adjustment. Nothing more, after 20 years in which there were significant changes in various aspects of the world economy.

In the OECD Model, with relevant limitations on the source country, the fiscal harm for developing countries is [*382] more evident. The OECD Model was conceived by and for countries with bilateral income flows in order for them to restrict or extend, as applicable, their power or right to subject to tax benefits or profits. In fact, taking into account the dual nature of OECD countries, recipient and income-paying countries, the fiscal sacrifice produced by the OECD Model’s structure for source countries is offset, to some extent or in some way, by the benefit from cancelling or minimizing the tax in the other country taking on the character of a residence country. It should be observed that the argument of compensation is used by officials and experts from developed countries when they consider treaties with developing countries. This is a fallacy since there is absolutely no compensation.

It should be added that experience and the actual data show that an OECD Model-type treaty does not have the effects attributed to it as a driver of investments. Indeed, experience demonstrates categorically that investment depends on a propitious climate for business. This is a blunt denial of the idea that such treaties are significant instruments for promoting foreign investment.

Further, with a good measure of truth, it is usually stressed that unilateral measures may be insufficient in certain circumstances and that they are susceptible to change which may affect the original economic and financial equation of some invest-

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ments—aspects that may find a solution under different schemes. It is argued that an OECD Model-type treaty concedes or grants, like a miraculous potion, extraordinary benefits to developing countries that adhere to such treaties. Indeed, it is pointed out, among other things, that a treaty:

1. fosters direct investment:
   a. it makes it possible to finance business expansion, increases production and improves productivity;
   b. it generates an increase in employment, both direct and indirect;
   c. it increases the transfer of cutting-edge technology; and
   d. it encourages the creation of more attractive economic conditions;
2. grants the status of "partner" to the developed country, an aspect that facilitates political relationships; and
3. establishes legal certainty and the stability required by business.

These arguments are weak. The scope of this article prevents comprehensive development of each point. But it is evident that for direct investment, in a world like today’s where there has been an implicit harmonization process regarding basic structure and income tax rates, a determining factor must be a propitious climate for investment in which the tax factor, the income tax, for the reason given, is no longer a determining element or factor. Job creation, increased productivity and more transfer of cutting-edge technology come about for economic and commercial reasons other than the tax system in force, if such a tax system is designed following the prevailing schemes used in the rest of the world. Finally, the status of political partner is not acquired through a tax treaty—in the same way that juridical or legal certainty and greater stability are, to a large extent, part of the climate a country should create or maintain to foster investment, and they do not depend on the existence of a tax treaty.

If the foregoing comments on the OECD Model did not suffice to indicate a need for change, it should be added that the OECD Model has become anachronistic, given that its basic structure is over 40 years old (1963) or over 50 if we take into account the decade in which the Model was conceived, and it is not appropriate for, nor does it fit into, the new ways of undertaking international economic activities. It should not be forgotten that, in the 1950s and early 1960s, only a few countries had domestic legislation containing measures for removing double taxation, meaning that the OECD Model provided solutions to one of the greatest problems of that time for a specific core of countries. Nevertheless, publication of the Draft OECD Model in 1963 did not seem to be very important.


Specifically, Elisabeth Owens pointed out in 1963 that, in the case of the United States, the OECD Model did not provide better solutions than those in the US Internal Revenue Code regarding unilateral
Apart from the modifications introduced since the adoption of the “dynamic” OECD Model in 1992, up to 2004 its structure and the basic conception are the same. In fact, for source countries, the OECD Model has worsened with some changes, such as in the case of equipment rental, a measure that lacks a solid technical and economic basis and only responds to the specific interests of a particular country. The basic objective of a treaty, to remove international double taxation, was important 50 years ago in order to offset the lack of foresight of domestic laws.

Today, there are no national standards which, according to the worldwide income criterion, establish an FTC scheme since it is very difficult, if not impossible, for the beneficiaries of foreign income to agree to pay the same tax or an analogous tax twice on the same income in different jurisdictions, without there being a credit for foreign taxes in their residence country. Indeed, a country’s own legal system would probably put a stop to it with the reasonable argument that it is confiscatory, an aspect which is also established in various national constitutions.

If, in general, neither the criteria in force in the 1970s nor those of the 1980s apply at the start of the 21st century, it seems absurd to maintain that the criteria in the UN and OECD Models are still pertinent today. In The Third Wave (1983), Alvin Toffler accurately pointed out the impossibility of fitting the new reality into yesterday’s conventional cubicles. Maintaining the schemes in these Models is irresponsible and ineffective, and it aims only at maintaining the status quo for certain sectors with very specific interests.

Objective doctrinal criticisms are increasingly strong and bitter against using the standard structure adopted in the Models, indicating at the least that tax treaties have simply become mere instruments for individuals who engage in international activities. For their part, official experts of developed countries stress that treaties create possibilities of evasion or avoidance which could not exist in countries that do not have tax treaties; this means that it is harder to trick the legislation of the countries involved than to manipulate a treaty or, in other words, to make abusive use of it. Since the other basic objective of a comprehensive tax treaty is to combat evasion, from what has been shown, it can be seen that not only does a treaty not combat evasion, but a treaty positively encourages it.

It is usually stressed, however, that the OECD Model is very successful since the OECD itself has counted some 2,000 treaties drawn up according to the Model.

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7 Members of the UN Group of Experts on International Tax Cooperation, active specialist officers representing the governments of developed countries, Group Annual Report (1983).
Argentina’s case is included, as maintained by the OECD. In fact, when Argentina negotiated its treaties, it did not use the OECD Model, and it should be noted that since 1980, with certain variations, Argentina has been closer to the UN Model. The success the OECD attributes to itself in the application or dissemination of its Model is relative since a more detailed analysis shows that the treaties between OECD countries amount to 900, meaning that 1,100 were concluded with non-OECD countries.

A substantial study carried out at the request of the UN Ad Hoc Group of Experts in International Cooperation on Tax Matters (1997) pointed out that 800 treaties contain specific clauses from the UN Model. Therefore, there are only 300 treaties signed by non-OECD countries that are based on the OECD Model, meaning that there could be only ten non-OECD countries that conclude treaties with OECD countries.

It is important in this analysis to take into account that developing countries attempt to overcome their chronic state of stagnation by various means. When they negotiated a tax treaty, they did so on the assumption that, in this way, they were entering into an agreement that would stimulate investment from the other country. Developed countries are generally the ones that demand to negotiate under pressure from one or more enterprises resident in their national territory. Negotiation is the result, then, of coercion arising from the prospect of investment, however small it may be, in countries with serious social problems. This assumes negotiations between sovereign countries with a logical balance that, in practice, does not exist when one country faces enormous needs. In the real world, the OECD Model becomes a kind of “imposition/tax” intended to reduce taxation in the source country with the supposed compensation of new investments which often do not materialize since, by definition, there can be no tax compensation in this balance of power. In such cases, it is injudicious to consider the negotiation of treaties as a success.

Thus, it is valid to ask whether there are any alternatives that will improve the current situation without generating undesired results, gaps in regulations, or simple basic abuses or attempts at abuse arising from an obsolete or anachronistic structure. The response is affirmative, but for this, it is vital to have a broad criterion and a great deal of common sense because countries do not want to give up resources, taxpayers do not want to pay more tax, and the new reality requires simplification of the existing scheme for the purposes mentioned above.

We cannot avoid the fact that the income tax is still the ruling tax, the logical and adequate tax, and part of a certain pattern of values in democratic systems of government. This means that the income tax may persist as an essential component of the instruments that make up a national tax system. Thus, it is reasonable to debate the objective jurisdictional principle, a common concept of source, by providing a more in-depth analysis of income from domestic sources derived by non-residents, with particu-
lar emphasis on aspects such as payments for financial services and for technological benefits in order to establish parameters that can be considered to be generally acceptable in determining net income at source.

4. Income Tax in Argentina—Overview

The income tax was introduced in Argentina in 1932, although the first attempts to introduce this tax into the national tax system were made in the first and second decades of the 20th century. As pointed out above, the source principle was adopted as the jurisdictional principle. In the first important tax reform after the introduction of the income tax, in 1946, a structure was adopted apart from the changes made on various occasions until its change in name in 1973, of a synthetic or overall nature, with four categories of income (real estate income, capital income, income from companies and income from labour) for purposes of allocation to a fiscal year and determining net income.

As from 1999, however, Argentina, without detriment to its position as a developing country (i.e. with minimal formal foreign investment) adopted the worldwide income criterion in its income tax, but there were significant reasons for it. This was the result of a special agreement in 1992 between the National Congress and the Ministry of Economic Affairs which, failing in its attempt to remove the income tax, pushed to extend the tax base. The tax could not be levied until 1999 due to the substantive technical defects in the law passed in 1992.

The technical structure of the current tax compared to the tax in force until 1998 is different only in that a chapter relating to income from a foreign source was incorporated into the legal text. This means that the same set of rules applies as before the change, source taxation to taxation of worldwide income, relating to the income categories and allocation to a fiscal year. When adopting the new subjective jurisdictional principle, the residence criterion was chosen. [*384]

5. Negotiation of Comprehensive Tax Treaties

5.1. Stages and general scheme

Until 1976, apart from the many negotiations undertaken by the tax policy division of the Ministry of Economy, Treasury Secretariat, with various countries, including the United States and European countries, only two comprehensive tax treaties had been signed. This was without detriment to the many specific agreements for avoiding double taxation with respect to international transport since Argentina adhered to the scheme by which each country reserves the exclusive right to tax its own transport enterprises.
In 1962, the treaty with Sweden entered into force. It is based exclusively on the source principle, i.e. each state levies its tax exclusively on income originating therein with no reduction in the rate of withholding tax in the source country, except in relation to royalties, where a withholding tax rate of 15% was set. This treaty responded to the position held by mutual consent by the tax policy division and by a large part of the national (Argentine) tax doctrine. The mechanism adopted to remove double taxation, in line with the guidelines suggested at the 1943 League of Nations meeting in Mexico, consisted of exclusive taxation in the source country of the income.

In 1967, the treaty with the then Federal Republic of Germany entered into force, negotiated by a de facto and unconstitutional government, the treaty being the result of a decision by that government that avoided the line of negotiation used until then. This is pointed out because Argentina did not have, nor does it now have, a clear position in favour of signing tax treaties in line with the existing models, UN and OECD Models, which provide a solution to the problem of international double taxation by mechanisms that involve removing or reducing taxation in the source country of the income.

The treaty with Germany, in line with the 1963 Draft OECD Model, was denounced by the Argentine government in 1973 due to the unilateral sacrifice the treaty imposed on the source country of the income, namely, Argentina. The unilateral nature of the income flows in the developed country-developing country relationship is manifest, based on a paper presented for discussion at the Seminar on Capital Movements and the Fiscal Factor in 1990, a position also held by this author in a discussion panel in which he took part at that seminar with Victor Tanzi.

For his part, Prof. P. Nimerman of the University of Hamburg, Germany, in a detailed study, confirmed Argentina’s unilateral sacrifice arising from the treaty with Germany, without the sacrifice being offset by an increase in the investment flow from Germany. The two countries renegotiated the original treaty (1967) and, in 1979, a new treaty entered into force. Although it improved the situation of the source country, Argentina, it did not substantially change the classic mechanisms envisaged in the UN/OECD Models for avoiding double taxation. It is very important to take into account that, once a tax treaty is signed and ratified, it is very difficult for any developing (or any) country to revoke it.

After the 1967 treaty with the Federal Republic of Germany, there were no new negotiations until 1977, although negotiations did continue with some countries in 1972 since the negotiations had been initiated in the late 1960s, but without a treaty that
being concluded. In 1977, the new de facto government accepted foreign demands to initiate negotiations. As can be appreciated, it was an unconstitutional government that undertook them.

In the second stage of negotiations, conversations were held with all the Western European countries, the former USSR, Japan, Hungary, Romania, the former Yugoslavia and five countries in the Americas: Bolivia, Brazil, Canada, Chile and the United States. The de facto government’s aim was to reach agreement with all these countries but, due to the position adopted by the technical division in charge of negotiations, treaties were concluded only with Austria, France and Italy; these treaties were ratified and entered into force. The treaty with the United States, signed in 1981, was not ratified for various reasons.

The treaties negotiated with developing countries in the Americas, such as Bolivia and Chile, were based on Decision No. 40 of the Joint Agreement of Cartagena (Andean Pact), that is, they were designed taking into account the method of exclusive taxation in the source country. The treaty with Brazil had an atypical slant compared with any classic pattern since Argentina and Brazil maintained their own positions in defining the source concept, without detriment to the fact that the two countries may subject to taxation, with no limit whatsoever, the income that, according to their legislation, originates in their territory. All these treaties are still in force.

The reasons for negotiating comprehensive tax treaties with developing countries in the Americas such as Bolivia, Brazil and Chile relate to the goal of the de facto governments in each country in connection with plans for integration and complementation between the countries in the region. The situation in the late 1970s tells us that there was very little chance of immediate and real investment from one country to the others, and relations in the economic field were limited to commercial aspects (imports and exports). In the case of negotiations with developed countries, investment expectations were the determining factor.

Removal of double taxation was not an objective because local residents were not subject to international double taxation since the domestic law—the income tax—had adopted the source principle, even though, if the worldwide income criterion had been in force, as in the case with the remaining developing countries, local residents did not derive formal income from foreign sources.

The structure of a comprehensive tax treaty contains relevant questions relating to the economic bilateral relationship and other less important questions taking into account such a perspective. The latter include the treatment of diplomats’ income, employment income, pensions, and income derived by artistes and sportspersons, students, professors and researchers, and government officials. That is, these provisions, while necessary to complete a tax treaty, do not involve issues that give rise
As to the negotiations in the second stage, it can be deduced that Argentina preserved as far as possible its criterion of taxation at the origin (source taxation). In addition, regarding dividends, interest and royalties, Argentina maintained a withholding level that could well be described as unusual compared with the treaties between other countries and the above-mentioned European countries and with the United States. The treaties negotiated with those European countries envisage having a tax sparing clause; it could not be otherwise since such a clause is a special mechanism that avoids transferring resources when, for some reason, the source country decides to exempt particular income.

The treaty with the United States, signed but not ratified, was negotiated assuming the position held by the United States on tax sparing clauses, but it incorporated a provision to avoid illogical transfers. The United States accepted the proposal to include a clause by which Argentina could levy its tax on the local-source income obtained by US residents at the time of transferring it, in cases where such income was previously exempted. The purpose was to avoid local fiscal sacrifice benefiting the treasury of the other contracting state, assuming that the purpose was to provide a fiscal benefit to the investor only. In the case of a comprehensive tax treaty between a developed country and a developing country, the former, having the status of treaty partner, should share the fiscal sacrifice of the latter for a period of at least five to ten years in order to facilitate the latter’s economic and social development.

It should be added that, in the treaties with Bolivia, Brazil and Chile, no limit was set on the withholding tax rate. In addition, none of the treaties includes a tax sparing clause because, in the treaties with Bolivia and Chile, each country reserved the exclusive right to tax the income generated in its territory, the source principle, with no limit envisaged in the bilateral agreement. This position is what sustains the Andean Pact to which the two countries were a party at the time; Argentina accepted this position since it is reflected Argentina’s domestic law. On the other hand, in the treaty with Brazil, taking into account that Brazil already applied the worldwide income criterion, Argentina reserved the right to apply Art. 21 of its domestic law which, as indicated in the previous paragraph, provides that all exemptions granted to a non-resident are rendered without effect on transfers overseas insofar as the exempt local income is subject to tax in the beneficiary’s residence country.

From 1981 to 1992, there were no negotiations on this issue because the constitutional government that took office in 1983 also interpreted that the classic version of tax treaties involves a fiscal sacrifice generally that is not offset for the source country by greater investment. The government that took office in 1989 changed this position and, in 1992, began the third and last stage of negotiating tax treaties.
In the last stage of negotiations, the criterion of taxation in the source country of all kinds of income was preserved. By a political decision, however, the withholding tax rates were lower compared to those agreed in the late 1980s. Including a tax sparing clause was also a constant in the negotiations undertaken in the 1990s and, in some cases, a reservation was made for applying Art. 21 of Argentina’s domestic income tax law, which establishes a provision for soak-up-type taxes in order to avoid transfers of resources to other treasuries.

During this stage of negotiations, the domestic income tax law did not yet have thin capitalization rules designed to avoid manoeuvres designed only to reduce the income tax in the source country. The treaties, however, included a rights-reserving clause establishing that no provision in the treaty will prevent Argentina from applying its domestic regulations because the local negotiators considered this issue to be a logical issue that should be included in the domestic law.

A new addition was made in the last stage of negotiations—the inclusion of a most-favoured-nation (MFN) clause. That is, Argentina undertook, from the first treaty signed in this stage, not to grant greater concessions to an OECD country than those granted to the country with which Argentina signed the first treaty. The MFN clause, included in a protocol to the treaties, covers cases of proportional withholding taxes at source and some headings such as, for example, the inclusion of the expression “technical assistance” in the definition of royalties in Art. 12 (Royalties). A provision of this type—MFN clause—restricts the possibility of negotiating with developed countries which propose lower withholding rates in the source country or want the source country not to subject to tax certain income derived by residents of the other contracting state, e.g. payments for “technical assistance”.

In a way, by considering Argentina as the constant and the other country as the variable, this made it possible to maintain a common line of negotiations, regardless of the specific negotiators, in order not to provide greater benefits to the residents of one country than to the residents of other countries. This is because it is evident that, in the relationship between a capital-exporting country and a developing country, the latter is the only one that makes a tax sacrifice in terms of giving up its normal and legitimate right to tax by granting that power to the other country in one case and, in the other, restricting the tax envisaged in its domestic laws. This is without detriment to a tax treaty that also prevents the exercise of domestic tax policy regarding the treatment of income derived by non-residents. In the real world, these issues do not arise in a capital-exporting or developed country because there is no transfer of exclusive power to the source country and the restrictions on withholding at source (tax reduction) do not favour residents of the developing country.

Further, if a developed country grants or concedes a tax sparing clause, assuming that the other contracting state, a developing country, is making a fiscal effort for
socio-economic [*386] purposes, the first-mentioned country accepts such a clause only for a certain number of years. In contrast, the developing country’s transfer of its taxing powers to a developed country and the tax reductions at source are permanent, that is, as long as the treaty is in force.

These treaties establish reciprocity of treatment as an inherent and transcendent aspect, characteristic of bilateral treaties between countries. However, regarding the transfer of the exclusive right to tax (from the source country to the residence country) and the reduction of withholding tax rates in the source country, this reciprocity is merely formal, a fiction, because, in the real world, residents of developing countries do not generally derive income from the other contracting state (developed country).

At this point of the analysis, it should be pointed out that it is a mistake to assume that Argentina has adopted the OECD Model—as does a certain doctrine or as indicated in some reports by the OECD’s technical areas. In fact, the UN Model was adopted as the basis ever since the Model appeared, with the modifications necessary in the treaties with capital-exporting countries, as determined by the political authorities. In this stage, the decision to negotiate cannot be considered part of the country’s negotiating policy, but rather a decision by the government in connection with its own particular objectives.

The economic authorities of the present government have suspended negotiations for comprehensive tax treaties on the basis of technical reports that point out the losses produced by tax treaties for a country like Argentina, with no compensation whatsoever in the form of receiving investment from the other country. The economic authorities also point to the opportunities that treaties provide for manoeuvres that harm the source country in particular, stressing how difficult it is for the tax administration to properly control such manoeuvres.

Argentina has signed treaties with practically all potential capital-exporting countries. It also considers, as do other countries with the same characteristics, that it is necessary to address the problems potentially posed by the exercise of taxing powers by more than one country with respect to the same income or benefit in a different manner from the current pattern. Nowadays, countries cannot and should not adopt attitudes that isolate them, but they cannot continue to adhere to schemes which, for them, result in an unjustified loss of resources. By virtue of this, it is necessary to set new formulae to resolve an old problem in a more balanced framework than the present one, without affecting the normal course of investment and international economic activity.

5.2. Some technical aspects

As mentioned above, in its treaty negotiations, Argentina adopted the UN Model, not the OECD Model, with the adaptations required in each case. They include consultancy work in the concept of permanent establishment (UN Model), the six-month
period for a permanent establishment (UN Model), and deletion of the word “delivery” (UN Model) from the exclusions of the permanent establishment concept in Art. 5.

The article on company profits (Art. 7) adopts the principle of “limited force of attraction” contained in the UN Model. In some cases, Art. 7 also includes the provision on the deduction of foreign expenditure from the income of a permanent establishment. In other cases, Art. 7 is adapted in line with the principle in the law on the taxation of domestic income regarding the general deduction of expenditure—the causality principle.

With regard to dividends, interest and royalties, it is clear that the position adopted is a direct reflection of the UN Model. The maximum withholding tax rates are different from those in the OECD Model, royalties can be taxed in the source country, and the definition of royalties, with additions, is closer to that in the UN Model. Likewise, a provision taking into account the branch tax is incorporated, as a reservation of rights, because the law in force has no provision of this kind.

In the residual provisions of Arts. 13 and 22, capital gains and capital tax (last paragraph), it is established that both states may tax goods which are located in one country but belong to a resident of the other country. This is another aspect that shows objectively that Argentina’s position differs from the OECD Model.

6. Final Reflection

Today, international double taxation does not appear to be the true reason for negotiating tax treaties. Forty-two years have gone by since the 1963 Draft OECD Model was published, and its little or no importance for US taxpayers was pointed out, the same year and quite frankly, by Elisabeth Owens. This is long enough to start thinking of better schemes which are more appropriate to the new times.

A better world requires better measures. It is not possible to continue promoting instruments which, according to qualified doctrine and off-the-record opinions of highlevel officials from capital-exporting countries, facilitate tax avoidance and, in some cases, tax evasion. This is a contradiction in terms.

If each country simply taxes income generated in its territory, if the concept of source is harmonized and if reasonable parameters are established for determining the net income of non-residents, the normal flow of investments will be facilitated, tax collection will not decline, and the income tax will continue in force as inherent to the democratic system of government.