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MEASURES TAKEN BY THE GOVERNMENT OF THE FEDERAL REPUBLIC OF GERMANY TO ENCOURAGE INVESTMENT IN INDUSTRIAL PROJECTS IN DEVELOPING COUNTRIES[1]

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MEASURES TAKEN BY THE GOVERNMENT OF THE FEDERAL REPUBLIC OF GERMANY TO ENCOURAGE INVESTMENT IN INDUSTRIAL PROJECTS IN DEVELOPING COUNTRIES

I. INTRODUCTION

1. As soon as the Federal Republic of Germany had sufficiently rebuilt her industry after the Second World War, she took an active part in assisting developing countries. An important part of this policy is to encourage and stimulate the business community to invest in these countries. For that purpose, a number of measures have been introduced.

2. Measures introduced at the national level include tax incentives, assistance with financing, and an investment insurance scheme. In addition, at the international level the Government has signed double-taxation treaties with 9 developing countries and bilateral investment guarantee treaties with nearly 30 developing countries. Subsequent sections of the paper will discuss these measures in this order.

3. The Government also helps to supply the necessary information for doing business in developing countries, an aspect which is extremely important for small and medium-sized businesses; to a large extent, these services are provided by government agencies of government-owned corporations which can operate more flexibly than the Government itself.

Size and distribution of resulting private investment

4. The value of German private investments in developing countries at 30 June 1968 is estimated by the author at approximately DM 6,000 million. Figures collected by the Ministry of Economy since 1952 show that the total net capital outflow of direct foreign private investment abroad has been DM 13,043 million, of which DM 3,793 million has been invested in developing countries.

5. This latter statistic, however, gives an inaccurate picture of German private direct investments abroad for two reasons. First

they do not take into account undistributed and reinvested profits, which might be estimated between 200 million and 500 million DM.[1] Secondly, the outgoing investment is allocated according to the initial destination of the outflow of capital. For tax and other reasons, many companies use foreign intermediary holding companies, mostly located in Switzerland and Canada. A substantial share of the investments of these base companies — including additional funds raised outside the country and not included in the above statistics — is eventually directed to developing countries.[2]

6. For these reasons also, the geographical distribution cannot be accurately determined. The following table lists those developing countries which have attracted more than DM 100 million of the DM 3,793 million measured capital outflow to developing countries since 1952 as defined above:

Brazil	DM 1,097 million
Argentina	DM 348 million
Mexico	DM 179 million
India	DM 157 million
Libya	DM 150 million
Liberia	DM 137 million
Colombia	DM 102 million

There is little information available on the branch or type of industry which this investment has helped to establish.

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(1) The Deutsche Bundesbank reported that the transfer of dividends and profits back to Germany had been negligible and therefore one can assume that substantial profits were retained. Cf. Deutsche Bundesbank: Die deutschen Direktinvestitionen im Ausland. *Monatsberichte der Deutschen Bundesbank*. December 1965 (also available in English).

(2) See H. Seifert: Die deutschen Direktinvestitionen im Ausland. Köln und Opladen 1967. pp. 53 - 65.

7. An analysis of the effect of tax incentives introduced in 1963 to stimulate investment in developing countries showed that just over 100 investors invested DM 200 million in each of the years 1963 and 1964. Investments qualifying for incentives were DM 75 million in 1963 and DM 123 million in 1964.

II. INSURANCE AND GUARANTEES FOR INVESTMENT IN DEVELOPING COUNTRIES

A. Investment Insurance Schemes

8. Businesses may obtain insurance from the Government against political risks for their investments in developing countries. This guarantee covers losses suffered by nationalization, expropriation, war, riots, revolution, standstill-agreement, exchange and transfer risks. Besides the original investment, profits and interest payments may also be included in the guarantee. In general, the investor will have to take only 10% of the total risk. The annual fee for the guarantee comes to 0.5% of the amount guaranteed; the guarantee is generally limited to 15 years; this period may be extended to 20 years only in exceptional cases.

9. Applications for such a guarantee will be accepted by the Deutsche Revisions und Treuhand-AG, (Hamburg 1, Hermannstrasse 40) only for investments in countries which seem to provide for a sufficient degree of legal protection. As a general rule this condition is fulfilled by all countries which have concluded an investment promotion treaty with the Federal Republic.

B. Investment guarantee treaties with developing countries

10. Since 1959 the Federal Republic has concluded treaties with developing countries for the purpose of increasing the legal position of German investors in the country receiving the investment. In these treaties the partners have agreed to the following principles:

- Fair, just and non-discriminating treatment of investments, for example by providing most-favoured-nation status;
- Guarantee of transfer of profits and of the proceeds realized when the investment is sold or liquidated;

- Protection against arbitrary nationalization without payment of an adequate indemnity;
- Clause of arbitration in case of disputes about the interpretation or application of the treaty;
- In case of termination, the treaty should remain in force for a certain number of additional years as far as investments are concerned which were made prior to the date of termination of the additional treaty.

11. Even when these agreements follow a certain model, the individual treaty may contain provisions which may differ quite substantially from one country to the other. This is especially true in respect of exchange regulations, the application of the treaty on investments made prior to the date when the treaty came into force, the extent of the legal protection etc. In any particular case the wording of the respective treaty must be thoroughly checked.

12. The bilateral treaties for the promotion and protection of investments which have been either signed, ratified, or are already in force are listed in Annex A.

III. ASSISTANCE WITH FINANCING INVESTMENTS IN DEVELOPING COUNTRIES

13. Two institutes have been established to provide long-term finance[3] for investments in developing countries — the Kreditanstalt für Wiederaufbau (KFW) and the Deutsche Entwicklungsgesellschaft (DEG). In addition, grants are provided by the Government for the training of labour for certain projects in developing countries.

1. Kreditanstalt für Wiederaufbau

14. The KFW grants long-term loans to business enterprises resident in the Federal Republic of Germany out of the E.R.P. Counterpart Fund in order to enable them to invest in developing countries. The

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(3) Finance provided in the form of export credits and related insurance guarantees are not considered in this paper.

intended purpose is the financing of the establishment, expansion, or the acquisition of interests in industrial and other enterprises in developing countries. So far under this programme loans totalling more than DM 100 million have been made. The loans are primarily intended for small to medium-sized businesses. Larger companies may be considered in cases where investment projects of a considerable development potential could not be otherwise financed.

15. Applicants are required to contribute their own funds which must be adequate in relation to their profits and net worth and the business needs for domestic operations. The loan may not be used for repaying and for funding existing obligations. The individual loans are usually limited to DM 500,000 but in exceptional circumstances loans of DM 1 million may be granted. The amount of DM 1 million may, however, be exceeded in cases where investment projects of a considerable development potential to the host country could not be otherwise financed. The interest rate is 6% per annum; the loan is paid out at its nominal value. The duration of the loan is up to 12 years, with repayments starting not later than after 4 years.

16. The loan can only be provided with the consent of the Federal Ministry of Government Holdings (Schatzministerium). The necessary consent is obtained by the Kreditanstalt für Wiederaufbau on behalf of the applicant.

2. Deutsche Entwicklungsgesellschaft

17. The German Development Company (Deutsche Entwicklungsgesellschaft = DEG) is an investment company with an authorised capital of DM 115 million. The company was established by the German Federal Government in September 1962 with the object of stimulating private enterprise to invest in developing countries and of supporting such projects.[4]

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(4) German Development Company: Possibilities of Co-operation. Second edition. Cologne 1966. 16 p.

Deutsche Gesellschaft für Wirtschaftliche Zusammenarbeit, Durener Strasse 295, 5 Köln-Lindenthal, Federal Republic of Germany.

18. DEG's activities are based on the principles of private enterprise. The German Development Company invests in private enterprises in developing countries (a) by participating in the equity capital, and (b) by granting loans with equity features, as a rule in combination with an equity participation. This applies to completely new investments as well as to investments for expansion of existing enterprises.

19. The DEG advises enterprises interested in investments in developing countries and endeavours to bring together prospective partners of a joint venture. Investments are carried out by DEG together with partners from both developing and industrialized countries.

20. Investments by DEG are on condition that at least one partner is able and willing to make available his business experience and technical know-how to the enterprise in the developing country. These partners who provide know-how are expected to acquire an adequate financial interest and to ensure competent management of the enterprise. In the case of new ventures, it may be assumed that the know-how comes from an industrial country.

21. DEG gives no preference to any particular developing country, branch or sector of industry. However, investments of DEG are primarily designed to promote the establishment of small and medium-size enterprises.

22. The amount invested by DEG depends - inter alia - on the financial commitments of DEG's partners and on the special requirements of the project. It is not the aim of DEG to obtain majority shareholdings. DEG will invest only in projects which show promise of commercial success. The proposed venture should, therefore, have a sound financial structure and should offer good prospects of providing an adequate return.

23. Investments of DEG will normally take the form of equity participation in the share capital of enterprises in developing countries, whereby its liability is limited to a fixed amount. In

consideration of its participation DEG expects to be accorded the usual rights in respect to votes, representation on the Board or other rights of supervision and making decisions, as well as a proportionate share in the profits of the enterprise.

24. In special instances the Company may grant so-called "loans with equity features", mostly in connexion with an equity participation The conditions of such loans and the extent of DEG's influence on the enterprise will be similar to the terms of an equity participation of DEG and will depend on the specific circumstances of the project concerned. As a matter of principle, loans with equity features are granted in Deutschmarks and must be repaid in the same currency.

25. As an investment institution, the German Development Company acts in co-operation with its partners' bankers; it does not give loans such as extended by banks.

26. Investment projects must serve the purposes of development policy, i.e. they should further the economic growth in the respective developing country. This requirement would be met, for instance, if the project in question assisted the country's development policy by:

- providing technical and managerial know-how;
- reducing imports by increased local production for the domestic market;
- increasing exports by expanding production;
- creating new permanent jobs;
- coordinating the project with development plans.

27. A favourable investment climate in the developing country concerned is an essential pre-requisite for an investment by DEG. It will invest its funds only if the legal position and the actual conditions prevailing in the country may be expected to ensure adequate protection of capital investments from government interference, as well as the unrestricted transfer of earnings and capital.

28. As a matter of principle, the German Development Company is free to participate in any kind of enterprise in developing countries. The

Company will, however, not invest in:

- enterprises operated or controlled by local governments;
- infrastructure projects, such as public utilities, schools, construction of roads and ports;
- enterprises with the main purpose of financing export transactions;
- companies which are solely in need of current assets;
- companies which should be reconstructed.

29. At the beginning of 1969 DEG was directly or indirectly engaged in 144 investment projects situated in about 40 developing countries. It claims it has so far made possible total investments of about DM 900 million by subscribing shares or giving loans totalling DM 86 million. Of its 57 direct holdings, 47 have started production and 28 have become profitable. Investments in the Mediterranean area and in LatinAmerica were especially successful.

30. In order to cope with the increased volume of business, the management of DEG recently announced its intention to ask the Federal Government to increase the share capital from DM 115 million to 250 million.

3. Grants for training local personnel

31. For the purpose of training local skilled labour and management personnel for investment projects in developing countries, grants may be given by the Federal Ministry of Economic Co-operation, Bonn, Kaiserstrasse 185-197.

32. As a rule, labour should be trained at the plant in the developing country, while management personnel may be trained in Germany as well. Projects providing for training facilities beyond the requirements of the enterprise are given preferential support.

IV. THE TAXATION OF INVESTMENTS IN DEVELOPING COUNTRIES

33. The Government's tax policy in respect to direct investments in developing countries appears somewhat ambiguous. Whereas some strong incentives are granted for the initial investment decision, income derived from such investments is quite often heavily discriminated against in comparison to domestic income.[5] This is especially true for investments in countries which have no tax treaty with the Federal Republic of Germany. But even when a tax treaty exists, income derived from direct investments may still be heavily taxed in Germany, although such taxation could in many cases be avoided by adequate tax planning. These different aspects of the taxation of investment in developing countries are discussed in this section of this paper.

A. Tax incentives granted for new investment in developing countries

(i) The incentives enacted in 1961

34. In 1961, special tax measures were introduced in the Income Tax Law as an incentive for German private investment in developing countries for the first time. These measures provided for a special deduction from domestic taxable income of up to one-third of the qualifying investment. This amount could be set aside as a tax-free reserve but had to be subsequently reincorporated in the enterprise's declared taxable income in five annual installments, the first being due after three years. Consequently this provision resulted in an average tax deferral of 5.5 years.[6]

35. Of course, this deferred taxation was not applicable when the foreign investment proved to be a failure. However, since the statutes generally tax business capital gains as ordinary income, in case of a failure the whole amount of the investment in a developing country may be written off as a loss.

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(5) This is also officially recognized: see, for example, the article by R. Offermann: Fragen der Ertragsbesteuerung deutscher Direktinvestitionen in Entwicklungsländern. Europäische Steuer-Zeitung Nr. 31, December 1966. p. 132-134 (also in French).

(6) See A.J. Rädler, Capital Export Incentives - The West German Experiment. Canadian Tax Journal 1961, p. 399-402.

(ii) The incentives enacted in the 1963 law

36. These provisions applied to investments made in 1961 and 1962. On 23 December 1963 the Government enacted a new set of measures contained in a special law entitled "Tax measures for the promotion of private investment in developing countries". This law has continued in force until the present time; the range of qualifying investments was widened by an amendment introduced in a law of 15 March 1965.

37. For investments in developing countries(7) made in 1963 and subsequent years, the amount which could be set aside as a tax free reserve (Rücklage) and deducted from domestic income liable to tax was increased from 33⅓% to 50%. The sum deferred in this way had to be reincorporated in the enterprise's domestic taxable income in annual instalments of at least one-sixth starting in the sixth year. Consequently the average tax deferral was increased from 5.7 to about 9 years.

38. The 1963 Law also introduced a special provision (Bewertungsabschlag) which permitted 15% of the cost of the qualifying investment to be written off and deducted from domestic taxable income in the first year. If this was written off in full, the tax deferral was reduced to 35% of 50%, i.e. 17.5% of the initial investment. This additional deduction was not permitted for investment in a treaty country. However, to compensate for this loss, the proportion of the cost of the investment allowed as a tax free reserve is increased to 60%.

39. A wide range of forms of investment — equity participation, loans, joint-ventures and investment in a branch office — are accepted subject to certain qualifications. The funds invested must be used for the acquisition of land, buildings or plant and machinery. Where

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(7) For the purposes of this law the following countries are defined as developing countries:

- Cyprus, Greece, Iceland, Malta, Portugal, Spain, Turkey.

- All countries outside Europe with the exception of: Australia, [illegible], [illegible], Japan, Canada, North Korea, [illegible], Mongolian People's Republic, New Zealand, [illegible], Asian parts of the Soviet Union, [illegible], North Vietnam, People's Republic of China.

1968, investments to increase inventories qualify for tax deferral only. Eligible activities include industry, mining, agriculture, forestry, etc. Investments in banking and insurance are covered by special provisions. The incentives provided by the 1963 law apply to the individual income tax (Einkommensteuer), the corporate income tax (Körperschaftsteuer), the trade tax (Gewerbesteuer), and the net worth tax (Vermögensteuer).

(iii) Economic impact of the 1963 Law

40. If a tax rate of [illegible]% is assumed for the benefitting investor and an interest rate of [illegible]% is used, the benefit to a business investing in a developing country is the same as a tax-free investment cash grant of [illegible]% of the initial investment in developing countries where the investment does not benefit from the existence of a double tax treaty and [illegible]% in those developing countries with whom such a treaty exists.

41. In a report[8] to Parliament of [illegible] December 1964, the Government made an analysis of the impact of the Development Tax Law which covers the years 1963 and 1964. In both years it happened that [illegible] taxpayers made use of the Development Tax Law. Altogether the following investments qualified:

	1963	1964
	DM	DM
in companies	[illegible]	[illegible]
in partnerships	[illegible]	[illegible]
in permanent establishments (branch offices)	[illegible]	[illegible]
total	[illegible]	[illegible]

42. The report also mentioned that the total investments which qualified for the Development Tax Law were considerably lower than the total direct investments made in developing countries which amounted to [illegible] DM in 1963 and DM [illegible] in 1964 (see

(8) BT-Drucksache IV/[illegible]: Bericht der Bundesregierung an den Deutschen Bundestag.

B. Taxation of income derived from investments in developing countries

43. German income taxation is based on the concept of worldwide taxation. Relief from double taxation is granted (a) on a unilateral basis by means of a tax credit, or (b) when a tax treaty exists, by means of tax credit or exemption of certain types of income.

(i) Unilateral relief

44. Where unilateral relief is granted, the tax credit can only be claimed under a per-country limitation. Excessive credit can neither be carried forward nor deducted as a business expense; there is no option to deduct foreign income taxes from taxable income. There is no indirect tax credit for corporation income tax in the case of dividends distributed by a foreign subsidiary.

45. The normal rates of German corporate income tax (Körperschaftsteuer), are 51% on retained profits and 15% on distributed profits; for personal income tax (Einkommensteuer), the maximum rate is 53%. However, these rates give an inaccurate view of the total tax burden. Since 1 January 19[illegible] a surcharge of 3% of the ascertained tax is payable. In addition to that, a municipal trade tax (Gewerbesteuer) of roughly 15% of profits and a net worth tax of 1% (Vermögensteuer) are levied on personal and corporate businesses. Since the trade tax is a deductable item for the purpose of computating taxable income of the same year, the effective rate is 13%.

46. The total income tax burden is thus raised to about 59% on undistributed corporate profits and to a maximum rate of about 60% on profits earned by an unincorporated business. Only income earned in a foreign permanent establishment is exempt from the trade tax. The tax burden on an investment in a subsidiary company operating in a developing country may therefore be something like the following example

Example: Assuming a German company has a subsidiary in Development Country A. On the income of the subsidiary which is assumed at 1,000 before taxes, a [illegible]% corporate income tax is levied by the

developing country. The remaining income should be distributed to the German shareholder, whereby the developing country levies a 30% withholding tax on dividends.

Computation:

Income of the subsidiary before taxes		1,000
40% corporate income tax	-	400
dividends paid out		600
30% withholding tax on dividends	-	180
amount received by German parent company		420
15% German trade tax on taxable income (15% of 600-78 = 522)	-	78
40% German corporate income tax(9) on taxable income (522) - 209; foreign tax credit 180	-	29
3% surcharge on remaining German corporate income tax	-	1
income after taxes.		328

47. As a special concession, foreign income from certain direct investments abroad may be taxed at a reduced flat rate of 25%, but then foreign income taxes may neither be credited nor deducted. This reduction is granted only upon the taxpayer's request. The reduction may be claimed for income of: (a) a foreign permanent establishment; (b) a share in a foreign partnership; (c) an inter-company holding of 25% or more in a foreign corporation, when the German investor is a company.

48. A further limitation requires that the activities of the foreign establishment are limited to those listed above in para 39. This concession was introduced to eliminate the well-known disadvantage of the tax credit system in relation to countries having a comparatively low income tax or countries giving special tax concessions to pioneer industries.

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(9) The rate of German corporate income tax is assumed to be 40% as an average rate on total taxable income.

(ii) Relief under tax treaties

49. Germany has concluded tax treaties with the following developing countries: Pakistan (1958), India, Egypt (1959), Ceylon, Israel (1962), Greece, Argentina, Spain (1966), Thailand (1967). Treaties with a number of other countries are in preparation.

50. The basic concept of German treaty policy is:

(i) To exempt income from the following sources from German taxes: permanent establishments[10], shares in partnerships[10], holdings of more than 25% in foreign corporations when the German taxpayer is a corporation[10].

(ii) To limit the right of the country of source to levy taxes on interest, dividends and royalties;

(iii) To impede the development country to levy income taxes on other activities of a German business, when it does not have a permanent establishment or an agent in the developing country;

(iv) To avoid double taxation by granting a tax credit when the foreign income is not exempted from German tax.

A comparison of some important points of the German treaties with developing countries is given in Annex A.

51. In order to counteract the negative effect of the tax credit system on investment incentives granted by developing countries, tax sparing provisions are included in a number of tax treaties[11]. These are listed in Annex B.

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(10) A bill currently before the Federal Parliament provides for a relief when losses are incurred in a permanent establishment in a treaty country. So far such losses could not be set off from taxable income in Germany because according to German interpretation the exemption under a treaty applies to losses as well as to profits. The new proposal would provide that such losses are deductable; however, subsequent profits from the same country which would otherwise be exempted must be included in taxable income up to the amount of total losses which were previously deducted.

(11) See Tax Sparing by European Countries. European Taxation, 196[illegible], p. 121-129.

(iii) Economic Impact

52. An economic analysis must necessarily come to the conclusion that the German rules of taxing foreign income are not based on an economic concept but are the result of a number of different historical, political, monetary and economic ideas and influences which have prevailed at one time or another since the beginning of this century.

53. For example, the principle of worldwide taxation, on which German tax law is based, cannot be the result of general economic considerations when under a treaty certain types of foreign income are generally exempted from German tax. There is also no economic logic present when income from a subsidiary in a developing country (for example when its shareholder is an individual) is taxed, whereas income from a permanent establishment in the same country is exempt from German taxes.

54. Fortunately, it is more and more recognised by economists as well as politicians and the general public that the tax law discriminates against foreign operations, that is against the interests of the economy and that a general revision of the international aspects of tax law may therefore be needed.

55. The combined impact of taxation in a developing country and the tax law in the Federal Republic of Germany and the treaty implications on the different types of foreign operation is analysed in Appendix C. The computation takes into account German individual and corporate income tax at a rate of [illegible]% and German trade tax at a rate of 15% of taxable income. It is also assumed that the income of subsidiaries is always fully distributed. The table is based on calculations similar to that made in para [illegible] above. The conclusions which may be drawn from the table are:

- in the absence of a treaty and assuming full distribution it is always more advantageous to set up a branch of the business instead of a subsidiary;
- even when a treaty exists, taxes are prohibitive when an individual (or a group of individuals) sets up a company in a developing country;

- in the case of a subsidiary the total tax burden depends largely on whether the developing country taxes the foreign subsidiary or its profit distributions. When tax is levied on distributions the total tax burden is usually much lower.

I. CONCLUSIONS

96. A number of financial, tax and other measures have been taken to encourage private investors to make investments in developing countries. One of the most important measures seems to be the insurance and guarantees for investment in industrial projects in developing countries.

97. Assistance with financing new projects is basically intended for small and medium-sized businesses. Since its establishment in 1962 the DEG has substantially increased its activities. Apart from providing equity or loan capital it offers very important services to small and middle-sized German businesses by preparing pre-investment studies and offering its substantial know-how. New plans to increase the financial potential of Kreditanstalt für Wiederaufbau to finance German direct investments abroad and especially in developing countries are currently under consideration.

98. It seems that the big corporations, which represent the bulk of the new investment in developing countries, have financed their foreign operations in developing countries mostly out of their own funds and out of funds which were borrowed abroad.

99. The policy in respect to direct investment in developing countries appears somewhat ambiguous. Whereas some strong incentives are granted for the initial investment decision, income derived from such investments is quite often heavily discriminated against in comparison to income earned at home, even when a tax treaty exists. It seems that the tax incentives are still not strong enough to outweigh these negative tax aspects.

100. To improve the situation, new legislation might provide that income derived from subsidiaries and permanent establishments located in developing countries was exempt from income tax; this

exemption for income from a subsidiary might also apply when the investor is not a company.

61. For interest and royalties earned in a developing country, a minimum tax credit might be granted even when no tax is levied in the developing country[12]. Additional relief from the local trade tax may also be warranted. Minimum requirements would be: (i) exemption for dividends from a subsidiary abroad, irrespectively whether the investor is a company or an individual; (ii) reduction of tax rate for dividends from portfolio holdings, interest or royalties earned in developing countries; such income could, for example, be taxed at only half of the normal rate.

62. If an increase in private investment in developing countries is a goal, such a realignment of the taxation of income earned in developing countries combined with the substantial incentives provided for the initial investment decision could help achieve this goal.

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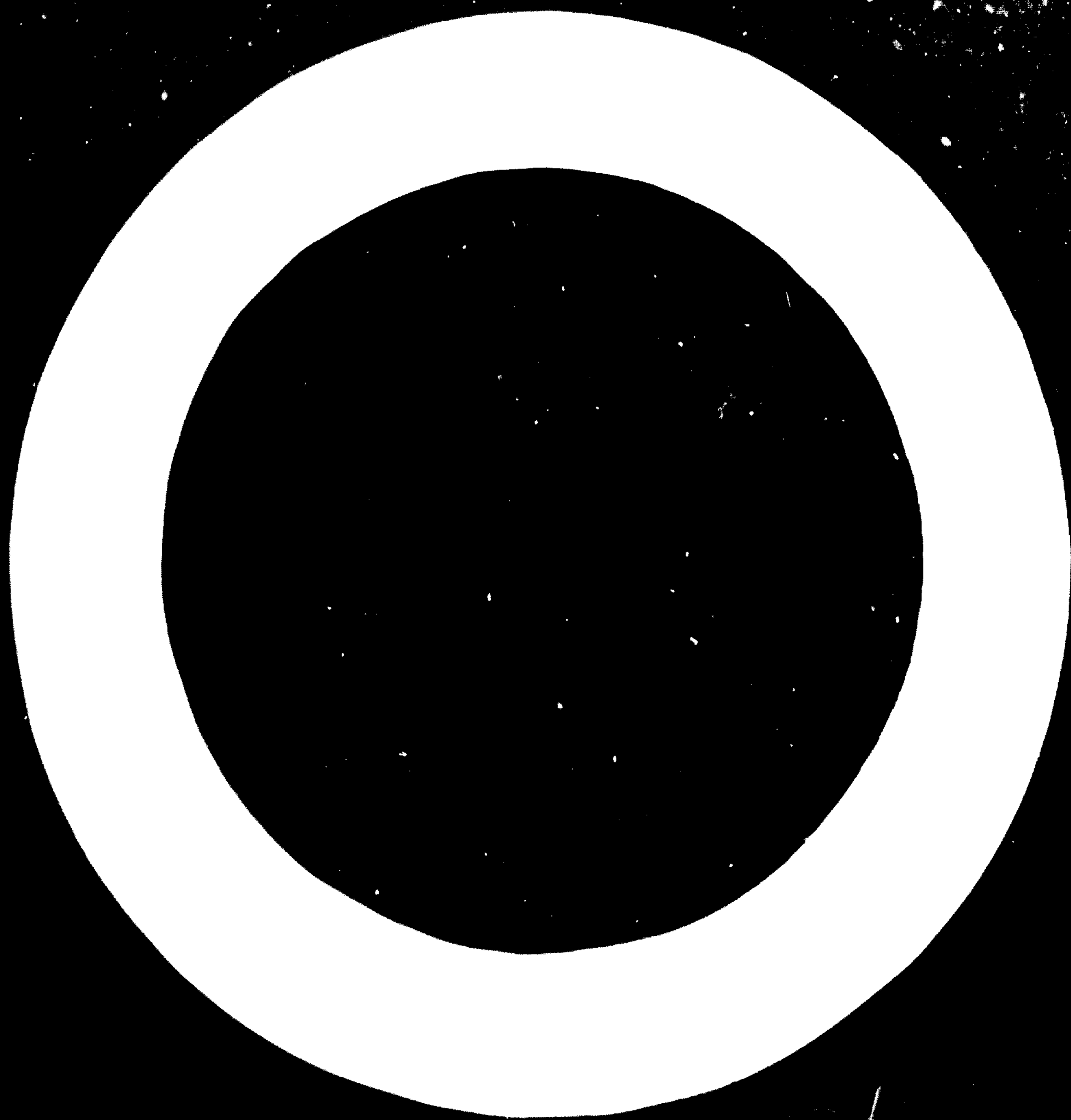
(12) See also [illegible] Offermann: Fragen der [illegible] deutscher Direktinvestitionen in Entwicklungsländern, [illegible], Vo. [illegible], No. [illegible], S.[illegible].

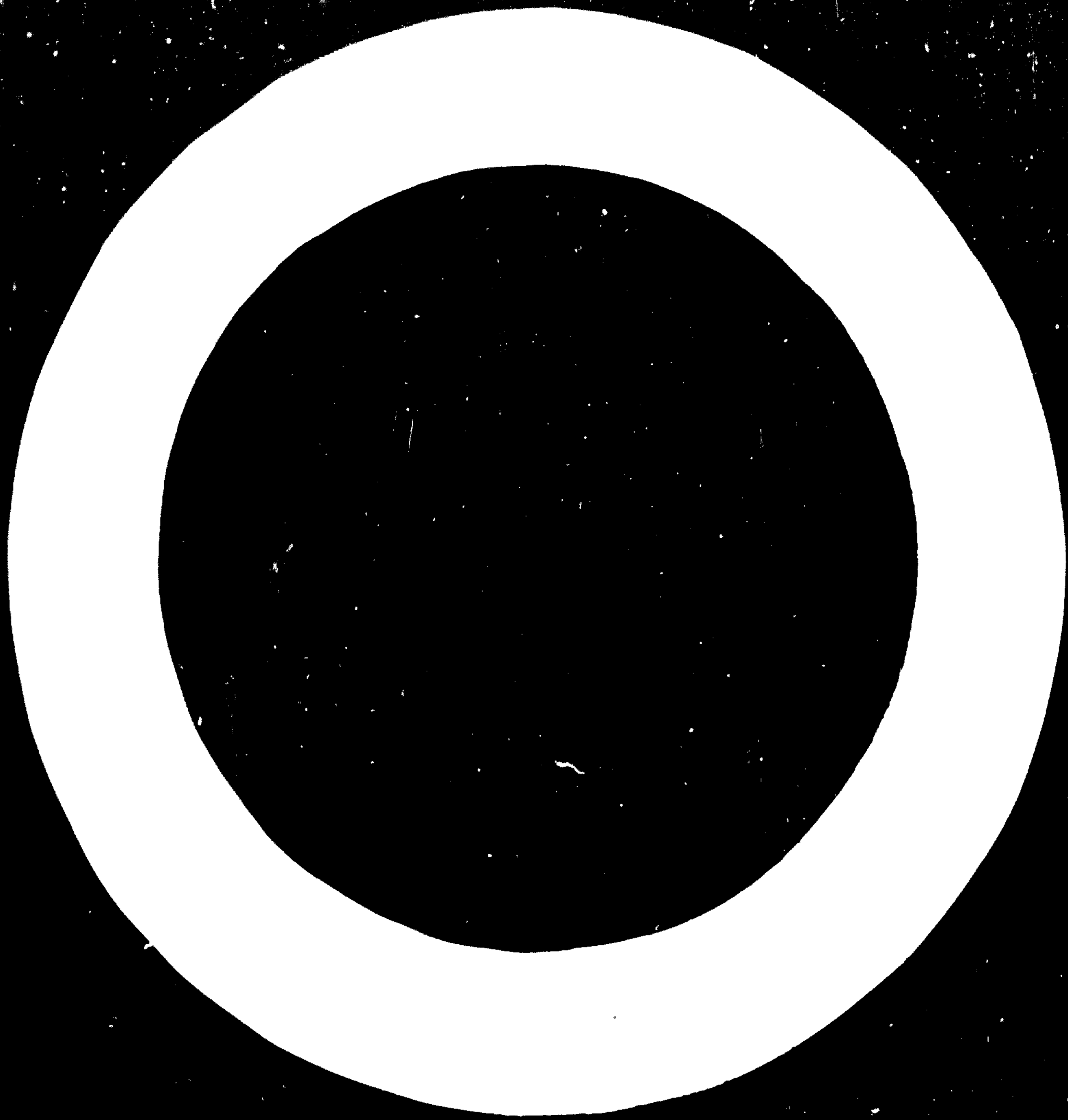


ANNEX A

Investment guarantee treaties negotiated by the Federal Republic of Germany

	Treaty signed	Treaty ratified by Federal Republic of Germany	Treaty in force
Central African Republic	x	x	x
Ceylon	x	x	x
Chile	x	-	-
Columbia	x	x	-
Ecuador	x	x	x
Ethiopia	x	-	-
Greece	x	x	x
Guinea	x	x	x
Ghana	x	-	-
India	-(13)	-(13)	-(13)
Indonesia	x	-	-
Iran	x	-	-
Ivory Coast	x	x	-
Kameroon	x	x	x
Kenia	x	x	-
Kongo (Brazz.)	x	x	x
Korea	x	x	x
Liberia	x	x	x
Madagascar	x	x	x
Malaysia	x	x	x
Morocco	x	x	x
Niger	x	x	x
Pakistan	x	x	x
Philippines	x	x	x
Rwanda	x	-	-
Sambia	x	-	-
Senegal	x	x	x
Sierra Leone	x	x	x
Sudan	x	x	x
Tansania	x	x	x
Thailand	x	x	x
Togo	x	x	x
Tschad	x	x	x
Tunisia	x	x	x
Turkey	x	x	x
Uganda	x	x	x

(13) executive agreement in force



Tax-sparing in the double-taxation treaties of the Federal Republic of Germany with developing countries

India

Art. XVI(3)(b)(aa) and (3)(b)(bb) of the treaty with India of 18 March 1959 states that the Federal Republic must grant its residents credit for Indian taxes paid on dividends on interest equal to at least 50% of the German tax.

Ceylon

Art. XV(2)(b)(bb) of the treaty of 4 July 1962 provides that Germany has to give a tax credit for Ceylon taxes on royalties received from Ceylon; this credit must at least amount to 75% of the Ceylon tax.

This provision is not typical for tax sparing since the starting point is not the waiving of tax by the developing country. On the contrary, the minimum tax credit is based on the foreign tax, thus setting aside any limitations to the tax credit based on national (German) law: The tax credit has to be granted in accordance with the treaty even when the average tax rate of the recipient is lower (which is the normal maximum limit for a tax credit).

Israel

According to the treaty of 9 July 1962, the Israeli tax on dividends is limited to 25% and the tax on interest to 15%. A tax sparing clause provides for minimum credits of 25 or 15% respectively when the Israeli tax has been wholly or partly relieved for a limited period of time under provisions of Israeli tax law specified by mutual agreement between the contracting states. Arts. 12(1), 13(1), 18(1)(c).

Pakistan

A protocol of 27 August 1963 amending the treaty of 7 August 1958 provides that interest paid to F.R.G. residents on loans made to enterprises resident in Pakistan and approved by the Government of Pakistan are exempt from Pakistan tax. It was also stipulated that German residents receiving such interest may credit against F.R.G. tax an amount equal to 50% of the F.R.G. tax, but not less than 20%,

provided the maximum credit does not exceed the Pakistan tax otherwise imposable. This protocol has not yet been ratified and according to official F.R.G. sources it seems likely that it will be replaced by a complete revision of the treaty.

Greece

The treaty of 18 April 1966 provides that Greece may tax interest earned in Greece by F.R.G. residents at a rate not exceeding 10%; this tax is allowed as a credit against the F.R.G. tax payable. A tax sparing clause in the treaty provides that if such interest is exempt from Greek tax, due to special provision of Greek law for the promotion of the country's economic development, F.R.G. residents may still credit 10% of the interest payment. Art. XVII(2)(a)(bb).

Argentina

The treaty of 13 July 1966 limits Argentina to tax dividends at 15%, interest at 20% and royalties at 15%. Tax sparing clauses provide that F.R.G. residents may claim credits against F.R.G. tax of:

- 15% irrespective of the percentage of Argentine tax imposed on dividends. (Art.20(1)(b)(1));
- 35% for Argentine tax on interest; this credit is reduced only to the extent that the generally applicable rate under Argentine law is lower (Art.20(1)(b)(2));(14)
- 15% on royalties, even if Argentine tax is wholly or partly reduced provided the exemption or reduction applies for a limited period of time (Art. 20(1)(b)(3)).

Spain

The treaty of 5 December 1966 contains a tax sparing provision on certain interest which is normally taxed at 10%. When interest is received by a F.R.G. banking organisation and the tax rate is lower than 10% on account of a special Spanish law of 1961, then the F.R.G. recipient can still claim a tax credit totalling 10% Art. 23(1)(b)(bb).

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(14) This tax sparing provision was an important factor for the recent issuance of a bond loan by the Republic of Argentina in Germany.

[illegible]

[illegible]

Case 1: Permanent establishment owned by a corporate or individual F.R.G. investor;

Case 2: Subsidiary owned by a F.R.G. corporation assuming full distribution;

Case 3: Subsidiary owned by a F.R.G. individual assuming full distribution.

Tax rates of the developing country	Net income after taxes on an income of 100					
	Case 1		Case 2		Case 3	
	No treaty	Treaty in existence	No treaty	Treaty in existence	No treaty	Treaty in existence
Tax rate: 0	75	100	65.25	100	41.75	41.75
Tax rate: 10%						
- exclusively levied on branch or subsidiary	65.0	90.0	58.73	90.0	35.26	35.26
- exclusively levied on shareholder	-	-	55.25	90.0	39.75	39.75
- equally levied on branch or subsidiary and shareholder	-	-	56.99	90.0	37.49	37.49
Tax rate: 20%						
- exclusively levied on branch or subsidiary	60.0	80.0	52.2	80.0	31.72	31.72
- exclusively levied on shareholder	-	-	60.63	80.0	39.75	39.75
- equally levied on branch or subsidiary and shareholder	-	-	48.73	80.0	35.26	35.26
Tax rate: 30%						
- exclusively levied on branch or subsidiary	49.0	70.0	47.63	70.0	27.60	27.60
- exclusively levied on shareholder	-	-	48.63	70.0	39.75	39.75
- equally levied on branch or subsidiary and shareholder	-	-	36.24	60.0	33.80	33.80

.../...

	Case 1		Case 2		Case 3	
	No Treaty	Treaty in existence	No Treaty	Treaty in existence	No Treaty	Treaty in existence
[illegible] 60%						
[illegible] levied on [illegible] subsidiary	43.0	60.0	39.95	60.0	23.49	23.49
[illegible] levied on [illegible] holder	-	-	42.43	60.0	39.15	39.1[illegible]
[illegible] levied on branch [illegible] subsidiary and share-[illegible]	-	-	34.93	60.0	31.10	31.10
[illegible] 50%						
[illegible] only levied on [illegible] subsidiary	43.0	50.0	32.42	50.0	19.57	19.57
[illegible] only levied on [illegible] holder	-	-	37.50	50.0	37.0	37.0
[illegible] levied on branch [illegible] subsidiary and share-[illegible]	-	-	31.91	50.0	29.26	29.26
[illegible] 40%						
[illegible] levied on [illegible] subsidiary	46.0	40.0	26.3	40.0	15.66	15.66
[illegible] levied on [illegible] holder	-	-	27.0	40.0	27.0	27.0
[illegible] levied on branch [illegible] subsidiary and share-[illegible]	-	-	25.24	40.0	21.40	21.40

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